Covid-19 pandemic to have prolonged impact on the health of India Inc.

Subrata Ray
Sr.Group Vice President
ICRA Ltd.

Shamsher Dewan
Vice President
ICRA Ltd.

The novel coronavirus (COVID-19) outbreak, which began in China in December 2019, as largely a regional outbreak till February, has since taken shape of a global pandemic, leading to significant social and economic impact. As on date, India stands at third most affected nation globally by the pandemic and continues exponential rise in cases. While the Government relaxed its stringent and timely lockdown measures from the last week of May, the deep impact of the disease outbreak and healthy concerns associated are likely to have prolonged impact on the GDP with forecast being revised sharply downwards on frequent basis.

ICRA broadly classifies the ripple effect of coronavirus on India Inc. has in the following factors:

a) **Domestic demand slowdown** due to regulatory restrictions, lockdown and fear of contagion has impacted certain sectors over the near-term, while purchasing power erosion due to job losses or pay cuts and trickle-down effect of demand deferral would have a longer-lasting impact on some other sectors, especially where demand is discretionary in nature.
b) **Global economic slowdown and lockouts** has impacted sectors with high dependence on global demand, especially that of key impacted markets like Europe, North America and South-East Asia.
c) **Impact on commodities** like oil & gas, metals etc. due to lower global demand and price realisation
d) **Foreign exchange rate fluctuations** to have bearing on import-heavy sectors with forex-denominated costs.
e) **Supply chain disruptions** globally to impact sectors where there is import dependence for raw materials

Given the multi-pronged impact of the pandemic, the Indian corporate sector, which was already grappling with weakening macroeconomic scenario, faced major disruption from Q4 FY2020 onwards. Across sectors, the impact of the outbreak started showing its impact in the financial performance of corporate entities in the quarter. ICRA's analysis of financial results of listed companies in the Indian Corporate Sector (excluding financial sector entities) showed a Y-o-Y (2.9%) contraction in revenues in Q4 FY2020 as compared to 12.6% growth reported in the same period in the previous fiscal. The decline in revenue was even sharper for consumer-oriented sectors at 9.5% during the same period. During Q4 FY2020, the EBITDA margins also contracted by 30 bps and 120 bps respectively, on Y-o-Y and sequential basis, while PBT margins fell to multi-quarter lows as well.

Further, the impact is expected to be even more pronounced during Q1 FY2021, given aggravation of existing challenges. With the stringent two-month long nationwide lockdown from the end of March 2020, the major part of Q1 FY2021 has seen negligible manufacturing, infrastructure development and consumption activities. Although the production and consumption of essential goods continued during the lockdown, the impact on production and consumption of discretionary items has been significant, both due to the restrictions in place, as well as the bleak consumer sentiment.

Early indicators of consumer sentiment indicate at sequential recovery in May and June 2020 vis-à-vis April 2020, as the lockdown restrictions gradually eased. However, it remains at a fraction of pre-lockdown levels, which was sub-optimal in the first place.

Furthermore, with industrial and manufacturing activity only gradually scaling up, given challenges on raw material and labour availability, logistics, and subdued demand, the path to normalcy is expected to be gradual.

On the consumption front, data for Q1 FY0221 suggest some recovery in demand from the end of May 2020 onwards, with pickup in credit card spending, food deliveries etc. The improvement was especially pronounced in rural areas and smaller towns, buoyed by a healthy rabi harvest and associated cash flows. Accordingly, tractor sales have bounced back to pre-covid levels, with some OEMs even reporting Y-o-Y growth in volumes. However, the demand in urban centres, especially metros, continue to remain subdued, given the continued rapid proliferation of the pandemic.

Additionally, while demand of essential goods has reverted close to normal levels, aided by supply chain normalisation, and improved adoption of digital channels, people continue to place discretionary purchases on the back burner. This remains especially true for large-ticket purchases. Given the layoffs, pay-cuts and general uncertainty regarding job stability, this trend is likely to continue over the near-term, in absence of any significant demand triggers. Other sectors like aviation and hospitality are also expected to see a longer timeline to recovery.

