Acuité
RATINGS & RESEARCH

Corporate Credit Quality: FY23

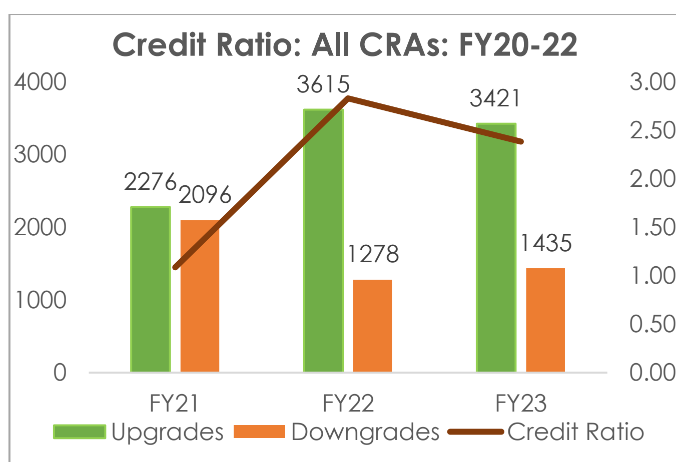
April 6, 2023

Visible resilience in corporate credit quality

Global headwinds and margin moderation likely to slow down rating upgrades in FY24

Acuité has undertaken a comprehensive analysis of the CRA industry rating migration data for FY23. This analysis is not just limited to the portfolio of Acuité Ratings & Research but covers the aggregate portfolio of CRAs to capture the overall credit landscape.

Notwithstanding the global headwinds, the performance of the Indian corporate sector has been largely resilient in FY22-23 and this is reflected in a moderate decline in the [1]Credit Ratio (CR) of the industry to 2.38x in FY23 from 2.83x in FY22. It can be recalled that there was a sharp post Covid recovery in CR in FY22 from 1.09x in FY21 and 0.91x in FY20 i.e. the pre-pandemic year.

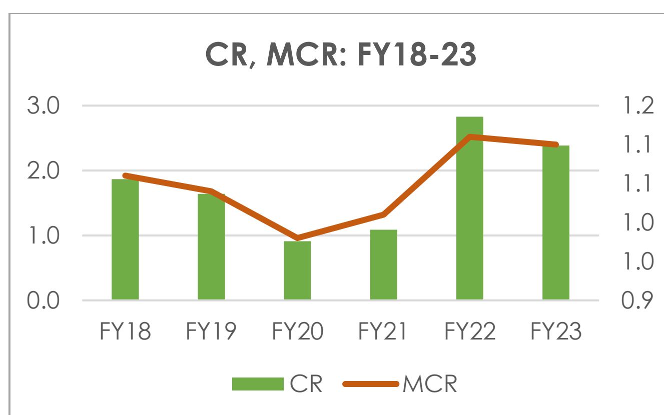


All CRAs	FY21	FY22	FY23
Upgrades	2276	3615	3421
Downgrades	2096	1278	1435
Credit Ratio	**1.09**	**2.83**	**2.38**

Source: Prime Rating Migration Database

The number of upgrades dropped slightly by 5.4% in FY23 vis-à-vis FY22 while the downgrades have increased by 12.3%. The credit quality in the corporate sector has seen some headwinds due to the impact of geo-political risks, higher global uncertainty and higher interest rates on their business and financial position. However, as compared to the pre-pandemic FY20, upgrades are still higher by 18.5% while downgrades have dropped sharply by 54.7% from those levels. This highlights the resilience in the corporate credit quality on the back of stronger balance sheets and a relatively conservative leverage profile.

[1] CR is the ratio of upgrades to downgrades in a given period, non-cooperative issuers excluded



	FY19	FY20	FY21	FY22	FY23
CR	1.64	0.91	1.09	2.83	2.38
MCR	1.04	0.98	1.01	1.11	1.10

Source: Prime Rating Migration Database

We have also looked at a longer time horizon since FY18 and analysed the movement of both Credit Ratio (CR) and [2]Modified Credit Ratio (MCR). While the volatility in the MCR is far less than the CR given the stability provided by addition of the reaffirmation cases, the trajectory in both the ratios reflect

(i) initially, the slowdown in the economy since FY19

(ii) the prolonged Covid pandemic starting from the last quarter of FY20 which led to a severe economic disruption through lockdowns and a significant contraction in GDP in FY21

(iii) the subsequent economic recovery that has been shaping up since Q2FY22 along with

(iv) signs of a business slowdown and margin moderation in some sectors due to global uncertainty, higher inflation and increased interest rates.

