ICRA

COVID-19 Crisis

ICRA's approach to reviewing the ratings

March 2020

How is ICRA approaching the review of its portfolio of ratings in response to the COVID-19 crisis?

COVID-19 Crisis | Analytical Approach

Because of the COVID-19 crisis, the credit profile of a large number of sectors and entities has become vulnerable. ICRA considers it imperative to communicate with the lenders, investors and other market participants about how ICRA is thinking about the credit developments in general and more so in uncertain times like these. In this endeavor, ICRA has already published research and commentary across a wide gamut of sectors highlighting our view on the credit implications and would be providing further updates to the market as credit conditions evolve.

This document outlines the approach ICRA is taking to review its ratings. The key objectives of this approach include: (1) bringing about consistency to the credit analysis, and (2) prioritizing efforts towards analyzing the relatively more vulnerable entities. To achieve these objectives, ICRA is adopting the following risk mapping method:

SECTOR-LEVEL RISK MAPPING

Creation of a heat map of sectors, marking out the **High Risk, Medium Risk** and **Low Risk** sectors

[The ongoing rating reviews are focused more on entities belonging to the Medium Risk and the High Risk sectors]

ENTITY-LEVEL RISK MAPPING

Carrying out a risk categorization at the entity-level, marking out the **Most Vulnerable, Moderately Vulnerable** and **Relatively Less Vulnerable** entities

[Efforts are being prioritized towards reviewing the ratings of entities marked as Most Vulnerable and Moderately Vulnerable]

Risk Mapping | Which sectors are being considered as High Risk?

ICRA

High Risk Sectors: These are defined as those sectors that face severe business disruption over the immediate term. Further, business recovery post crisis would also likely be more prolonged, heightening credit risks.

Aviation	**Ports**
Ceramic Tiles	**Retail**
Exhibitors	**Seafoods**
Gems & Jewellery	**Shipbreaking & Shipbuilding**
Microfinance Institutions	**Shipping**
Non-Ferrous Metals	**Textiles (Cotton Spinning)**
Port Support Services	**Tourism, Hotels and Restaurants**

Risk Mapping | Which sectors are being considered as Medium Risk?

Medium Risk Sectors: These are defined as those sectors that are likely to face some business disruption in the immediate term but where the aftereffects of the COVID-19 crisis^ may not persist for long.

Auto Ancillaries	**Consumer Durables**	**Logistics**	**Power**
Automobile OEMs	**Distributors**	**Manpower Outsourcing & Security Services**	**Private Sector Banks**
Breweries & Distilleries	**Electronics & Electricals**	**Mining**	**Public Sector Banks**
Building Materials	**Engineering**	**Mutual Fund**	**Real Estate - Residential**
Cables	**Ferrous Metals**	**Packaging**	**Solvent Extraction**
Chemicals	**Financial Institution**	**Paper**	**Textiles (Apparels)**
Construction	**Financial Service Companies**	**Petrochemicals & Polymers**	**Timbers, Plywood etc.**
Construction Equipment	**Footwear & Leather Products**	**Pharmaceuticals**	**Trading**
Consulting	**Housing Finance Companies**	**Plastics**	

^ *This presumes that the COVID-19 crisis would not persist for long*

Risk Mapping | Which sectors are being considered as Low Risk?

Low Risk Sectors: These are defined as those sectors that are unlikely to face business disruption or a material increase in credit risks over the near term as a fallout of the COVID-19 crisis.

Agricultural Produce	**Healthcare**
Dairy Products	**Medical Products & Devices**
Education	**Roads (Annuity)**
Fertilizers	**Seeds**
FMCG	**Sugar**
Food & Food Products	**Telecom**

Risk Mapping | Assumptions for sensitivity analysis

ICRA is carrying out a risk categorization of the entities in its portfolio based on the following set of broad assumptions:

	A broad set of assumptions
Revenues	To assume a certain level of decline in YoY revenues over the immediate term. Depending on the sector and the rated entity's business attributes, the assumption of revenue decline could vary from anywhere between 0% to 100%. *Example*: For certain manufacturing entities, the decline in revenues might be assumed as 100%
Fixed Operating and Non-Operating Costs	To assume a certain level of decline in fixed costs over the immediate term. Fixed costs would include employee costs and rentals etc. Depending on the sector and the rated entity's business attributes, the assumption of lower fixed costs could vary
Debt Servicing Obligations	Based on the moratorium permitted by the RBI (till May 31, 2020) for loans taken by borrowers from lending institutions, ICRA to consider the revised due dates applicable for debt servicing. For debt servicing related to market instruments like NCDs and CPs, no change being assumed in the debt servicing due dates^
Capex and Investments	Discretionary capex and investments to be assumed as deferred

^ *See the Annexure for more details*

Risk Mapping | Revision of ICRA Projections

In addition to the immediate term liquidity assessment…..