In terms of investment-related sectors like construction, the immediate impact is negative given that even post partial relaxations of the lockdown from April 20th, the pace of construction activity has been slow due to reverse migration of labour. Additionally, fiscal constraints, especially of state governments, are likely to hamper the pace of execution over the immediate future. Furthermore, almost all the major commodity sectors, including Oil and Gas, Metals & Mining, Iron & Steel, Cement etc. would also report revenue contraction on the back of tepid realisations due to benign commodity prices and subdued volumes.

Nevertheless, the Indian economy had started to recover from the troughs experienced in April 2020, when the lockdown was at its severest, and many sectors seemed to be adjusting to a new normal. However, the unabated rise in Covid-19 infections in the unlock phase and localised re-imposition of lockdowns in several states, have interrupted this recovery in recent weeks. Given the severity of the pandemic and the duration of the safety measures that need to be employed, ICRA expects a sharp contraction of 9.5% in Indian GDP in FY2021. ICRA also anticipates more unevenness, as different regions move in and out of lockdowns, and persisting labour supply mismatches affect supply chains and consumption patterns. Additionally, the timeline for a firmer recovery out of the contractionary phase is expected to be at least Q4 FY2021, despite some optimism regarding the outlook for agricultural growth and rural consumption.

The rapid spread of the pandemic across major economies and the resultant disruptions in international markets have also had a ripple effect on financial markets. Equity markets have witnessed sharp correction and the resultant turmoil has negative credit implications, especially for entities that have high refinancing requirements.

In the current scenario, where demand has been adversely impacted and payment cycles have elongated, an entity’s liquidity position is of paramount importance to support its credit profile. It has been seen that several entities have endeavoured to conserve cash, either by invoking force majeure clauses to revoke payments, or by deferring payments to the extent possible. Accordingly, many entities have faced working capital blockage as their receivables got stretched and inventory didn’t run-down simultaneously.

Taking into cognizance these aspects and the near-term pressures on entities on account of the nation-wide lockout, the central bank of India, RBI, permitted a three-month moratorium on bank borrowings from March 2020, which was further extended for another three months till August 2020. It also announced a significant reduction in repo rates so as to support companies in preserving their liquidity to some extent and reduce the cost of borrowing.

Nevertheless, despite the RBI intervention, ICRA believes entities with weak liquidity buffer relative to its fixed overheads and non-deferrable debt service obligations would have seen significant weakening of their credit profile over the past quarter, which is expected to continue over the near term as well. On the other hand, entities which maintain a comfortable liquidity buffer in the form of cash and liquid investments or undrawn sanctioned lines, would be better placed to tide over this phase.

In this challenging environment, the priority of India Inc. continues to be managing liquidity, cutting costs and improving digital infrastructure, wherever possible. Pay reduction, employee rationalization and renegotiating on vendor agreements like lease rentals has already been effected by many corporates. However, despite these efforts, credit implications of the pandemic will remain significant for many entities.

Accordingly, there has been a need to review the creditworthiness of rated entities, especially in sectors hard-hit by the pandemic. Consequently, ICRA’s rated portfolio has witnessed pace of downgrades increase while upgrades have nearly dried up since the pandemic struck. The pace of rating downgrades has accelerated, with the average monthly downgrades increasing by 23% during the period from March 1, 2020 to June 30, 2020, compared to the monthly average of FY2020. Of the 491 negative rating actions taken by ICRA on the rated entities during this period, a majority of them were attributable to the pandemic outbreak. Nearly half of these negative rating actions have been downgrades (242), while a significant proportion has also undergone a change in outlook to negative (199). Given the current uncertainties with regards to the pandemic and the evolving situation, 50 entities were also placed on Ratings Watch. However, negative rating actions have so far impacted only 13% of ICRA’s rated portfolio.

The sectors directly impacted by the pandemic have faced the brunt of rating actions. Accordingly, negative rating movements have been more in sectors that were at high risk from the impact of the pandemic. Out of the top ten sectors which witnessed a negative rating action since March 2020, a large proportion were those that were categorized as “High Risk” by ICRA. These included sectors like aviation, hotels and restaurants, retail, and ports. This underscores the aspect that these sectors are more vulnerable to business disruptions caused by the pandemic, and accordingly, the credit quality of entities is likely to be more impacted than other sectors. On the other hand, several “Low Risk” sectors like FMCG, sugar, seeds, and utilities have not experienced significant negative rating actions during this period, despite a large portfolio-base (100+ entities), highlighting their relative resilience to the pandemic.