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BALANCE SHEET STRENGTH OF CORPORATES KEY TO SURVIVE THE PANDEMIC

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Overall, we feel no sector is untouched with the impact of Covid-19 and subsequent lockdowns even after opening up will prolong the economic pain. Results in Q4FY20 (in listed space ex BFSI and refineries) reveal a de-growth of 5% in revenue and around 30% both in operating profit as well as bottom line. In particular, sectors such as Automobiles including Auto Ancillaries, Textile, Steel, Non-Ferrous Metal, Real Estate, Construction and Capital Goods Non-Electrical Equipment etc. have reported double digit negative growth across parameters.

However, we believe in the current exceptional circumstances it is futile to look at profit and loss parameters. What will be more important will be to closely observe the balance sheet strength. Ideally, corporates with such strength will be able to navigate through this exceptional times. Subsequently, we observe that sectors such as Automobile, FMCG, Consumer Durable though have reported negative growth in all key parameters in Q4FY20, have the requisite balance sheet strength to come out of the current situation. However, there are sectors such as Sugar, Steel, Telecom Services, Constructions, Realty etc that do not have the balance sheet strength and may face difficulties in this uncertain period.

The pandemic has resulted in unprecedented rating downgrade across sectors. We had 182 rating upgrades and 2996 rating downgrades, for the select sectors, during Q1FY21. Further, it is important to understand the current rating downgrades in comparison with FY14 taper tantrum crisis. It may be noted that unlike taper tantrum, almost all sectors face a significant rating downgrade: Fertiliser, Textile, Automobile, Consumer Durable, Reality , Construction, Sugar, Capital Goods etc to name a few. Interestingly, all such sectors have a predominant reflection of consumer demand and it is thus imperative that policy makers are cognizant to give a meaningful push to demand as we meander through the current crisis! Beyond such, it will be futile to ask for a strong rebound or even a modicum of a V-shaped recovery as we might envisage!

CORPORATE RESULTS IN Q4 ALREADY REFLECT SIGNIFICANT DEMAND LAGGARD EVEN BEFORE COVID

- Overall, we feel no sector is untouched with the impact of Covid-19 and subsequent lockdowns even after opening up will prolong the economic pain. Results in Q4FY20 (in listed space ex BFSI and refineries) reveal a de-growth of 5% in revenue and around 30% both in operating profit as well as bottom line. In particular, sectors such as Automobiles including Auto Ancillaries, Textile, Steel, Non-Ferrous Metal, Real Estate, Construction and Capital Goods Non-Electrical Equipment etc. have reported double digit negative growth across parameters.
- The only positive thing is that sectors such as Pharmaceuticals, IT Software, Healthcare, Gas Distribution etc. reported growth in all key parameters during Q4FY20 as compared to Q4FY19.
- We have also observed, out of total 3774 admitted cases in NCLT, 1527 cases are from manufacturing sector which include basic metal, chemicals, textiles etc. followed by Real estate, Construction etc. (see table). However, up to Mar'2020, till the time IBC was working 221 cases were resolved under IBC with a recovery Rs 1.77 lakh crore from the total admitted of Rs 3.84 lakh crore by Financial Creditors i.e. 45.96%. With the IBC now suspended for a year, this will post significant challenges for banks.
- As per initial trends in quarterly results, most of the sector had reported negative growth and we expect the same trend to continue in FY21.
- However, we believe in the current exceptional circumstances, it is futile to look at profit and loss parameters. What will be more important will be to closely observe the balance sheet strength. Ideally, corporates with such strength will be able to navigate through this exceptional times. Subsequently, we looked into the balance sheet strength of sectors based on some key parameters i.e. Debt to Equity (DE), Debt Service Coverage (DSCR), Interest Service Coverage Ratio (ISCR), Cash and Bank balance to debt etc.
- We observed that sectors such as Automobile, FMCG, Consumer Durable though have reported negative growth in all key parameters in Q4FY20, have the requisite balance sheet strength to come out from the current situation. For example, Automobile sector

Sector-wise distribution of CIRPs as on Mar'20

Sector	Corporate Insolvency Resolution Processs		
	Closed	Ongoing	Total
Manufacturing	676	851	1527
Food, Beverages & Tobacco Products	76	120	196
Chemicals & Chemical Products	69	85	154
Electrical Machinery & Apparatus	61	51	112
Fabricated Metal Products	39	46	85
Machinery & Equipment	74	94	168
Textiles, Leather & Apparel Products	125	136	261
Wood, Rubber, Plastic & Paper Products	66	114	180
Basic Metals	119	147	266
Others	47	58	105
Real Estate, Renting & Business Activities	307	450	757
Construction	147	261	408
Wholesale & Retail Trade	168	210	378
Hotels & Restaurants	42	46	88
Electricity & Others	30	87	117
Transport, Storage & Communications	57	55	112
Others	177	210	387
Total	1604	2170	3774

