CRISIL Ratings

Positive bias amid cautious clouds

Ratings Round-Up | Second half, fiscal 2023

Analytical contacts

Subodh Rai
President and Chief Ratings Officer
CRISIL Ratings
subodh.rai@crisil.com

Somasekhar Vemuri
Senior Director & Head, Ratings Criteria, Regulatory Affairs and Operations
CRISIL Ratings
somasekhar.vemuri@crisil.com

Krishnan Sitaraman
Senior Director and
Deputy Chief Ratings Officer
CRISIL Ratings
krishnan.sitaraman@crisil.com

Rama Patel
Director
CRISIL Ratings
rama.patel@crisil.com

Varsha Chandwani
Associate Director
CRISIL Ratings
varsha.chandwani@crisil.com

Hardeep Bhogal
Manager
CRISIL Ratings
hardeep.bhogal@crisil.com

Vidyank Nayar
Rating Analyst
CRISIL Ratings
vidyank.nayar@crisil.com

Nikita Ramdas Mahadik
Rating Analyst
CRISIL Ratings
nikita.mahadik@crisil.com

Piyush Khanduri
Rating Analyst
CRISIL Ratings
piyush.khanduri@crisil.com

Design: Kamraj Nadar, Sanket Nagvekar

Contents

Executive summary

CRISIL Ratings credit ratio moderates to 2.19 as expected amid global slowdown, high inflation

The CRISIL Ratings credit ratio — of upgrades to downgrades — moderated to 2.19 in the second half of fiscal 2023 from 5.52 times in the first half.

Our Ratings Round-Up report for the first half of fiscal 2023 had presaged rising global inflation and the resultant interest rate hikes could temper growth and weigh on the credit ratio.

In all, there were 460 upgrades and 210 downgrades across sectors in the second half. Though the upgrade rate fell ~320 basis points (bps) from the first half to 13.46%, it was still higher than the 10-year average (till fiscal 2022) of 10%.

Corporate balance sheets have strengthened significantly and gearing levels remain at decadal lows. The median gearing of the CRISIL Ratings portfolio is expected be ~0.45 time by fiscal 2024 end, marking a correction from fiscal 2023.

That, along with steadfast domestic demand and the government's unwavering focus on infrastructure spending, has kept the upgrade rate elevated.

These reasons lend a positive bias to the credit quality outlook of India Inc.

The downgrade rate, on the other hand, has gone up to 6.14% and almost reverted to its 10-year average.

Volatile commodity prices have impacted profitability, particularly of micro, small and medium enterprises (MSMEs), while export-oriented sectors face headwinds from a slowdown in their major markets. MSMEs, which benefited from policy interventions during the pandemic, will now have to contend with higher input cost and increasing interest rates — just as repayments on restructured loans begin.

About 60% of the downgrades in the second half of fiscal 2023 were in the sub-investment grade category, and these largely comprised MSMEs. As much as ~70% of the downgrades were because of decline in profitability and/or liquidity pressure.

The third edition of the CRISIL Ratings proprietary Corporate Credit Health Framework analyses the operating cash flow strength (measured by expected change in absolute Ebitda[1]) and balance sheet strength of the top 44 sectors for fiscal 2024 over fiscal 2023. These sectors account for ~70% of the rated debt (excluding the financial sector).

In the previous edition, the framework had indicated that export-oriented sectors would see cash flows moderate due to a slowdown in global demand. Unsurprisingly, the upgrade rate for export-oriented sectors halved to 12.2% in the second half of fiscal 2023 from 21.8% in the previous half, and the downgrade rate increased to 7.0% from 3.0%. However, some export-oriented sectors, such as pharmaceuticals and electronic components, continue to benefit from the Production-Linked Incentive (PLI) scheme and increased global sourcing from India.

Key takeaways from the study for the second half of fiscal 2023:

[1] Earnings before interest, tax, depreciation and amortisation

- The most buoyant bucket has 19 sectors with favourable cash flows and robust balance sheets, accounting for 41% of the rated debt. Their operating cash flows are expected to grow over 10% on-year in fiscal 2024, led by volume growth, even as commodity prices soften. This segment includes sectors driven by domestic demand such as automobiles and components, hospitality, and dairy products
- The remaining 25 sectors will log favourable trends in one of the two parameters — operating profit or leverage — and hence their credit quality outlook will vary between positive and stable. These include some infrastructure sectors such as highway tolling, renewables, and construction

In the financial sector, we see balance sheets improving steadily for both, banks and non-banking financial companies (NBFCs)[2], because of better capitalisation, asset quality and profitability. Bank credit growth is expected to be ~15% in fiscal 2024, almost similar to the level expected in fiscal 2023, with corporate credit picking up on the back of rising capital expenditure (capex).

For non-banks, credit growth is expected at 13-14% in fiscal 2024 versus 12-13% in fiscal 2023, and will continue to be driven by the retail segment.

India's banking system has been largely insulated from recent global events such as the near-collapse and subsequent rescue of a global bank, and the collapse of some regional US banks.

Interest rate risk, the root cause of stress at some banks in the US, is relatively lower for Indian banks for three reasons. One, loans (~70% of deposits), a large part of which are at floating interest rates, dominate asset books, while investments, which are vulnerable to interest rate risks, account for a lower share (~30% of deposits). Two, with base interest rates in India higher and rate hikes fewer, the sensitivity of investments to mark-to-market losses is relatively lower. Three, regulations currently allow banks to hold investments up to 23% of net demand and time liabilities[3] (NDTL) under the held-to-maturity category, which significantly shields them from interest rate movements.

Upgrades are expected to outnumber downgrades in fiscal 2024 as well, albeit on a smaller scale. Domestic consumption should continue its post-pandemic recovery, given that India's gross domestic product (GDP) is expected to grow 6% in fiscal 2024 — the fastest among large economies, but slower than the 7% estimated by CRISIL for fiscal 2023.

That said, the CRISIL Ratings credit quality outlook has a cautious undertone despite the positive bias as the full impact of the interest rate hikes on domestic demand is yet to be seen, and a worse-than-expected global slowdown could impact exports further. Also, tightening of global monetary conditions and depreciation in rupee could increase refinancing risk, particularly for companies with sizeable maturing overseas debt, and will be monitorable.

[2] Non-banking finance companies (NBFCs) include housing finance companies (HFCs), but exclude government owned NBFCs
[3] According to RBI regulations, banks may have investments under the held-to-maturity category up to a limit of 23% of net demand and time liabilities (NDTL) till March 31, 2024. This limit progressively reduces to 19.50% on March 31, 2025. As per latest estimates, deposits constitute over 90% of NDTL of Indian banks.

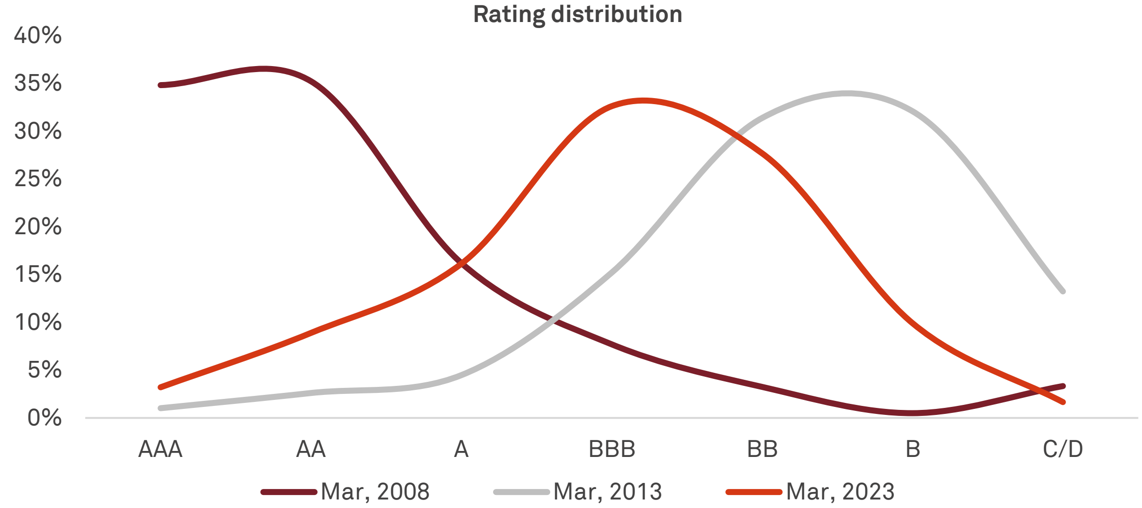
About Ratings Round-Up

The Ratings Round-Up is a semi-annual publication that analyses rating actions by CRISIL Ratings and traces the linkages between such actions and the underlying economic and business trends. It takes a deep dive into sectoral trends and sets expectations for credit quality based on an understanding of the current business environment and potential performance of different sectors in near future. This edition analyses the rating actions from September 30, 2022, to March 30, 2023.

Note: A credit rating is an opinion on the likelihood of timely repayment of debt. Therefore, analysis of rating actions on a large and diverse portfolio of companies is a reasonable indicator of the economy's outlook.

Median rating at 'BBB' category — unchanged in H2FY23

Figure 1: Trends in rating distribution of the CRISIL Ratings portfolio



Source: CRISIL Ratings

Our outstanding ratings as on March 30, 2023, cover around 7,000[4] companies. Of these, ~60% are in the 'BBB' or above rating categories, up from 55% in the last half. With the introduction of bank loan ratings in 2007 and rapid expansion of our rated portfolio, especially in the lower rating categories, the median rating had moved to 'BB' as on March 31, 2010, from 'AA' as on March 31, 2008, and stayed there up to fiscal 2021.

The median rating shifted to the 'BBB' category in fiscal 2022 and remained in this category in fiscal 2023 as well. The proportion of ratings in the 'BB' or lower categories fell from ~76% as of March 2013 to ~40% as on March 30, 2023. This is attributable to the portfolio shrinking at the lower end of the rating spectrum — a phenomenon seen across the rating industry in India.

This is mainly because several banks have increased the threshold of minimum exposure that requires an external credit rating in the past five years, leading to withdrawal of ratings, or, more commonly, non-cooperation in the rating process by the rated entities, especially in sub-investment-grade categories.

[4] This excludes companies in the 'Issuer not cooperating' (INC) category. The CRISIL Ratings portfolio had ~11,600 such issuers as on March 30, 2023. Including such ratings, our outstanding rating list would comprise ~18,600 issuers.

Analysis of rating actions in the second half of fiscal 2023

India Inc has weathered many a challenge in recent years, but has acquitted itself fairly well after the pandemic. Like many countries, it now has to walk the tightrope of managing inflation without stifling growth.

In its previous Ratings Round-Up, CRISIL Ratings had envisaged a 'Positive' credit quality outlook for the second half of fiscal 2023 with upgrades expected to outnumber downgrades. At the same time, we expected moderation in the credit ratio in a challenging global macroeconomic environment. In line with our expectation, the CRISIL Ratings credit ratio moderated to 2.19 in the second half of fiscal 2023 from a high of 5.52 times in the first half. In totality, there were 460 upgrades and 210 downgrades.

The global economy has been plagued by persistently high inflation and slowdown due to tightening monetary conditions. India, while not fully insulated from the external developments — as seen by the moderation in exports — is still much better placed and is expected to grow 6% in fiscal 2024, as per CRISIL. An analysis of rating actions reveals upgrades were driven by sustenance of domestic demand, infrastructure spending by the central government, and healthy balance sheets across the rated portfolio.

The upgrade rate moderated by ~320 bps from the first half of fiscal 2023 to 13.46% for the second half, but remains higher than the 10-year average of ~10%. Domestic demand has sustained, as reflected in India's GDP growth of 7% in fiscal 2023. Upward revisions in India's GDP estimates for fiscals 2021 and 2022 also reflect better traction in underlying economic activity than earlier expected.

For the second half of fiscal 2023, upgrades and downgrades were quite broad-based — across domestic consumables, infrastructure, exports, and services. In domestic consumables, upgrades were driven by automotive and allied sectors, and food products. In services, upgrades were propelled by hospitality, healthcare, and education services. However, a slowing world economy has impacted India's exports and export-oriented sectors saw the upgrade rate halving to 12.2% in the second half of fiscal 2023 compared with the first half.