For various cases, ICRA may also be redrawing its projections by assuming that a ‘business as usual’ operating environment may not return soon.

The recovery would likely be gradual and even long drawn in several sectors. Accordingly, the projections might be drawn in a manner that assumes a severe disruption for at least three months, followed by only a slow recovery.

The above analysis would be an additional input for deciding upon the rating action.

Risk Mapping | Approach being taken to review the ratings

ICRA

A couple of scenarios and the approach being adopted for reviewing the ratings

Scenario	Approach for reviewing the ratings
For entities whose borrowings are a mix of loans from banks/ financial institutions as well as market instruments (like NCDs and CPs)	❑ The focus of analysis over the immediate term would be on liquidity assessment, besides determination of financial flexibility and availability of other forms of external support such as that from parent/ group. ❑ ICRA projections may also be redrawn for these entities with the assumption that a 'business as usual' operating environment may not return soon.
For entities that have borrowings only from banks or other financial institutions	❑ Following the moratorium permitted on debt servicing obligations, the immediate near term pressure on the liquidity of borrowers is likely to have been alleviated somewhat. This also implies that the possibility of occurrence of default on bank borrowings at least until May 31, 2020 is less of a concern. ❑ The above however does not imply that credit pressures on borrowers (with only bank borrowings) have eased following the relief on debt servicing. Accordingly, ICRA projections may be redrawn for such entities with the assumption that a 'business as usual' operating environment may not return soon. Further, the relief permitted by the RBI only has the effect of deferral of payment dues, not a suspension.

Risk Mapping | Preliminary risk mapping to be guided by the liquidity position

ICRA

Based on the outcome of the sensitivity analysis, entities are being categorized as Most Vulnerable, Moderately Vulnerable or Relatively Less Vulnerable. The criteria adopted for this is outlined below:

	Risk Categorization Criteria
Most Vulnerable	Entities that have a highly precarious liquidity position, weak financial flexibility, with limited or no other back-up (such as parent support) such that they are unlikely to service their debt obligations over the next one month
Moderately Vulnerable	Entities whose liquidity, financial flexibility or other back-ups are such that while they are expected to be able to service their debt obligations over the next couple of months, they might face cash flow challenges in the subsequent period
Relatively Less Vulnerable	Entities that have a comfortable liquidity, financial flexibility or have other back-ups that should allow them to service their debt obligations over the near term

To conclude….

- The COVID-19 pandemic has triggered a widespread deterioration in the credit quality of India Inc.

- ICRA is in the process of reviewing its ratings and would be taking rating actions as warranted to reflect the breadth and the severity of this crisis.

Annexure

RBI Announcement | On moratorium

In its seventh bi-monthly Monetary Policy Statement, dated March 27, 2020, the RBI announced:

Moratorium on Term Loans: In respect of all term loans (including agricultural term loans, retail and crop loans), all commercial banks (including regional rural banks, small finance banks and local area banks), co-operative banks, all-India Financial Institutions, and NBFCs (including housing finance companies) ("lending institutions") are permitted to grant a moratorium of three months on payment of all instalments falling due between March 1, 2020 and May 31, 2020. The repayment schedule for such loans as also the residual tenor, will be shifted across the board by three months after the moratorium period. Interest shall continue to accrue on the outstanding portion of the term loans during the moratorium period.

Deferment of Interest on Working Capital Facilities: In respect of working capital facilities sanctioned in the form of cash credit/overdraft ("CC/OD"), lending institutions are permitted to defer the recovery of interest applied in respect of all such facilities during the period from March 1, 2020 upto May 31, 2020 ("deferment"). The accumulated accrued interest shall be recovered immediately after the completion of this period.

Comments | Default recognition approach

- The RBI has "permitted" the lending institutions to allow a moratorium in payments until May 31, 2020. Also, the lending institutions are required to frame Board-approved policies for providing the reliefs to all eligible borrowers. Till the finalization of the Board-approved policies, it is possible that in the intervening period, the borrowers eligible to be provided relief, miss their payments to the lending institutions. ICRA would not be considering such missed payments as default for the time being. However, if there is no official deferment communication from the lending institutions in due course, ICRA would review the above stance on default recognition.

- As for market instruments, only if all investors approve the restructuring of payment terms of the instrument before the due date of debt servicing, would ICRA not consider such missed payments as default.

- The change in the default recognition policy of ICRA, as outlined above, is in line with SEBI circular SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53 dated March 30, 2020 and would be applicable till the period of moratorium allowed by the RBI.

Thank You!

Contact Details

Anjan Ghosh

Executive Vice President & Chief Rating Officer

aghosh@icraindia.com

+91 22 6114 3407

Jitin Makkar

Vice President & Head Credit Policy

jitinm@icraindia.com

+91 124 4545368

Pratik Singhania

Vice President, Credit Policy

Pratik.Singhania@icraindia.com

+91 124 4545801