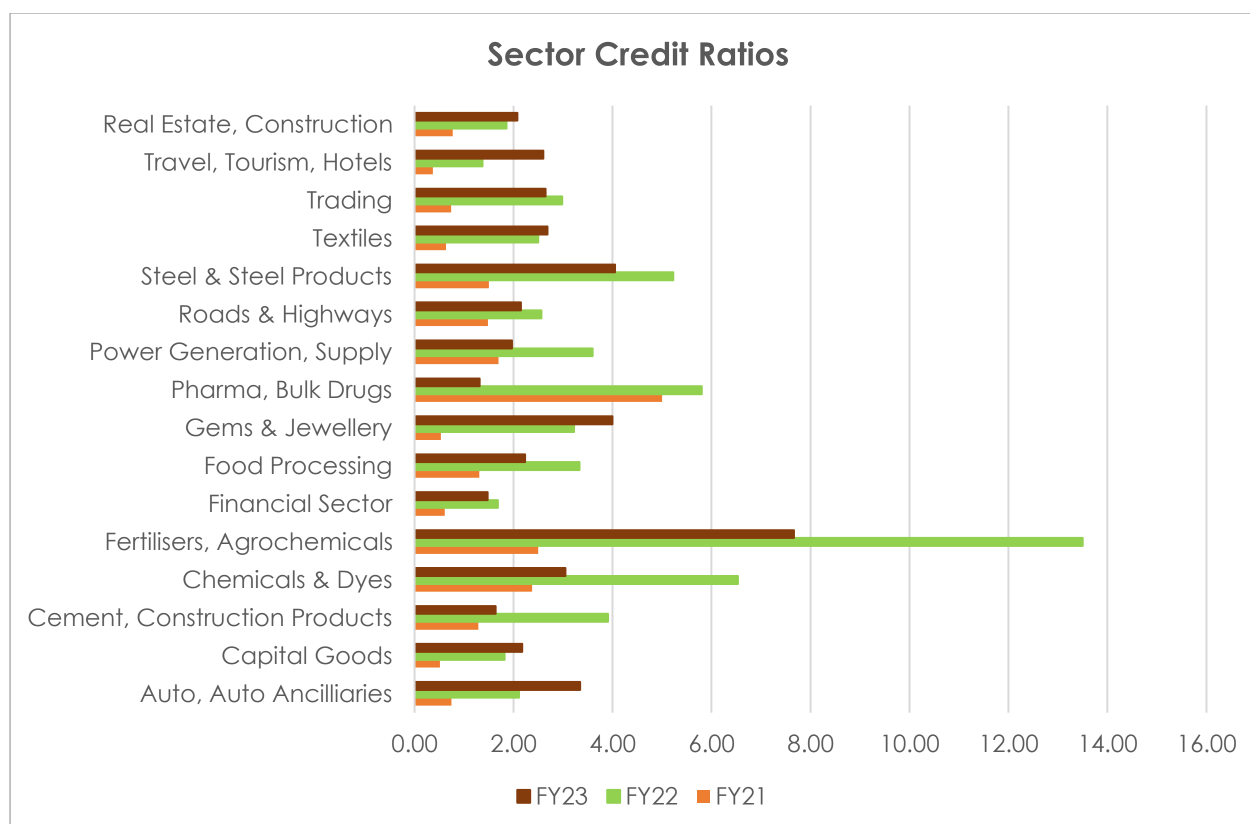
The sharp upsurge in rating upgrades in FY22 and its continuing momentum well into FY23 can be explained by the following:

- A resilient financial performance in FY21-FY23 in a significant part of the corporate sector including low debt levels
- The strong revival of urban demand due to the pent-up factor supported by a moderate recovery in rural demand

The downgrades during FY21-FY22 to a large extent, had taken into account the deterioration in the liquidity position of the rated entities in the wake of the prolonged pandemic and the severe lockdowns across India. Had it not been for the various relief measures announced by the Government of India importantly, the Emergency Credit Line Guarantee Scheme (ECLGS) and other special dispensation from RBI that improved access to funds, the extent of downgrades in FY21-FY22 could have been higher.

The downgrades in FY23 and those likely in FY24 are being driven by a slowdown in revenues and/or a decline in profitability on account of an inability to pass on the cost pressures to their customers. The buoyancy in the export sector, which was somewhat visible in FY22, has given way to sluggishness due to higher geo-political risks and the ongoing global slowdown, thereby impacting the rated entities engaged in manufacturing exports in particular.

[2] MCR is the ratio of upgrades and reaffirmations to downgrades and reaffirmations