The downgrade rate increased across sectors and has started reverting to the long-term average. Our deep-dive into reasons for rating actions shows ~70% of the downgrades were because of an expected decline in profitability and/or liquidity pressure.

Because of elevated commodities prices, smaller firms deferred order execution, particularly in the first half of fiscal 2023. MSMEs are facing challenges such as rising input costs and limited ability to pass them on, higher interest rates and initiation of repayments on restructured loans. Unsurprisingly, in the second half of fiscal 2023, about 60% of downgrades were from the sub-investment grade category, mainly consisting of MSMEs.

As seen historically, ratings on ~80% of the CRISIL Ratings portfolio were reaffirmed or unchanged during the second half of fiscal 2023. Hence, the modified credit ratio (MCR[5]) did not change materially and stood at 1.08 as against 1.16 times in the first half.

In the next section, we address how global and domestic trends will impact our credit quality outlook for fiscal 2024. We also present the credit ratio and debt-weighted credit ratio trends for the second half of fiscal 2023 and compare them with the previous halves.

[5] MCR is defined as the ratio of rate of upgrades and reaffirmations to rate of downgrades and reaffirmations

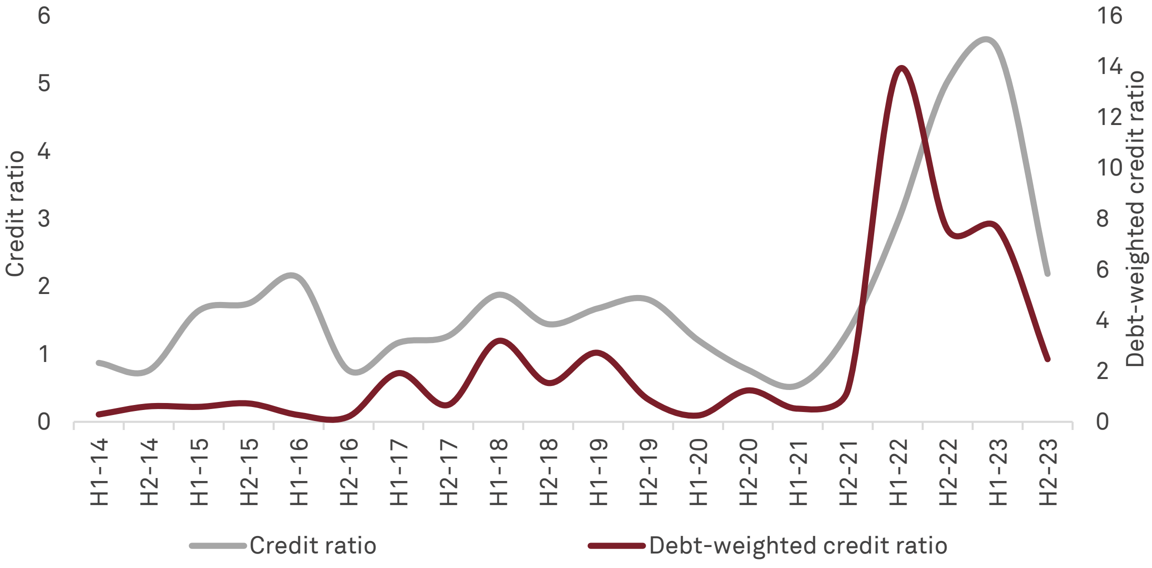
Credit ratio dips to 2.19 times for the second half of fiscal 2023 from 5.52 times in the first half, in line with expectation

With 460 upgrades and 210 downgrades, the CRISIL Ratings credit ratio stood at 2.19[6] for the second half of fiscal 2023.

Rating actions in the CRISIL Ratings portfolio for the second half of fiscal 2023 underscore the continuing upward march of corporates, although at a slower pace compared with the first half.

In the previous Ratings Round-Up, we had highlighted that while the credit quality outlook will remain positive, the credit ratio could moderate due to global slowdown, increasing interest rates and persistent inflation.

Figure 2: Credit ratio and debt-weighted credit ratio moderate in the second half



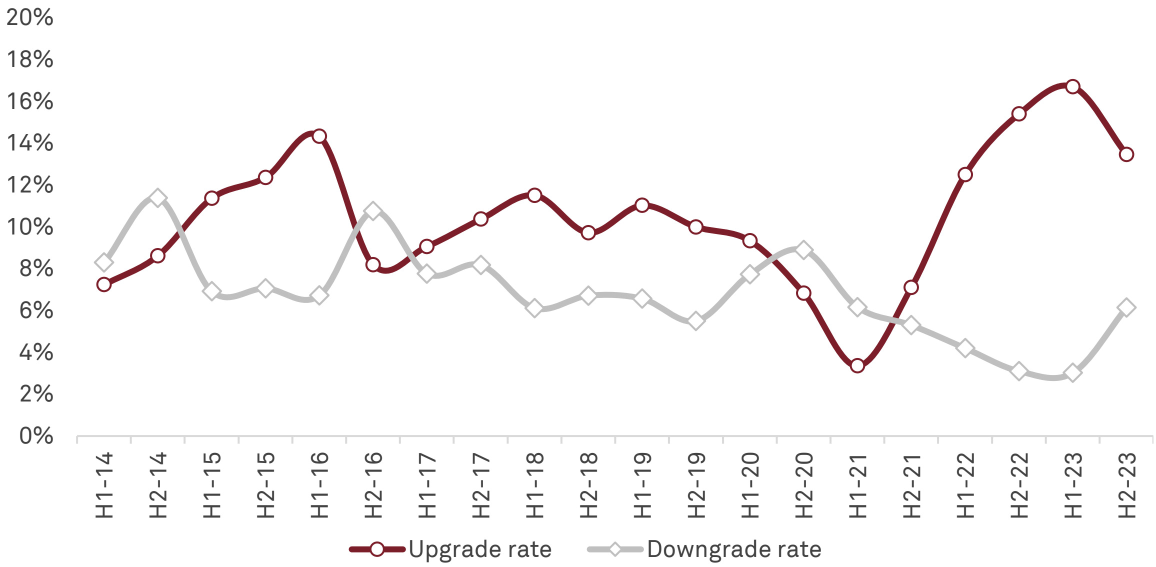
Source : CRISIL Ratings

The debt-weighted credit [7]ratio dipped to 2.47 times for the second half of fiscal 2023 from 7.64 times in the first.

Adjusting for group upgrades and downgrades (where all the group company upgrades and downgrades are considered as one), the adjusted credit ratio was 2.04 (4.8 in the first half). There were 16 upgrades (14 in the first half of fiscal 2023) and 2 downgrades (1 in the first half) in 'homogenous groups'[8] of companies with significant business, financial and managerial linkages. In such cases, the ratings of individual entities are arrived at by following the homogenous group criteria[9] and the rating actions are usually in tandem.

[6] These do not include ~14 migrations of credit enhancement (CE) ratings which were transitioned to plain vanilla as per the regulatory requirement
[7] Debt-weighted credit ratio is defined as the ratio of debt in the books of companies upgraded to debt in books of companies downgraded. This excludes non-cooperative issuers as well as financial sector entities.
[8] Group upgrades are considered for 3 or more companies
[9] https://www.crisil.com/mnt/winshare/Ratings/SectorMethodology/MethodologyDocs/criteria/Criteria%20for%20rating%20entities%20belonging%20to%20homogenous%20groups.pdf

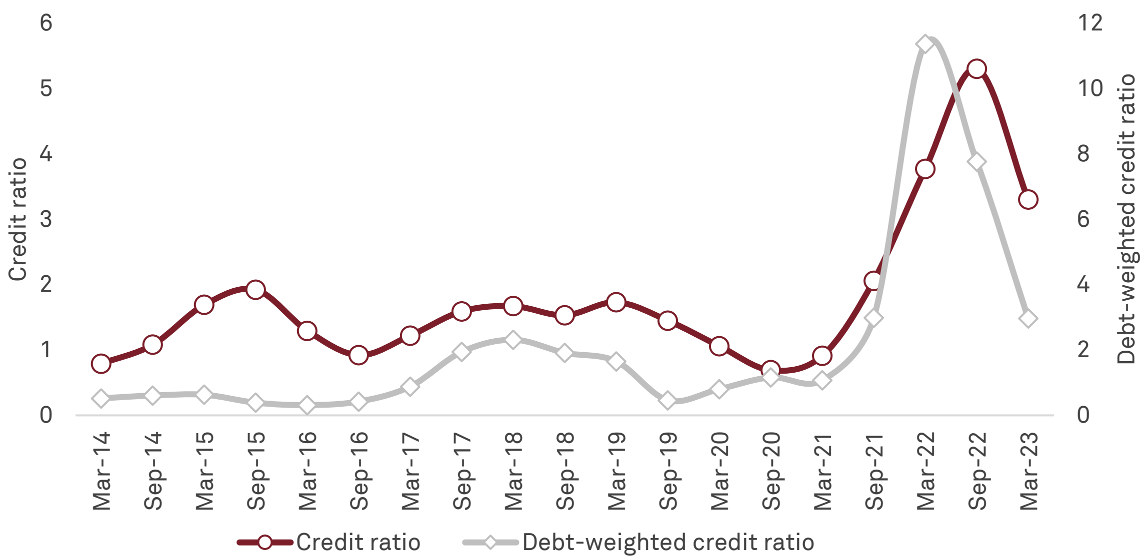
Figure 3: Trends in upgrade and downgrade rates



Source : CRISIL Ratings

The upgrade rate tapered to 13.46% in the second half of fiscal 2023 from 16.7% in the first half, while the downgrade rate increased to 6.14% from 3.02%. That said, a vast majority of the portfolio (~80%) continued to see reaffirmations. This compares well with the historical average of 83% in the past decade.

Figure 4: Trends in credit ratio and debt-weighted credit ratio (on a 12-month rolling basis)



On a 12 month rolling basis, the credit ratio has dropped to 3.30 times in March 2023 from 5.30 times in September 2022, following a similar trend as half-yearly credit ratio.

Rating actions were broad-based across sectors[10]

India is expected to be among the world's fastest-growing large economies in fiscal 2024.

[10] Exports include sectors such as textiles, pharmaceuticals, gems and jewellery, and information technology (IT). IT is included in exports instead of under services.

India Inc has lighter balance sheets after deleveraging, and gearing is expected to be ~0.45 time as at fiscal 2024 end.

Capex is likely to pick up in fiscal 2024, particularly in the second half. Even if additional debt is contracted for this capex, gearing would increase only moderately to 0.5-0.6 time.

Some prominent sectors that saw a higher upgrade rate were automotive and auto components, food products, construction, and downstream sectors such as distribution. From the chart below (figure 5), it can be inferred that domestic demand is still riding on post-pandemic recovery, which is driving upgrades for both, domestic consumables and services.

The upgrade rate for domestic consumables stayed high at 14.9% for the second half of fiscal 2023 as against 14.6% in the first half. For instance, automotive and allied sectors also had higher upgrade rate with passenger vehicles expected to grow ~10% to 50 lakh units in fiscal 2024 — an all-time high and significantly higher than the pre-pandemic peak of 40.5 lakh units.

Some domestic consumables sectors are benefiting from higher realisation despite tepid volume growth. For instance, growth of 9-11% for fast moving consumer goods in fiscal 2023 was driven by price hikes. However, in fiscal 2024, growth is seen at 7-9%, driven by volume, with rural demand expected to improve.

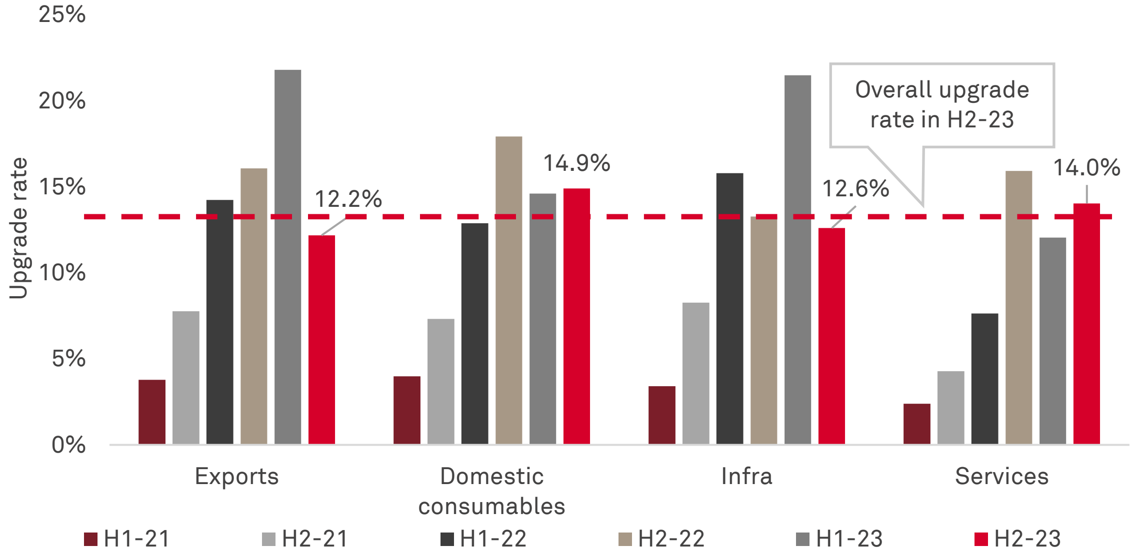
The services sector saw an increase in upgrade rate to 14.0% for the second half of fiscal 2023 from 12.1% in the first half. The sector has benefited from pent-up demand, especially for hospitality and aviation. Strong recovery in business and leisure travel pushed up average room rates and occupancy in the hospitality sector, while air passenger traffic is expected to log double-digit growth in fiscal 2024 with international travel picking up and business travel rebounding strongly.

Infrastructure and allied sectors benefit from central government spending, which is expected to increase 30% in fiscal 2024. The government's unwavering focus on infrastructure build-out has bolstered economic activity and expanded the order books of engineering, procurement and construction companies.

However, the upgrade rate of infrastructure firms moderated to 12.6% in the second half of fiscal 2023 from 21.5% in the first half. Credit profiles were constrained by lower operating margins as well as delayed execution of projects given the volatility in commodity prices.

Domestic consumables include sectors such as automotive and automotive components, agricultural items, FMCG, food products
Infrastructure includes sectors such as real estate, construction, power, and highways tolling
Services cover sectors such as hospitality, transport, retail, healthcare, telecom

Figure 5: Sector-wise upgrade rates



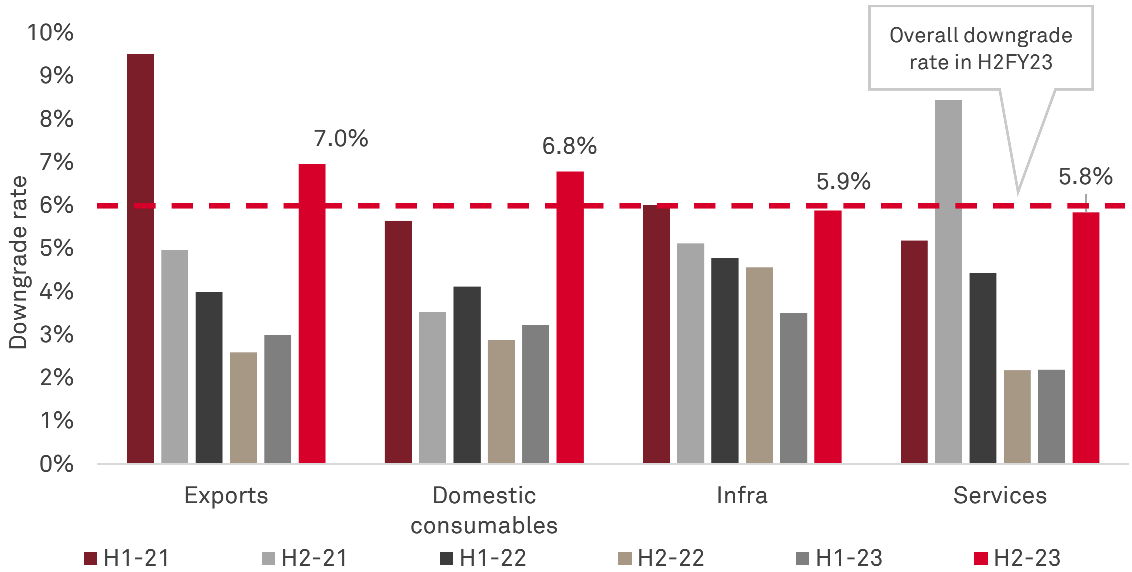
The upgrade rate moderated sharply for export-oriented sectors to 12.2% in the second half of fiscal 2023 from 21.8% in the first half. With persistent inflation and hawkish monetary policies, the global economy is expected to grow 2.2% in calendar year (CY) 2023, down from an estimated 3.4% in CY 2022, according to S&P Global.

The US and the European Union (EU) account for ~42% of the global GDP, and dominate global trade. Demand slowdown in these geographies has impacted India's export-linked sectors.

For instance, spending on discretionary items such as apparel is expected to be lower. Moreover, the textiles sector has had to contend with higher cotton prices and lower capacity utilisation.

In the next section, we delve into the reasons for downgrades.

Figure 6: Sector-wise downgrade rates



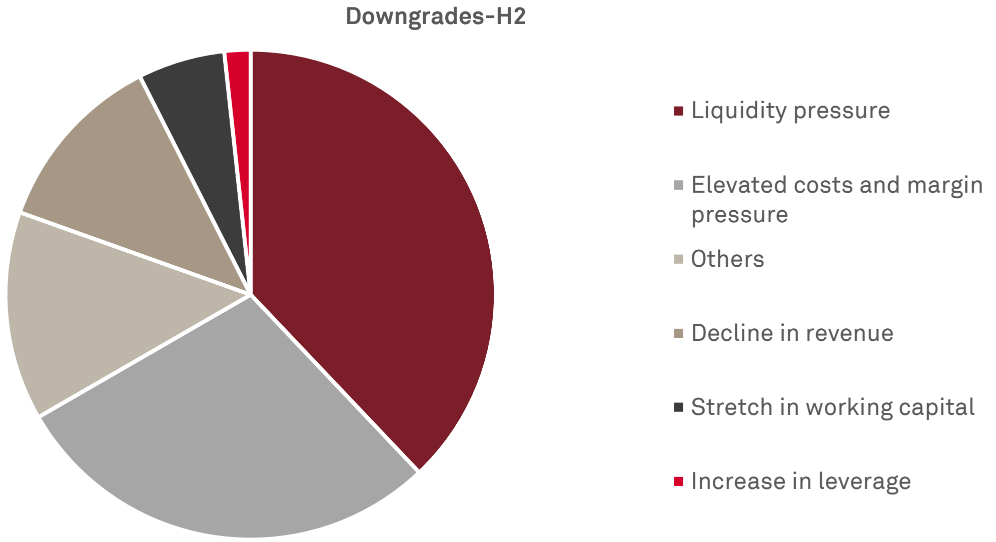
Source: CRISIL Ratings

What drove downgrades in the second half of fiscal 2023?

The downgrade rate increased to 6.14% from 3.02% earlier, closer to the 10-year average of 7.1%. Diving deep, we found three reasons for the downgrades:

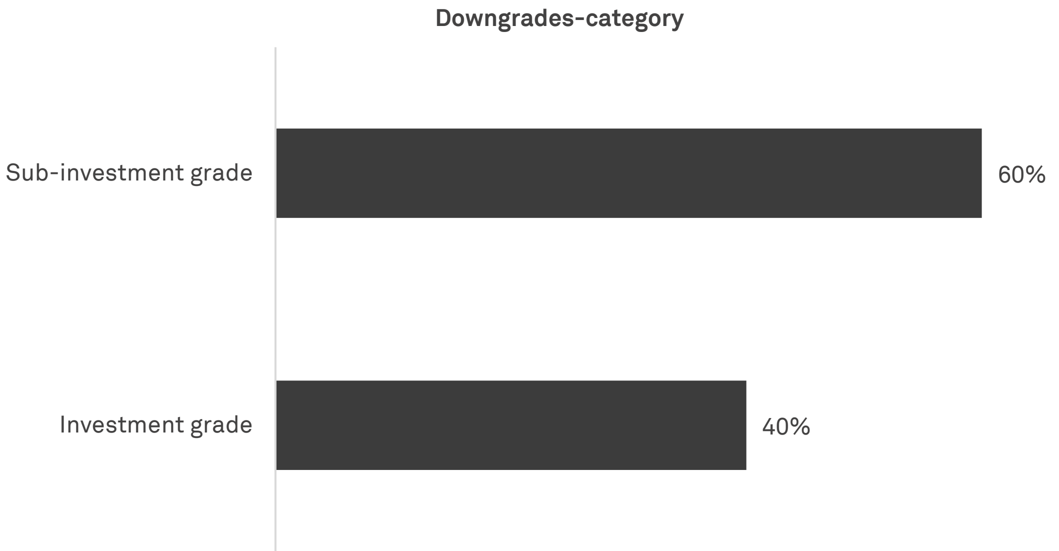
1. Liquidity pressure
2. Elevated costs and margin pressure
3. Decline in revenue

Figure 7: Reasons for rating downgrades during second half fiscal 2023



Liquidity pressure, along with elevated costs, and margin pressure accounted for more than two-thirds of downgrades in the second half of fiscal 2023. Another reason for downgrades was revenue degrowth in fiscal 2023.

Figure 8 : Category-wise downgrades during second half fiscal 2023



In the sub-investment-grade category, liquidity pressure, elevated costs and margin pressure accounted for ~80% of the downgrades. This category largely comprises MSMEs, which have had to face pricing pressure, higher input cost (with limited ability to pass it on), and elevated interest rates, even as repayments have begun on their restructured loans.

In the second half of fiscal 2023, the upgrade and downgrade rates in the sub investment grade category were ~12% and 9%, respectively. For the investment grade, these were at ~15% and ~4%, respectively.

Secular deleveraging continues despite elevated costs

As seen in the chart below, the trend in median gearing indicates secular deleveraging from over 1 time in fiscal 2015 to a decadal low of 0.35-0.45 time in fiscal 2024.

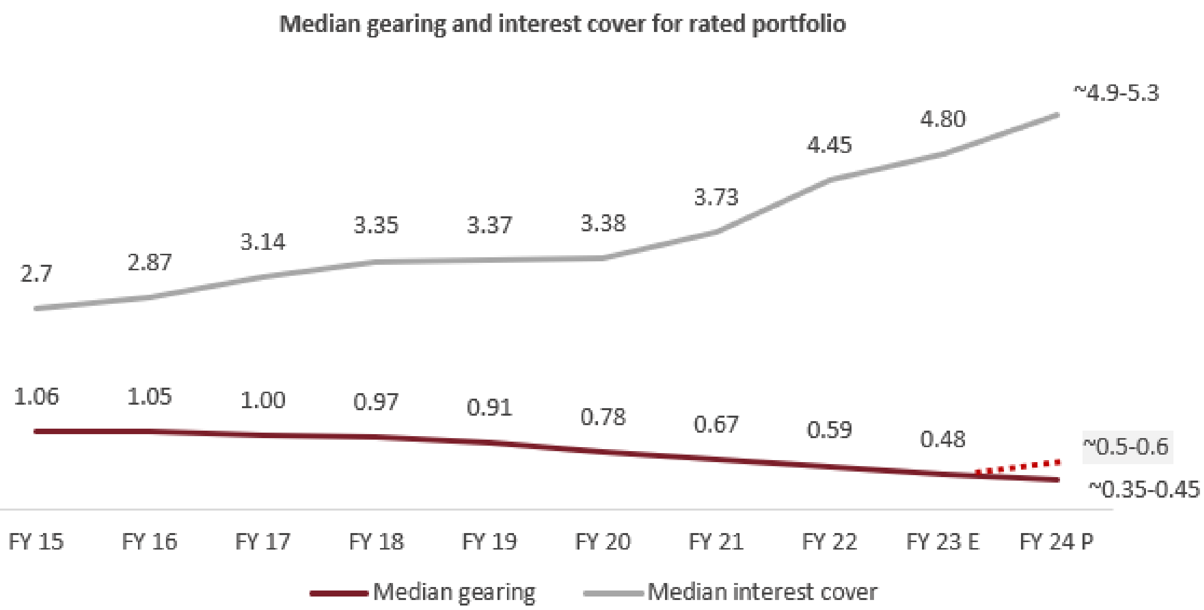
This could rise moderately if capex picks up in the second half of fiscal 2024. The extent of rise will depend on the incremental debt taken up, yet median gearing will remain low, as indicated in figure 9 below.