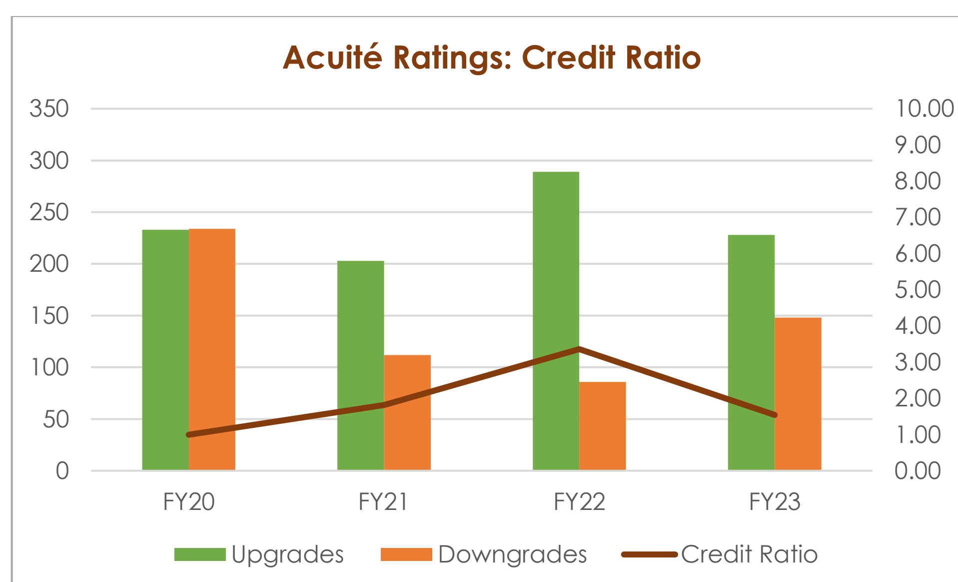


The credit ratio across the various sectors highlights the following aspects:

- In all the major sectors, upgrades continued to exceed downgrades by a significant margin, reflecting the expectation of a healthy domestic demand over the medium term. Some of the downgrades effected earlier due to the pandemic impact, have been subsequently reversed due to better than expected performance and this is also captured in the enhanced credit ratio.
- Fertilisers and agro chemical sector have continued to deliver a robust performance with consistently healthy agricultural growth over the last three years.
- After the pandemic disruption, the road sector has seen a recovery both in terms of project completion and toll collection.
- There is also a significant revival in sectors such as auto, gems and jewellery and textiles with the play out of pent-up demand; however, the sustenance of such demand in the current fiscal needs to be seen.
- While the pharma and the chemical sectors continue to exhibit a healthy performance along with a conservative financial risk profile, there has been a normalization in their credit ratios in FY23; nevertheless, the upgrades in the sector surpass the downgrades by a wide margin.
- The credit ratio in the financial sector has been relatively stable; while the number of upgrades has increased by 36%, there has been a larger increase in downgrades of 55%. Largely, the differentiator among the NBFCs has been the ability to improve collections from the retail and SME loans after the pandemic, minimise write-offs and maintain healthy capitalization levels. As regards the banking sector, public sector banks have been witnessing upgrades after a clean-up and government recapitalization of their balance sheets.

- The travel and the hospitality sector had been severely impacted during the pandemic as observed from the particularly low credit ratio in FY21 but with the decline of such risks, the prospects of these contact intensive sectors have improved, reflecting in higher pace of upgrades from H2FY22 which have continued into FY23.
- There also appears to be an uptick in the capital goods sector due to a gradual pickup in both public and private sector capital expenditure from FY22.

Ratings Performance: Acuité Ratings



While Acuité Ratings continue to have upgrades exceeding downgrades by a significant margin (CR – 1.54 in FY23), the pace of upgrades have been on a decline. With the expected slowdown in economy in FY24 due to the increased global uncertainties and the higher interest rates, we expect revenue growth to slow down and margins to moderate in several sectors including steel and cement. Furthermore, many MSMEs in the rated portfolio are expected to face higher debt repayment pressures from FY24 due to the upcoming repayments of the ECLGS loans.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research, "The relative stability of the industry credit ratio in FY23 is driven by not only the visible post pandemic recovery in domestic demand but also by the improvement in the financial risk profile in a large section of the corporate sector owing to healthy cash flows and limited debt driven capex plans. The operating environment for various services such as hospitality and travel saw a strong revival in FY23. Going into FY24, the external headwinds have intensified but a further pickup in public infrastructure investments and improved domestic demand on the back of moderating inflation are likely to deliver a healthy GDP growth of 6.0%. Nevertheless, the pass through of higher operating and interest costs in some sectors will prove to be difficult and a further decline in margins is likely. A part of the MSME sector, which is yet to see an adequate revival, may face stress due to ECLGS repayments. Therefore, we expect the credit ratio for the industry to witness a moderation in FY24."

Annexure: Industry Wise Credit Ratio

	FY20	FY21	FY22	FY23
Auto, Auto Ancillaries	0.81	0.75	2.11	3.35
Capital Goods	1.03	0.52	1.82	2.18
Cement, Construction Products	0.84	1.29	3.91	1.64
Chemicals & Dyes	3.19	2.38	6.53	3.05
Fertilisers, Agrochemicals	1.07	2.50	13.50	7.67
Financial Sector	0.57	0.61	1.68	1.48
Food Processing	2.19	1.31	3.33	2.23
Gems & Jewellery	0.42	0.53	3.22	4.00
Pharma, Bulk Drugs	0.80	5.00	5.80	1.32
Power Generation, Supply	1.14	1.70	3.60	1.97
Roads & Highways	0.83	1.48	2.56	2.15
Steel & Steel Products	1.12	1.50	5.23	4.05
Textiles	0.78	0.64	2.50	2.68
Trading	0.64	0.74	2.98	2.64
Travel, Tourism, Hotels	0.51	0.37	1.37	2.60
Real Estate, Construction	0.45	0.77	1.86	2.08

Source: Prime Rating Migration Database

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About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,500 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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