Median interest cover is expected to increase to nearly 5 times from 2.7 times in fiscal 2015, supported by improved operating cash flows — despite higher interest cost and increase in absolute debt to fund incremental working capital.

Absolute debt rose an estimated 25% at the end of fiscal 2023 over fiscal 2020, while net cash accrual surged 70%.

That said, the quantum of capex and its funding will be monitorable. Furthermore, with monetary tightening across the globe, refinancing risk could increase for entities which have relied on fixed-rate overseas borrowing, especially in the infrastructure sector.

Figure 9: Improvement in median gearing and interest cover supporting credit quality



A pick-up in capex is likely in the second half of fiscal 2024, by availing of some debt. That could raise the gearing level, as indicated by the dotted line.

Source: CRISIL Ratings

Private capex seen picking up in fiscal 2024, but global headwinds may push it to the second half

An uptick in private sector capex is evident, especially among larger corporates. Additionally, government spending on infrastructure is increasing investment opportunities in allied sectors. Going forward, the drivers of pick-up in capex will be strong domestic demand, the Production-Linked Incentive (PLI) scheme, and the China+1 derisking strategy of global majors.

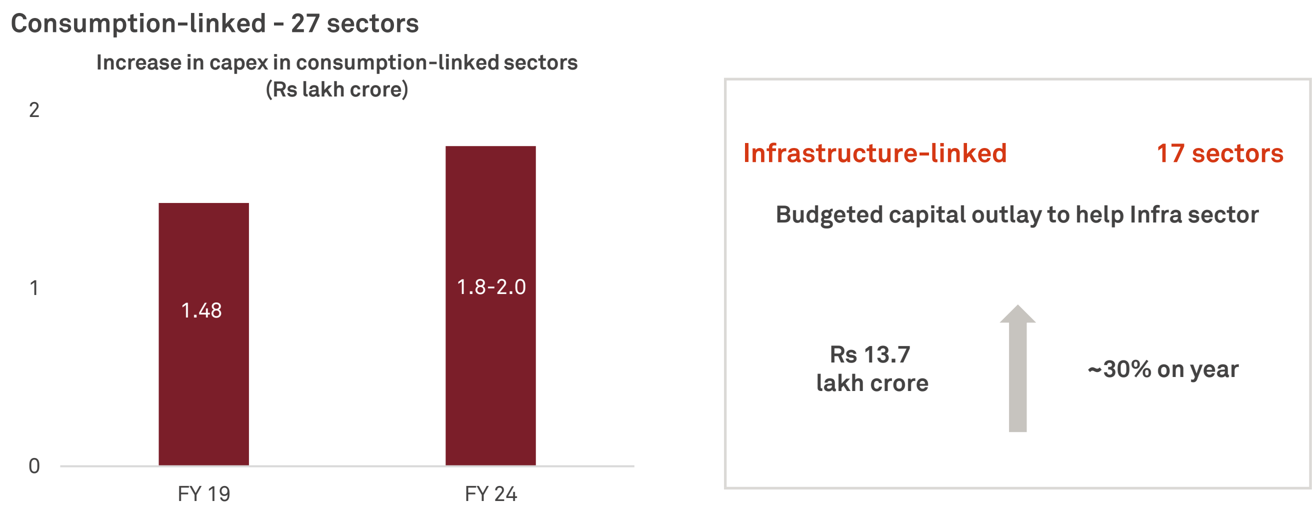
The PLI schemes will propel investments in sectors such as automotive(auto) and auto components, hospitality, renewables, pharmaceuticals, textiles, healthcare, chemicals and electronics in fiscal 2024.

According to our recent analysis of 44 sectors covered under the Corporate Credit Health Framework, which account for more than 70% of the debt rated by us (excluding the financial sector), capex will be broad-based in both infrastructure and consumption-linked sectors.

Of the 44 sectors, 27 are consumption-linked (including services) and capex in most of them will surpass pre-pandemic levels. At an aggregate level, planned capex in consumption-linked sectors is estimated at Rs 1.8-2.0 lakh crore in fiscal 2024, up 30% over the pre-pandemic level. Sectors such as steel, aluminium, automotive and auto components, brick & mortar retail, hospitality, healthcare and chemicals are expected to drive capex. However, capex in export-oriented sectors is likely to fall.

The remaining 17 sectors are infrastructure and linked and, will continue to see capex facilitated by government initiatives. A healthier domestic financial system, cleaner balance sheets, improved capital ratios, and secular deleveraging will be supportive.

Figure 10: Sector-wise expectations for private capex

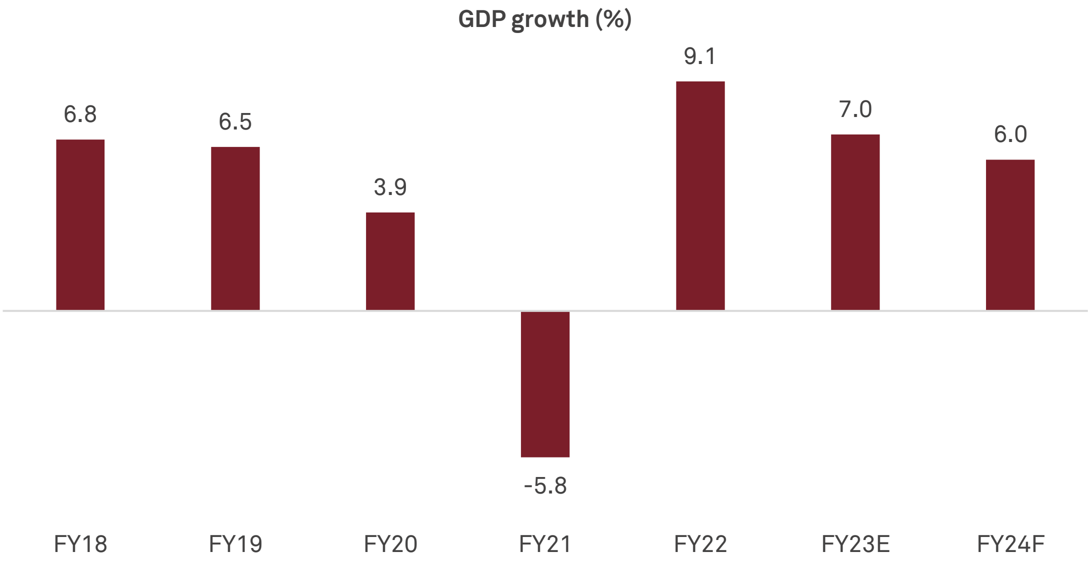


Source: CRISIL Ratings

Macroeconomic outlook

CRISIL expects India's GDP to grow at 7% in fiscal 2023, and then slow to 6% in fiscal 2024. While the post-pandemic recovery has become broad-based with domestic demand rebounding fast, especially for contact-based services, fresh headwinds pose a risk. Global growth is slowing and tighter domestic financial conditions could curtail consumption. Moderating domestic inflation, however, could spell relief.

Figure 11: Looking good relatively



Note: FY23E refers to second advance estimates by the National Statistics Office (NSO)

Source: NSO, CEIC, CRISIL

Increased capex by the government, and fresh ones by the private sector should drive medium-term growth. Digitalisation, together with efficiency-enhancing reforms will increase productivity and its contribution to growth.

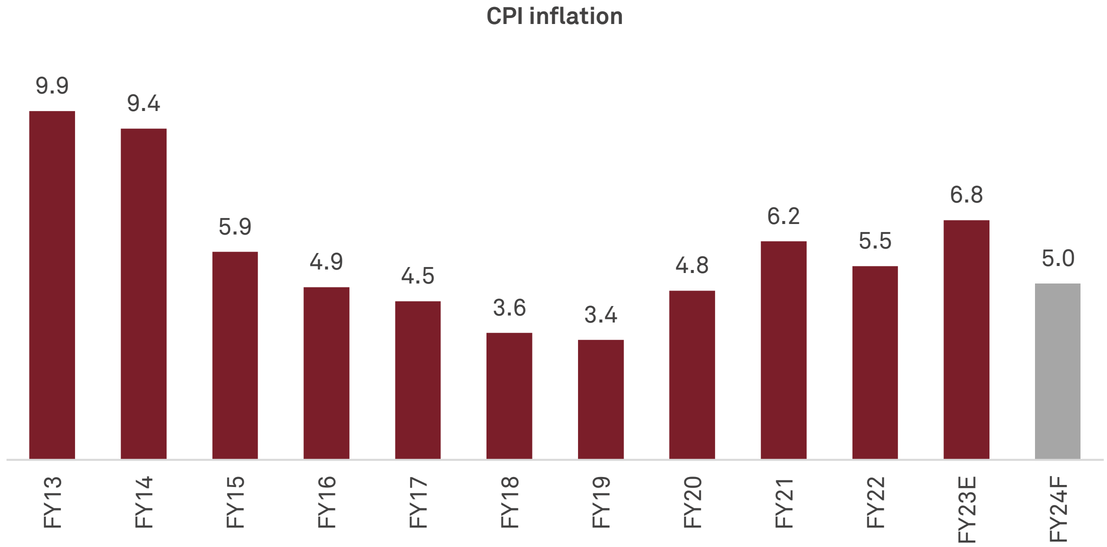
CRISIL expects the economy to continue reaping efficiency gains from reforms such as Goods and Services Tax (GST) and the Insolvency and Bankruptcy Code (IBC). Better physical infrastructure will improve connectivity and lower logistics costs for industries, while digital infrastructure will enhance efficacy through innovation and efficient payments systems.

The Indian economy is looking at better growth prospects over the next five fiscals. Structural improvements in the financial system, steady pace of reforms, and policies supporting a revival of the private sector herald a better medium-term growth outlook. Technological advancements and other structural shifts such global supply-chain de-risking and green transition hold out greater promise. Overall, CRISIL expects India's GDP growth to average 6.8% between fiscals 2024 and 2028, a tad better than the pre-pandemic five-year average (6.7% during fiscals 2016-2020)

With the impact of the pandemic receding, fiscal 2024 will see fresh challenges arising from the fallout of the Russia-Ukraine conflict and aggressive rate hikes by major central banks to fight inflation. Policy rates are at a decadal high across the advanced economies. Slowing global growth will weigh on India's exports. Additionally, as policy rate hikes filter through the economy in fiscal 2024, tighter domestic financial conditions can weaken demand.

On the one side, slowing global growth will reduce demand for India's exports and affect domestic industrial activity in the corresponding sectors. The full impact of tighter monetary policy by the Reserve Bank of India (RBI), which typically plays out with a lag of 3-4 quarters, will show up in the coming months. Continued geopolitical strife will keep commodity prices elevated compared with the pre-pandemic years, and can create headwinds to growth. On the other side, corporate balance sheets look healthier. A robust banking system and the government's capex thrust should create forward momentum and support fixed investment. Net-net, real GDP should grow in fiscal 2024, but at a slower pace than in fiscal 2023.

Figure 12: Feels reined in



Source: CRISIL

Inflation remains the swing factor. After a sharp rise to 6.8% in the first 10 months of fiscal 2023, Consumer Price Index-based inflation is expected to moderate to 5% in fiscal 2024, driven by lower global commodity prices, demand slowdown and base effect. But disruptions to food production due to El Niño and other extreme weather events (leading to volatile food prices), and continuing geopolitical risks (impacting commodity prices), could upset the math.

Reduction in fuel and core inflation will help curb inflation in fiscal 2024. Food, a big mover of overall inflation, faces risks from weather disruptions and abnormal monsoons. Easing of commodity prices from the highs seen last fiscal will tamp fuel and core inflation. Producers, meanwhile, continue to pass on higher costs to retail consumers. While goods inflation has already risen sharply, services inflation is gradually catching up as well.

Credit quality outlook is positive for fiscal 2024

Our credit quality outlook for India Inc has a positive bias, with upgrades expected to outnumber downgrades in fiscal 2024, backed by steady domestic consumption, government-led capex and lower corporate leverage.

The banking sector is well positioned relative to recent years on fundamentals, with non-performing assets (NPAs) at decadal lows, capital buffers comfortable, provisioning covers high, and profitability improved.

The imminent slowdown in global growth bears watching because of increasing inter-linkages between India and the world. The impact on export sectors is already visible in fiscal 2023. Additionally, the lagged impact of interest rate hikes on domestic demand may be seen in fiscal 2024.

The recent crisis in some global banks has been contained by swift actions by central banks and governments. However, tightening liquidity conditions globally could increase the refinancing risk for some highly leveraged entities.

Corporate Credit Health Framework update: Sectoral show versus expectations, and the way ahead

In the previous Ratings Round-Up published in October 2022, CRISIL Ratings had signalled a 'Positive' credit quality outlook for fiscal 2023. This was supported by strong domestic demand revival and secular deleveraging in the backdrop of risks of a global slowdown (with export-oriented sectors such as textiles already witnessing a decline in orders), the Russia-Ukraine conflict and tightening monetary policy in India and abroad.

Global supply chains have been clawing back from the massive disruption caused by the conflict in Europe, and commodity prices have come off their recent highs. Yet inflation has been pervasive and has prompted several central banks to maintain a hawkish stance on rates. The RBI, too, has increased the repo rate from 5.9% in September 2022 to 6.5% in February 2023.

We have been seeing steady domestic demand for products and services. Amid continuing deleveraging by corporates, the government has stepped up by pushing ahead with direct infrastructure spending as well as nudging the private sector to adopt cleaner and better technologies through the PLI scheme.

India is expected to be an outlier by being among the fastest growing large economies in fiscal 2024, in a volatile world.

In the following section, CRISIL Ratings presents the third edition of the Corporate Credit Health Framework. It indicates the relative positioning of sectors and their credit quality by assessing two parameters: operating cash flow strength and balance sheet strength. This helps identify sectors that may require close monitoring in this rapidly changing environment as well as differentiate sectors that will likely remain buoyant.

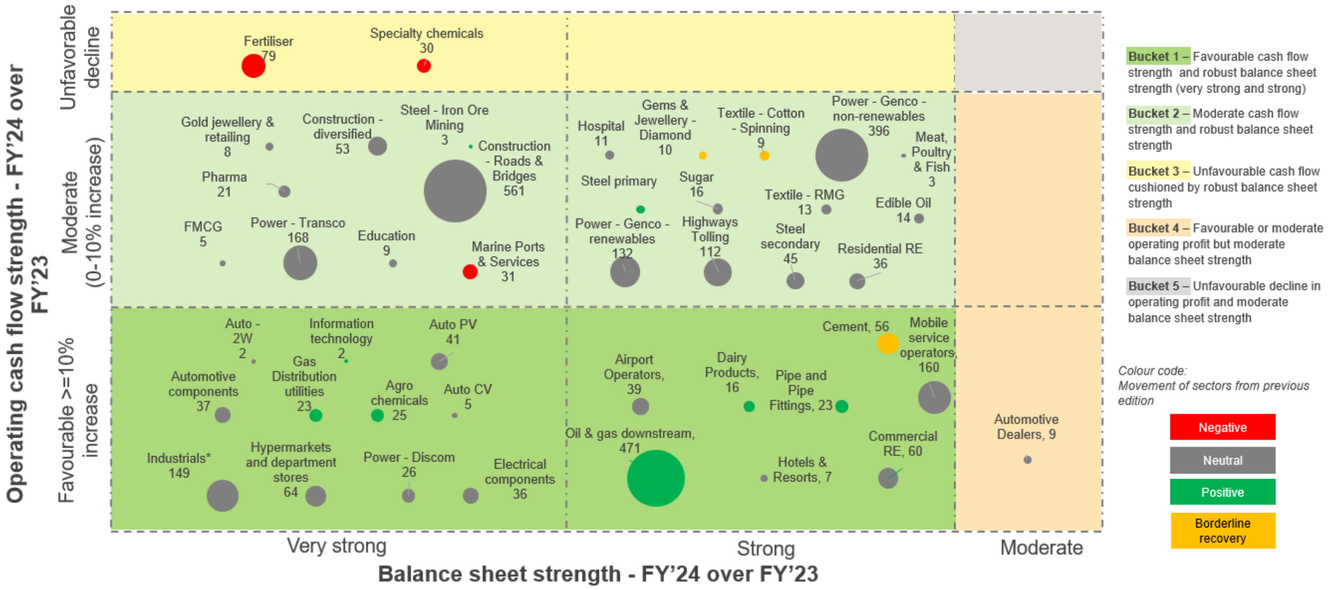
Notably, the sectors that were classified under 'the most buoyant bucket' in the previous edition saw higher upgrade rates in the second half of fiscal 2023. These included automotive and auto components, industrials, hospitality, electrical components, and commercial real estate.

Methodology and assumptions

CRISIL Ratings has analysed 44 key sectors, accounting for around 70% of the total debt rated (excluding financial sector entities), on two parameters: operating cash flow strength, which considers absolute growth in Ebitda expected in fiscal 2024 over fiscal 2023; and balance sheet strength, which considers expected gearing at the end of fiscal 2024 and the change from a year earlier. The forward-looking framework factors in the change in our expectations on these parameters based on current trends.

Figure 13: Corporate Credit Health framework

Expectations on cash flow and balance sheet strength for FY24 compared with FY23



1) Industrials comprise engineering and capital goods, industrial machinery and consumables, and heavy electrical equipment

2) Power distribution companies (discoms) include private players

3) Size of the bubble indicates rated debt quantum (figures in Rs '000 crore)

4) Colour of the bubble represents movement of sectors in this edition from expectations set in the Ratings Round-Up for the first half of fiscal 2023

Source: CRISIL Ratings

Terminologies used in the framework:

- The X-axis denotes the score on balance-sheet strength, which is derived using a combination of gearing expected as on March 31, 2024, and the change from a year earlier. Lower gearing reflects deleveraging, seen across companies over the past two fiscals, and provides some protection from unforeseen risks.
  - The balance sheet strength score could be 'very strong', 'strong' or 'moderate'
  - For instance, hypermarkets and department stores show well-managed balance sheets due to low gearing, categorised as 'very strong'
- The Y-axis denotes expected growth in absolute Ebitda in fiscal 2024. Absolute growth in Ebitda is an interplay of change in realisation, cost structures and sales volume. It could arise due to substantial volume expansion, albeit at lower margins. For example, in our current analysis, automotive companies have seen improved profitability due to demand revival
  - Cash flow strength will be favourable if Ebitda growth is 10% or above, moderate if Ebitda growth is less than 10%, or unfavourable if there is a decline
- In the third edition of the Corporate Credit Health Framework, we have also analysed the movement of sectors compared with the expectations set in the Ratings Round-Up for the first half of fiscal 2023. Hence, the placement of a sector has to be read in conjunction with the colour of the bubble representing the sector, as enunciated below:

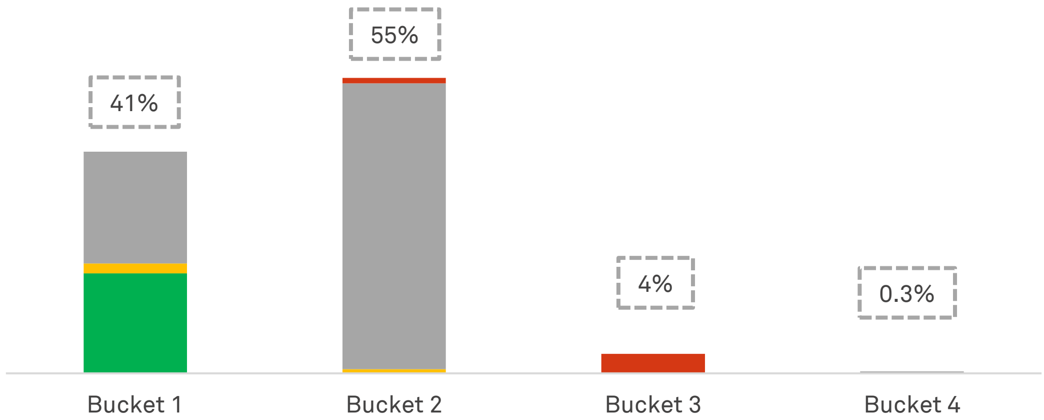
- **Red**: Negative movement in either operating cash flow or balance sheet strength in fiscal 2024 over fiscal 2023
- For instance, Ebitda could decline on-year for the fertiliser industry in fiscal 2024 due to softening gas prices that, in turn, could normalise profit for the urea segment. Even for complex fertilisers, given final product prices are softening, the value gap initially earned by companies is now expected to normalise, especially for backward-integrated entities
- **Amber**: Indicates borderline recovery. This could arise due to expectation of volatility going ahead because of the global slowdown or other macroeconomic factors
  - For instance, textiles-spinning had a phenomenal run in fiscal 2022 with decadal-high operating profitability, leading to a very high base. Exposure to overseas markets and dependence on pricier domestic cotton prices led to pressure on Ebitda margin in fiscal 2023. From the low base, a mild recovery is expected in cash flow in fiscal 2024 as cotton availability could improve but international demand is expected to decline
- **Green**: Positive movement in either operating cash flow, or balance sheet strength, or both
  - For instance, oil and gas downstream companies may see Ebitda increase in fiscal 2024 given the moderation in oil prices, which is a key input
- **Grey**: Neutral with no movement expected in either operating cash flow, or balance sheet strength

In our study, we have categorised the sectors into four buckets as per their placement in the framework.

- **Bucket 1** refers to sectors that are expected to see favourable operating cash flow strength — through margin expansion, or volume growth, or both — as well as robust balance sheets (very strong or strong). We have 19 of the 44 sectors in this bucket, as seen in figure 13 above
- **Bucket 2** refers to sectors that may see moderate operating cash flow strength and robust balance sheets. This covers 22 sectors, as seen in figure 13 above
- **Bucket 3** refers to sectors that are expected to see unfavourable operating cash flow cushioned by robust balance sheets. We have two sectors here
- **Bucket 4** refers to sectors that are expected to see favourable or moderate operating cash flows but will have moderate balance sheets. We have one sector in this bucket

Key conclusions of the study

Figure 14: Bucket-wise split of rated debt (%) and movement of sectors compared with the previous framework



Our analysis shows many sectors will be able to withstand challenges over the medium term, driven by higher operating profits and stronger balance sheets. However, the credit quality of a few will be moderate, and the credit ratio may dip

- Of the 44 sectors, 19 are in the 'most buoyant' bucket, accounting for 41% of the rated debt, and will likely have favourable operating profit and very strong/strong balance sheets in fiscal 2024. These sectors will benefit from healthy domestic demand or from the government's infrastructure push through the PLI scheme for direct infra spends, and include automotive and auto components, hypermarkets, hospitality, industrials, and mobile service operators. Bucket 1 also includes most of the sectors (6 out of 8) that saw a favourable movement compared with the previous edition, as reflected in green colour in figure 14.
- The remaining 25 sectors, accounting for 59% of the total rated debt, will see a favourable trend in one of the two parameters — operating profit or leverage — and will have a positive credit quality outlook. These include some infrastructure sectors, such as highway tolling, renewables and construction, which have maintained their position in the framework. Bucket 2 includes two sectors coloured green, and two sectors coloured amber, indicating borderline recovery.
- Six sectors moved favourably to Bucket 1 in this edition of the framework, including oil and gas-downstream, gas distribution utilities, agrochemicals, and pipe and fittings
- Bucket 3 comprises specialty chemicals and fertilisers, which have had a negative movement (indicated in the colour red above). These sectors are expected to see a decline in absolute operating profit because of either lower realisations given the price correction (fertilisers), or lower revenue growth (specialty chemicals)
- Export-oriented sectors such as textiles, gems and jewellery will see borderline recovery in cash flows, and any further deceleration in global growth could limit their recovery.
- Fertilisers and specialty chemicals will see unfavourable trend in terms of operating cash flow due to lower realisations expected in fiscal 2024.

The next section touches upon key factors such as revenue and profitability, working capital requirement, leverage, and credit risk profiles across sectors.

Credit quality outlook for key sectors for fiscal 2024

In this section, we present the credit quality outlook for fiscal 2024 for a few key sectors that fall in the four buckets identified in the Corporate Credit Health Framework, along with changes in the key parameters (revenue visibility, profitability and working capital) versus fiscal 2023. Improvement in performance, or continued strong performance is represented in green, marginal improvement or no change in amber, and deterioration in red.

Very strong credit quality outlook for 41% of the rated debt analysed

These sectors are estimated to have favourable operating profits and very strong or strong balance sheets in fiscal 2024. Sectors such as automotive(auto) and auto components, power and hospitality will likely report higher profits.

	Revenue visibility	Profitability	Working capital	Credit quality

Auto – two-wheelers/PV/CV

Two-wheelers

Estimates for fiscal 2023: Revenue growth: 18-20%; Ebitda margin: 13-14%

Expectation for fiscal 2024: Revenue growth: 12-14%; Ebitda margin: 14-15%

Two-wheeler volume is projected to rise 11-13% in fiscal 2024 after robust growth in fiscal 2023. This, along with higher realisations backed by ability to pass on cost of meeting regulations, will result in healthy double-digit revenue growth. Volume is expected to be driven by continued demand for mid-level and high-end motorcycles due to increased affordability, recovery in scooter sales with educational institutions and offices re-opening and higher demand for electric vehicles.

Operating profitability is fiscal 2024 will benefit from higher volume and moderating raw material prices, and increase in realisations which will likely offset the higher cost of compliance with emission norms effective from April 1, 2023.

Passenger vehicles (PVs)

Estimates for fiscal 2023: Revenue growth: 27-30%; Ebitda margin: 7.5-8.5%

Expectation for fiscal 2024: Revenue growth: 10-12%; Ebitda margin: 8.5-9.5%

Overall PV sales will grow 9-10% on-year in fiscal 2024 to hit an all-time high of ~50 lakh units. Healthy order book will be driven by pent-up demand, higher incomes, and better availability of semiconductors. Demand for sports utility vehicles (SUVs) remains strong and will drive overall volume growth while exports will remain sluggish.

Operating profitability in fiscal 2024 will benefit from higher volume, moderating raw material prices. and increase in realisations, which will likely offset the higher cost of compliance with emission norms.

Commercial vehicles (CVs)

Estimates for fiscal 2023: Revenue growth: 18-20%; Ebitda margin: 13-14%

Expectation for fiscal 2024: Revenue growth: 12-14%; Ebitda margin: 14-15%

CV domestic sales volume growth is in line with economic recovery across segments, improving transporter profitability, healthy construction activity and materialisation of deferred replacement

	Revenue visibility	Profitability	Working capital	Credit quality

demand. Also the implementation of BS-VI phase 2 norms from April 2023 is expected to be smooth. To meet the cost of the new emission norms, CV manufacturers have already announced price hikes of 4-6%. This, along with moderating raw material prices and higher volume, will result in better operating profitability in fiscal 2024.

	Revenue visibility	Profitability	Working capital	Credit quality

Auto components

Estimates for fiscal 2023: Revenue growth: 20-22%; Ebitda margin: 11-12%

Expectation for fiscal 2024: Revenue growth: 10-12%; Ebitda margin: 11.5-12.5%

Demand from original equipment manufacturers (OEMs), which is the largest segment, will continue to drive growth for auto components, followed by the replacement market. That said, exports will see limited growth due to continuing inflationary trends impacting consumption in key overseas markets.

Operating margin will see modest improvement in fiscal 2024, due to better utilisation, stabilisation of freight costs and continued cost control measures. Working capital requirement is seen rising because of higher volume growth and increase in key raw material inventory due to volatile prices.

Capex is also expected to increase given the strong demand outlook, including for electric vehicles, and investments related to the PLI scheme.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality

Information technology

Estimates for fiscal 2023: Revenue growth: 18-20%; Ebitda margin: 22-22.5%

Expectation for fiscal 2024: Revenue growth: 10-12%; Ebitda margin: 23%

Resilient growth in cost-optimisation deals, along with strong digital solutions, cloud and automation capabilities will drive revenue growth, with a sharp depreciation in the rupee providing a further upside.

It will be the third straight year of double-digit growth, albeit lower than the 18-20% growth in fiscal 2023 (accentuated by the sharp depreciation of 7-8% in the rupee value) and ~19% in fiscal 2022 (the highest in eight years). Employee costs are expected to be lower in fiscal 2024 leading to 25-50 bps on-year improvement in operating margin to ~23% with companies taking a cautious approach to fresh hiring as they strive to normalise headcount after the hiring peaks of fiscal 2022.

	Revenue	Profitability	Working capital	Credit quality
Agrochemicals				

Estimates for fiscal 2023: Revenue growth: 15-17%; Ebitda margin: 15-16%

Expectation for fiscal 2024: Revenue growth: 10-12%; Ebitda margin: 15-16%

Good to normal monsoon, better profitability in exports, strong cash generation, healthy asset churn (despite high capex) and control over working capital have helped sustain credit quality.

Operating margins should remain in double digits. That said, the extent of pass on of input prices, logistics issues, weather conditions in India and key international markets, currency fluctuation and regulatory issues will bear watching. The credit quality outlook is expected to remain stable despite higher working capital intensity and continued large capex of Rs 6,000-6,500 crore for fiscal 2024. Capacities are being added to cater to domestic demand and exports as international customers seek to de-risk dependence on China. Export growth will continue to outpace domestic growth driven by the China + 1 strategy.

	Net leasing	Occupancy	Credit quality
Commercial real estate			

Net leasing growth 2023E: 13-15%,

Net leasing growth 2024E: 10-12%

Net leasing of commercial office space in India will grow 10-15% over fiscals 2023 and 2024 due to improvement in demand as employers increasingly favour employees working from office, although with some flexibility.

The ratio of debt to Ebitda should be comfortable at 4.6 times in fiscal 2023 and 4.4 times in fiscal 2024. While the cost of debt has been inching up, the debt service coverage indicator should remain adequate at 1.7-1.8 times in fiscals 2023 and 2024.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality
Cement				

Estimates for fiscal 2023: Revenue growth: 20%; Ebitda margin: 12-13%

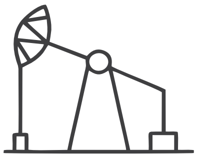
Expectation for fiscal 2024: Revenue growth: 10-12%; Ebitda margin: 15-17%

Demand for cement was led by rapid execution of infrastructure projects and strong traction in the real estate and rural affordable housing segments.

Buoyed by the infrastructure-focused Union Budget and affordable housing schemes announced by the government, cement demand is set for its third straight year of growth with a 7-9% jump to ~425 million tonne (MT) in fiscal 2024. Demand growth is likely to be sharper in central and eastern regions, which account for over 80% of PMAY-G (Pradhan Mantri Awas Yojana – Gramin) construction.

However, the outlook on operating margin, which has been under pressure, remains clouded with the prices of key inputs – coal and pet coke – remaining elevated.

	Revenue	Profitability	Working capital	Credit quality



Oil and gas downstream

Estimates for fiscal 2023: Revenue growth: 20-25%; Ebitda Margin 1.5 - 2%

Expectations for fiscal 2024: Revenue growth: (4-6)%; Ebitda margin: 4-5%

Demand is estimated to have grown 7-9% on-year in fiscal 2023. Profitability of oil marketing companies (OMCs) was severely impacted, as retail prices of auto fuels remained unchanged despite rise in crude oil prices, but has recovered since the third quarter, with softening crude oil prices.

For fiscal 2024, operating profitability and overall cash flow should improve if the current trend in oil prices sustain, easing ease the working capital cycle and thereby improving financial metrics. That said, trending crude oil prices and resultant decisions on retail fuel prices could alter the eventual performance of OMCs. Revenue may dip due to lower average crude oil prices expected in fiscal 2024 vis-à-vis fiscal 2023.

	Revenue	Profitability	Working capital	Credit quality

Airport

Estimates for fiscal 2023: Revenue growth: 50-55%; Ebitda margin: 50-55%

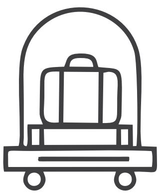
Expectation for fiscal 2024: Revenue growth: 25-30%; Ebitda margin: 50-55%

Air traffic volume at Indian airports is estimated to have grown over 70% to 325 million for fiscal 2023 and is expected to rise ~17% on-year to over 380 million in fiscal 2024.

Buoyed by traffic volume, revenues of airports will also climb. Both, aeronautical and non-aeronautical revenues, are expected to increase 25-30% in fiscal 2024, driven by increasing volume of higher-spending international passengers and more monetisation opportunities coming onstream from almost-complete capacity expansions at private airports.

After factoring cost escalations, cash flows of private airports are expected to rise ~20% above the fiscal 2020 level in fiscal 2024 (25-30% over fiscal 2023). This is essential to maintain long-term debt service cushion of 1.4 time.

	Revenue	Profitability	Working capital	Credit quality



Hospitality

Estimates for fiscal 2023: Revenue growth: 90%; Ebitda margin: 34%

Expectations for fiscal 2024: Revenue growth: 4-5%; Ebitda margin: 34-35%

Higher average room rate (ARR) and occupancy helped the Indian hotel industry log strong improvement in profitability in fiscal 2023.

Revenue is seen increasing over the pre-pandemic level, riding on the strong recovery in business travel and continued traction in leisure travel. With the opening of international travel, occupancy is expected to remain robust.

The gap created by strong demand and limited supply addition will aid the improvement in ARR. Developers had held back on capex amid the pandemic-induced uncertainties. While the sharp rebound in demand may spur an increase in capex, supply will take a while to catch up due to the long execution cycle of projects.

Positive to stable credit quality outlook for 55% of the rated debt analysed

These sectors are expected to have favourable trends in one of the two parameters— operating profit or leverage. Absolute operating profit is expected to improve for fiscal 2024, or the balance sheet score is expected to be strong or very strong.

	Revenue	Profitability	Working capital	Credit quality

Construction (roads)

Estimates for fiscal 2023: Revenue growth: 13-15 %; Ebitda margin: 12-12.5%

Expectation for fiscal 2024: Revenue growth: 10-12%; Ebitda margin: 12.5-13.0%

The sector will see healthy revenue growth in fiscal 2024, driven by robust infrastructure spend by the government.

After falling by an estimated 150 bps in fiscal 2023 due to high input prices, operating profitability is expected to be marginally better in fiscal 2024 due to softening of input costs. However, it will remain muted at 12-13%, compared with 14-15% in the past, as players execute the aggressively bid contracts awarded in the past 2-3 fiscals.

	Revenue visibility	Profitability	Working capital	Credit quality

Gold jewellery

Estimates for fiscal 2023: Revenue growth: 23-25%; Ebitda margin: 6.7-7%

Expectations for fiscal 2024: Revenue growth: 8-12% ; Ebitda margin: 6.6-7%

Revenue growth is expected to normalise to past levels of 8-12% in fiscal 2024 on the high base of two strong growth years.

With increased marketing and store-related expenses, operating margin declined 40-70 bps on-year in fiscal 2023 and should stabilise at the pre-pandemic level of 6.7-7% for fiscal 2024.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality

Diamond

Estimates for fiscal 2023: Revenue growth : (7)-(10)%; Ebitda margin: 3.5-4%

Expectations for fiscal 2024: Revenue growth: 0-1%; Ebitda margin: 4%

India majorly exports its cut and polished diamonds to the US, the EU, and China, among other geographies. While China is fully coming out of lockdown, demand from the US and the EU is expected to remain subdued amid recessionary trends, which will result in tepid volume growth in fiscal 2024. Despite correction in the second half of fiscal 2023, average prices remained high during the fiscal, compared with previous years because of the US sanction on Russian diamond miner - Alrosa. With steadying prices of rough diamonds, the average price for fiscal 2024 is expected to be lower, thereby leading to flattish value sales in fiscal 2024.

	Revenue visibility	Profitability	Working capital	Credit quality

FMCG

Estimates for fiscal 2023: Revenue growth: 9-11%; Ebitda margin 19-19.5%

Expectation for fiscal 2024: Revenue growth: 7-9%; Ebitda margin: 20-20.5%

In fiscal 2024, the sector is expected to grow 7-9% driven by volume growth with revival in rural demand as inflation eases. After moderating by 100-150 bps in fiscal 2023 on higher input costs (primarily wheat, milk, maize, rice, crude derivatives) and increased selling and marketing expenses, operating margins are expected to remain stable in fiscal 2024 because of softening prices of some raw materials, such as edible oil and sugar.

Hike in the minimum support price (MSP) for all rabi crops and increased government spending on rural infrastructure projects will drive rural demand. The impact of El Nino remains a monitorable.

	Revenue	Profitability	Working capital	Credit quality

Education services

Estimates for fiscal 2023: Revenue growth: 12-15%; Ebitda margin: 28%

Expectations for fiscal 2024: Revenue growth: 8-10%; Ebitda margin: 26-28%

An uptick in enrolment, especially for higher education, and a hike in fees after two years of hiatus pushed revenue of schools and colleges 12% higher in fiscal 2023. With marginal growth in enrolments and regular fee hikes in certain streams, the revenue is expected to increase 8% in fiscal 2024.

Operating profitability remained steady in the past two fiscals, initially supported by cost cutting measures and then by growth in revenue. Annual capex increased in fiscal 2023, which should continue in fiscal 2024. While the capex is being funded partly through debt, balance sheets of education institutes have the cushion to absorb it.

	Revenue	**DSCR** (Debt service coverage ratio)	Credit quality

Highway tolling

Estimates for fiscal 2023: Revenue growth: 16-18%

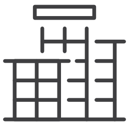
Expectations for fiscal 2024: Revenue growth: 9-11%

Pick-up in economic growth with easing of supply side issues has helped traffic bounce back, registering an increase of 16-17% on-year between April and October 2022, due to low base of traffic in the corresponding period of the previous fiscal.

High toll rates and traffic growth of 5-7% resulted in estimated revenue growth of 16-18% in fiscal 2023, though the growth will moderate in fiscal 2024.

Healthy revenue with regular toll hikes and traffic growth, along with moderately leveraged balance sheets, will continue to support the credit profiles of toll roads/projects.

	Revenue visibility	Profitability	Working capital	Credit quality

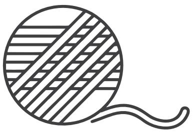


Residential real estate

Sales of realtors will grow 8-10% on-year in fiscal 2024 after growing an estimated 15-17% in fiscal 2023. Large, listed realtors will outpace the sector, growing ~25% on-year in fiscal 2023 and 10-15% in fiscal 2024, as they continue to gain market share and consolidate their position.

Growth will moderate in fiscal 2024 on account of decline in affordability due to increase in capital values and interest rates. Residential prices are estimated to have risen 6-10% in fiscal 2023 and may increase further by 3-5% in fiscal 2024 across the top six cities (Mumbai Metropolitan Region, National Capital Region, Bengaluru, Pune, Hyderabad and Kolkata) because of increase in raw material, labour and land costs, and relatively favourable demand-supply dynamics.

	Revenue visibility	Profitability	Working capital	Credit quality



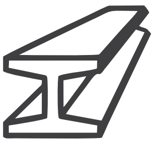
Textiles – Cotton

Estimates for fiscal 2023: Revenue growth: (8)-(10) %; Ebitda margin: 10.5-11%,

Expectations for fiscal 2024: Revenue growth: (10)-(12)%; Ebitda margin: 11.5-12%

Healthy domestic demand and recovery in exports and improved price competitiveness due to lower cotton prices will drive volume growth of 3-5% in fiscal 2024. However, revenue may decline due to fall in realisation by 15% on-year. Operating margin may improve in fiscal 2024 due to higher demand, lower material prices and higher capacity utilisation.
Credit metrics will remain stable on deleveraged balance sheets.

	Revenue visibility	Profitability	Working capital	Credit quality



Steel (Primary and secondary)

Primary steel:

Estimates for fiscal 2023: Revenue growth: (7)-(10) %; Ebitda margin: 16-18%,

Expectations for fiscal 2024: Revenue growth: 1-2 %; Ebitda margin: 17-19%

Primary steel producers are expected to see healthy volume growth of 7-8% in fiscal 2024 driven by infra push. Average realisations may drop ~ 10% on-year for fiscal 2024. Rollback of export duty from the second half of fiscal 2023 may push up exports in fiscal 2024.

Despite moderation from the peaks witnessed in fiscal 2023, raw material prices are expected to remain high for primary steel producers. Hence, working capital requirements may not ease significantly.

Secondary steel

Estimates for fiscal 2023: Revenue growth: 8-10 %; Ebitda margin: 6-8%

Expectations for fiscal 2024: Revenue growth: 3-5%; Ebitda margin: 7-8%

Secondary steel players are expected to see 8-10% volume growth for fiscal 2024 driven by infra spends and continual demand from real state. Long steel realisations will moderate 3-5%. Nevertheless, revenue will grow by ~3-5% backed by elevated volume.

Operating margins are expected to remain broadly stable in fiscal 2024.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality
Pharmaceuticals				

Estimates for fiscal 2023: Revenue growth: 8-9%; Ebitda margin: 19.5-20%

Expectation for fiscal 2024: Revenue growth: 9-10%; Ebitda margin: 20-21%

Steady domestic demand and continued growth momentum in semi-regulated markets will drive growth in fiscal 2024.

Exports to regulated markets continued to face headwinds in fiscal 2023, but were supported to some extent by rupee depreciation. Growth in fiscal 2024 is likely to be driven by new product launches, entry into products with low competition, and diversification into untapped markets. The US continues to face pricing pressure amid intense competition, but new launches and increase in India's share in abbreviated new drug approvals could improve export volume and ease pricing pressure.

Some improvement in operating margin is expected in fiscal 2024 as inflationary pressure on input and logistics costs ease.

Incentives worth Rs 65 billion through the PLI scheme will result in capex of Rs 60-65 billion over 2-3 years. However, dependence on China is unlikely to reduce significantly over the medium term.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality
Hospitals				

Estimates for fiscal 2023: Revenue growth: 10-12%; Ebitda margin: 16-17%

Expectation for fiscal 2024: Revenue growth: 10-12%; Ebitda margin: 16-17%

Larger hospitals are expected to witness revenue growth of 10-12% in fiscal 2024, while smaller hospitals will grow at a slightly slower pace. Larger hospitals will benefit from high occupancy, amidst aggressive bed expansions, while smaller hospitals will focus on enhancing occupancy levels and sustaining revenue per bed.

Operating margins may moderate from the fiscal 2022 levels but will remain higher than the pre-pandemic levels. supported by healthy occupancy and improvement in average revenue per operating bed (ARPOB). Capex will increase in fiscal 2024 with addition of almost 6,000 beds (at a cost of Rs 12,000 crore), compared with addition of ~6,000 beds between fiscals 2019 and 2022 (cost of Rs 11,500 crore).

	Revenue	Profitability	Working capital	Credit quality

Power: Genco - renewables

Estimates for fiscal 2023: Revenue growth: 15-20%; Ebitda margin: 80-85%,

Expectations for fiscal 2024: Revenue growth: 15-20%; Ebitda margin: 80-85%

Renewable capacity additions are expected to expand, particularly in solar power with 40-45 GW likely to be added over fiscals 2023 to 2025 to take the installed capacity to 150 GW by March 2025. Wind capacity addition will be relatively lower at ~2 GW per annum on account of lower auction activity in the past 2-3 years.

The sector has been positively impacted by continuing release of stuck receivables by state discoms with the implementation of the late payment surcharge (LPS) scheme.

Operational performance remains a key monitorable with solar performance lagging below overall P90 expectations in fiscal 2023. Wind performance also remains weak compared with the P90 estimates.

	Revenue	Operating Profits	Working capital	Credit quality

Power: Genco - non-renewables

The demand for power is expected to increase 5.0-5.5% between fiscals 2023 and 2028, supported by healthy economic growth and improved reach and strengthening of distribution infrastructure. Central and state entities will contribute by widening their capacities over the medium term. As of February 2023, ~67 GW of conventional power capacities was under construction, and by 2028, 27 GW of coal based, 13-14 GW of hydro and 5GW of nuclear power capacities is expected to be added. Conventional capacity additions should remain steady over fiscals 2023 to 2027 due to growing focus on non-fossil fuel capacity. The central entities will account for a majority of the capacity addition on account of assured power purchase agreements and sound financial health. Working capital position of gencos has improved with improved payments by counterparties under the new Electricity (Late Payment Surcharge and Related Matters) Rules, 2022. Sustenance of timely payments by counterparties remains a key monitorable.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality

Capital goods

Estimates for fiscal 2023: Revenue growth: 14-16%; Ebitda margin: 10.5-11%

Expectation for fiscal 2024: Revenue growth: 10-12%; Ebitda margin: 10.5-11%

A pickup in in the private sector investment cycle and the continuing government thrust on infra augur well for cash flows. At the other end, correction in commodity prices from the March-April 2022 peaks, along with moderating economic outlook for overseas markets, may slacken the pace of order book growth in fiscal 2024, though order books will remain sizeable

OEMs account for a larger share of profits compared with EPCs, given their market position and ability to pass on price increases and shorter delivery duration. 'Make In India' initiatives along with Plus 1 strategy by customers is supporting domestic capital goods players.

	Order book/Revenue visibility	Profitability	Working capital	Credit quality
Textiles – Readymade garments	**Estimates for fiscal 2023: Revenue growth: 15-18%; Ebitda margin: 8%** **Expectations for fiscal 2024: Revenue growth; 10-12%; Ebitda margin: 8-9%** Growth of the readymade garment industry will slow to 8-10% in fiscal 2024 from 13-15% in fiscal 2023 amid global headwinds. Growth in exports to key destinations such as the US and Europe may moderate. With recovery in sales from schools, offices, and retail outlets/malls, the domestic market may grow 10-12% in fiscal 2024. Credit metrics should remain stable on low capex requirement and healthy cash generation.			

Stable credit quality outlook for 4% of the rated debt analysed

These sectors are expected to see a decline in operating profit in fiscal 2024, even as the balance sheet remains very strong or strong.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality
Specialty chemicals	**Estimates for fiscal 2023: Revenue growth: 15-17%, Ebitda margin 11-12%** **Expectation for fiscal 2024: Revenue growth: 10-12% Ebitda margin: 13-15%** Indian dyes and pigments manufacturers have a global market share of 16-18%, and derive ~48-50% of their revenue from exports. With economic growth subdued in key export markets demand (especially Europe), companies have not been able to pass on the full impact of rising raw material (RM) prices, half of which is linked to crude and crude-linked derivatives, to customers. This has adversely impacted margins. However, with raw material prices currently softening and demand also picking up, margins are expected to improve going forward. Another major segment would be the PVC segment where ~45% of the domestic demand is met through imports. Owing to pandemic-related restrictions and subdued demand conditions in China, manufacturers there started dumping PVC products into India, leading to a crash in domestic prices in the first nine months of fiscal 2023. This resulted in significant inventory losses for Indian manufacturers. However, with China re-opening, and steady domestic demand conditions, prices have again started picking up, which will help support the margins of Indian companies. Similar trends are being observed across the specialty chemicals value chain. Overall, profitability margin moderated by 600-800 basis points in fiscal 2023 due to a sharp increase in input costs, especially imported (linked to crude and dumping by China). While operating margin is expected to improve in fiscal 2024 with crude prices softening and dumping from China moderating since December 2022, revenue growth would be lower compared with last fiscal. The credit quality outlook on the sector continues to be stable given the healthy balance sheets. Debt levels, however, will rise to fund capex needs and higher working capital, due to rising exports. Debt metrics though will remain at adequate levels.			

Credit quality outlook for the financial sector

Banks seeing improvement across key performance metrics

After a phase of sharp increase in gross non-performing assets (NPAs), falling profits and subdued credit growth, banking sector performance is improving across key metrics.

Credit growth for the banking sector is expected at ~15% over fiscals 2023 and 2024. However, growth in deposits continues to lag credit, and with surplus liquidity now normalising, ability to garner deposits remains a key monitorable.

From a segmental growth perspective, corporate credit, constituting around 45% of total bank credit, would benefit from a pick-up in capex across sectors domestically, as well as in industrial and infrastructure capex.

Retail credit, which comprises ~26% of banking sector advances, is likely to see healthy growth across sub-segments. Home loans, the largest sub-segment, has maintained comfortable growth despite rising interest rates. The unsecured segment is also witnessing healthy growth.

With increasing formalisation of the MSME sector and the number of MSMEs registered under Udyam, the addressable base for banks is expanding, especially for priority sector loans. Plus, MSMEs continue to benefit from government reforms, which will lead to continued growth in this segment.

Asset quality trends are benign, with overall gross NPAs expected to touch a decadal low of sub-4% in fiscal 2024.

The biggest improvement will be in the corporate segment, where gross NPAs are seen falling below 2% in fiscal 2024 from a peak of ~16% as on March 31, 2018, as a result of significant clean-up by banks in recent years and strengthened risk management and underwriting. Fundamentally, too, the health of Corporate India has improved with secular deleveraging over the past few fiscals and through the pandemic.

Asset quality in the MSME segment remains a monitorable — this sector had seen the highest level of restructuring. While the increasing formalisation of the sector enhances the ability of banks to assess and underwrite these loans, the sector remains vulnerable to macroeconomic factors such as rise in interest rates.

Gross NPAs in the retail and agricultural segments are expected to remain range-bound over the medium term.

The improvement in asset quality and already high provisioning cover ratio of ~76% as on December 31, 2022, helped reduce credit costs, thereby improving profitability in fiscal 2023, despite the impact of rising interest rates on treasury profit in the first quarter. Net interest margins rose for banks as deposit rate hikes lagged increases in lending rate. However, as the full impact of deposit rate hikes gets transmitted, net interest margin expansion could taper, keeping overall return on assets at ~1-1.1% for fiscal 2024 — similar to levels estimated for fiscal 2023, with lower credit costs supporting overall profitability.

From a capitalisation perspective, the banking sector now has adequate buffers and is well placed for growth over the medium term. While most private banks have traditionally maintained comfortable buffers, many are also benefiting from capital raised in the past three fiscals. Public sector banks (PSBs), too, have raised some equity, apart from the substantial capital infusion by the government over the last few fiscals, and have stronger balance sheets and capital ratios. As of March 2022, all PSBs had a Tier I buffer of more than 100 bps over the regulatory requirements, indicating ability to absorb asset-side risks and support credit growth. This is in sharp contrast with March 2018, when only about a quarter of the PSBs had a Tier I cushion of over 100 bps in excess of the regulatory requirement.

Overall, the banking sector is on a relatively stronger footing today compared with the past few years.

Whether deposit growth can keep pace and support bank credit growth needs to be seen. For the past several months, bank credit growth has outpaced deposit growth, with banks utilising the surplus liquidity that they had built up to support growth. With excess liquidity normalising, banks have started raising deposit rates, especially since the third quarter of fiscal 2023, in an attempt to increase deposit growth.

More importantly, to avoid a repeat of past asset-quality challenges, it is important that banks do not relax their credit underwriting standards while focusing on higher credit growth.

Non-banks to see four-year-high growth in AUM; profitability to remain steady despite rising borrowing cost and amid lower credit cost

The past three fiscals saw non-banking finance companies (NBFCs)[11] focussing on bolstering liquidity, capital and provisioning buffers to reinforce their balance sheets. This, combined with the rebound in economic activity and receding asset quality pressures, has put the sector in a better position now to capitalise on growth opportunities.

Asset quality metrics are expected to improve across segments. Over March 2021 to March 2022, there was a marginal increase in 90+ dpd (days past due) for a few segments, but the restructured book was a more pressing concern. However, the restructured book has now reduced considerably over the past year and the outstanding restructured portfolios for most of the segments are negligible.

Asset quality metrics across segments have shown improvement and the fundamentals are expected to hold with the supportive macro environment which has seen business activity normalise. Nevertheless, any major challenges stemming from rising inflationary pressures, interest rates, and job losses remain monitorable.

NBFCs have weathered multiple challenges over the past few fiscals — made worse by the pandemic — but fiscal 2023 brought growth back. With the momentum expected to continue, NBFCs will likely see assets under management (AUM) increase 13-14% in fiscal 2024, compared with single-digit growth in the three fiscals to March 2022. The upturn will ride on multiple tailwinds — improving economic activity, strengthened balance sheet buffers and receding asset quality concerns.

This growth is expected to be relatively broad-based across the retail segments. That said, there are risks to look out for. First, intensifying competition from banks, especially in the traditional retail segments, such as home loans and new vehicle finance. Second, the rising rates environment, which is translating into increasing cost of borrowings for NBFCs, limiting their competitiveness in some asset classes.

For home loans, the biggest segment comprising 40-45% of the NBFC AUM, structural factors driving end-user housing demand are intact despite the rising real estate prices and interest rates. That should drive 13-15% growth in the AUM for this segment in fiscal 2024. That said, housing finance companies (HFCs) may keep losing market share to banks amid intense competition on interest rates, especially in the urban and the formal salaried segments. They are expected to sharpen focus on the affordable and non-urban housing finance segments to enhance volumes.

Vehicle finance, the second-largest segment (20-25% of NBFC AUM), is expected to grow 13-14% in fiscal 2024 compared with an estimated ~12% in the previous fiscal, on the back of solid underlying-asset sales. Strong

[11] Including housing finance companies (HFCs), excluding government owned NBFCs

pent-up demand and new launches will continue to drive car and utility vehicle sales. The ongoing rebound in economic activity, demand for fleet replacement, and focus on last-mile connectivity will support commercial vehicle sales. In the new-vehicle finance segment, especially cars, borrowers are highly sensitive to interest rate. Hence, competition from banks remains tough given their ability to offer finer pricing. Consequently, NBFCs will likely capitalise on their core strengths of last-mile connectivity, customer relationships, innovativeness, and strong understanding of micro markets to sharpen focus on used vehicle and light commercial vehicle financing, which offer higher yields and better profitability from a risk-adjusted return perspective.

In this competitive landscape, realignment of portfolio strategies by NBFCs will support growth. The focus is on non-traditional asset classes such as unsecured loans, MSME finance and used vehicle finance, where growth rate is expected to be higher. Consequently, these segments are garnering higher share in incremental disbursements by NBFCs. Unsecured loan (8-10% of NBFC AUM) is the cynosure for many large NBFCs. Demand for consumer loans is high across durables, travel and other personal consumption activities, while business loans have benefited from macroeconomic tailwinds. The AUM in this segment is seen growing 20-22% in fiscal 2024.

As large NBFCs turn towards non-traditional segments, symbiotic partnerships may increase with segment-focused emerging NBFCs, especially in unsecured lending. This allows large NBFCs to venture into newer segments in a more cost-efficient manner while reducing time-to-market. For emerging NBFCs, it supports capital-efficient AUM growth. Co-lending with banks remains another preferred route for growing AUM, especially for mid-sized and emerging NBFCs.

Geopolitical issues, sharper-than-expected increase in interest rates, and inflation will bear watching. Any impact on the funding environment driven by the recent global events remains a monitorable.

Securitisation volume on the rise as asset quality concerns recede

Share of foreign investors increases; more originators come in, unsecured segments gain popularity

The first nine months of fiscal 2023 saw securitisation volume cross the Rs 1.15 lakh crore mark, surging 42% on-year. Direct assignment (DA) deals comprised the largest chunk, at 60% of the quantum, with most mortgage and gold loan pools being securitised through this route. The issuance of pass-through certificates (PTCs) accounted for the balance 40%.

As macroeconomic uncertainties and asset quality concerns ebbed, more than 120 originators executed deals in the space. Among these, the presence of small finance banks (SFBs), large issuers in their previous avatar of non-banks, drew attention from several investors.

Among asset classes, property-backed loans constituted the largest segment, though, their proportion declined to ~38% in fiscal 2023 from ~43% a year ago. Within the non-mortgage space, commercial vehicle (31%) and microfinance (14%) loans were other large sub-segments. The proportion of unsecured loans, including personal and business loans, rose to 7% from 3% in fiscal 2022.

Foreign banks and multinational institutions were more active than earlier, given their preference for investing in PTCs backed by loans advanced to economically weaker sections. However, private banks (53%) and PSBs (25%) remained the largest investor groups. More PTCs continue to be listed on exchanges, with interested investors such as corporate treasuries, high networth individuals, and family wealth office firms attracted by the stable performance of past securitised loans.

Stable economic outlook and steady collections to shape future market trajectory

As the Indian economy rebounded strongly from the impact of the pandemic, collection efficiencies in retail loans have improved across asset classes. This augurs well for the outlook on securitisation volume as concerns around repayment ability of borrowers get addressed.

As the economy stabilises, the track record of steady pool collections will draw traction among traditional and new investors in securitisation transactions.

Furthermore, improved growth outlook for NBFCs, which are key originators of securitisation transactions, also bodes well for securitisation volume as these entities look to enhance their fund mobilisation activities with securitisation being a key avenue.

Over the past several years, securitisation transactions have withstood several episodes of stress, including the pandemic. The regulatory framework governing securitisation offers a reliable model for entities to raise funds from the market by offering exposure to cherry-picked loans, per the investor's criteria.

While some of these securitised pools may have witnessed shortfalls in collections at certain points in time, such episodes have been rare and temporary. In most cases, such instances have been followed by surplus collections that have replenished the credit collateral in the transactions.

Any fall in collections, rising delinquencies, credit enhancement utilisation, or occurrence of any unforeseen events that amplify risks to future investor pay-outs will continue to be monitorable.

Epilogue

In line with our expectations, the CRISIL Ratings credit ratio moderated in the second half of fiscal 2023 to 2.19.

From a macroeconomic perspective, India, while not completely insulated from externalities, is much better placed compared with other large economies.

The credit quality outlook for India Inc is positive, given the benefits of secular deleveraging, buoyant domestic demand and favourable government policies in the form of the push to infrastructure and the PLI scheme.

In the financial sector, we see balance sheets steadily improving for both banks and NBFCs because of better capitalisation, asset quality and profitability.

India's banking system has been largely insulated from recent global events such as the near-collapse and subsequent rescue of a global bank, and the collapse of some regional US banks.

The financial sector is expected to maintain growth momentum and healthy credit profiles. We also believe that unlike its global peers, Indian banks face lower interest rates risks.

Our credit quality outlook on India Inc has a positive bias — upgrades are expected to outnumber downgrades in fiscal 2024, too, as the underlying drivers stay apace.

However, a cautious undertone is warranted because the lagged effect of interest rates hikes of the recent past is expected to manifest and impact domestic demand, while exporters are likely to feel the impact of the global slowdown.

Notes

Notes

About CRISIL Ratings Limited (A subsidiary of CRISIL Limited, an S&P Global Company)

CRISIL Ratings pioneered the concept of credit rating in India in 1987. With a tradition of independence, analytical rigour and innovation, we set the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 33,000 large and mid-scale corporates and financial institutions. We have also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and infrastructure investment trusts (InvITs).

CRISIL Ratings Limited ("CRISIL Ratings") is a wholly-owned subsidiary of CRISIL Limited ("CRISIL"). CRISIL Ratings Limited is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI").

For more information, visit www.crisilratings.com

About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions with a strong track record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers through businesses that operate from India, the US, the UK, Argentina, Poland, China, Hong Kong, UAE and Singapore.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

For more information, visit www.crisil.com

Connect with us: LINKEDIN | TWITTER | YOUTUBE | FACEBOOK | INSTAGRAM

CRISIL Privacy Notice

CRISIL respects your privacy. We may use your personal information, such as your name, location, contact number and email id to fulfil your request, service your account and to provide you with additional information from CRISIL. For further information on CRISIL's privacy policy please visit www.crisil.com/privacy.

Argentina | Australia | China | Hong Kong | India | Japan | Poland | Singapore | Switzerland | UAE | UK | USA
CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India
Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com
/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited /lifeatcrisil

CRISIL
An S&P Global Company