Source: IBBI; SBI Reseacrh

Status of CIRPs - Mar'2020

Status of CIRPs	Number of Cases	
Admitted	**3774**	
Closed on Appeal/ Review /Settled	312	
Closed on Withdrawl	157	
Closed by Resolution	221	
Closed by Liquidation	914	
Ongoing CIRP	**2170**	
> 270 days	738	34%
> 180 days ≤ 270 days	494	23%
> 90 days ≤ 180 days	561	26%
≤ 90 days	377	17%

Source: IBBI; SBI Research

have a DE ratio of 0.20 and DSCR and ISCR of 1.57 and 5.56 respectively. It is also interesting to note that Consumer Durable sector that reported negative growth in all parameters in Q4FY20, have a DE of 0.25 and DSCR and ISCR of 4.77 and 8.93 respectively. Further, it has a cash and bank balance to loan fund at 1.04, which means it has a liquid balance of 1.04x to the total loan funds and could easily liquidate the debt if required.

- We also expect, dividend pay out by IT firms likely to dip as companies are looking at conserving cash due to Covid-19 uncertainties and after affects.
- Sectors which are having strong balance sheet parameters are as under (see table A).
- However, there are sectors such as Sugar, Steel, Telecom Services, Constructions etc that do not have the balance sheet strength and may face difficulties in this uncertain period. For example, Sugar sector which is not performing well is also having high DE of 1.58 and low DSCR and ISCR of 1.03 and 1.52 respectively. Further, the cash and bank balance are also very low to support any balance sheet stress. Sectors such as Textile and Constructions have DSCR and ISCR that are significantly low which shows the weak repayment capacity of loan as well as interest. Within such sectors also there may be some corporates with higher DE as compared to others and may be affected more.
- List of such sectors with weak performance as well as balance sheet is as under (see table B):

Growth in Key Parameters in Q4FY20 vis-à-vis Q4FY19

Sector	Net Sales	EBIDTA	PAT
Gas Distribution	16.9	12.3	51.8
Agro Chemicals	14.1	158.4	LTP
Healthcare	12.2	-0.3	3.3
IT - Software	7.9	8.2	14.4
Pharmaceuticals	3.0	-16.3	13.8

Source: Cline around 500 listed entities: SBI Research; LTP= Loss to Profit

Growth in Key Parameters in Q4FY20 vis-à-vis Q4FY19

Sector	Net Sales	EBIDTA	PAT
Capital Goods-Non Electrical Equipment	-33.2	-70.0	-67.8
Steel	-19.7	-6.4	-102.1
Auto Ancillaries	-17.5	-41.0	-19.1
Automobile	-15.7	-19.6	-16.1
Capital Goods - Electrical Equipment	-15.6	-29.2	-27.5
Textiles	-15.0	-19.1	-21.2
Cement	-10.3	7.3	85.7
Consumer Durables	-9.8	-15.2	11.4
FMCG	-4.6	-17.6	-25.4
Realty	-2.4	-40.3	-256.0

Source: Cline around 500 listed entities: SBI Research

Table A : Sectorwise key financial parameters

Sector	Debt Equity	DSCR (EBIDTA/Int. +Principal)	Int. Service Coverage Ratio	Cash and Bank (CB)/ Total Loan	CB and Investment to total loan	Rating Upgrades	Rating Downgrades
Gas Distribution	0.21	2.77	12.24	0.31	1.07	1	-
Healthcare	0.21	0.10	2.50	0.24	3.22	22	109
Non Ferrous Metals	0.21	1.49	6.04	0.34	2.54	1	30
Automobile	0.20	1.57	5.56	0.12	3.92	-	6
Capital Goods-Non Electrical Equipment	0.19	2.60	15.06	0.68	1.85	45	770
Auto Ancillaries	0.12	3.58	7.98	0.88	3.07	5	95
IT - Software	0.08	4.97	38.75	1.84	6.79	3	62
Cement	0.28	2.17	4.53	0.41	1.73	-	5
Consumer Durables	0.25	4.77	8.93	1.04	1.79	1	71
Pharmaceuticals	0.21	0.16	4.06	0.25	2.66	12	51
Tyres	0.56	2.71	3.53	0.04	0.50	-	12
FMCG	0.23	3.95	13.55	1.06	2.84	29	481
Diamond, Gems and Jewellery	0.33	1.78	2.61	0.43	1.33	-	79

Source: Cline - Latest available around 1800 listed entities; SBI Research; CRISIL - all agencies period April to June 2020

Table B : Sectorwise key financial parameters

Sector	Debt Equity	DSCR (EBIDTA/Int. +principal)	Int. Service Coverage Ratio	Cash and Bank (CB)/ Total Loan	CB and Investment to total loan	Rating Upgrades	Rating Downgrades
Sugar	1.58	1.03	1.52	0.02	0.10	5	14
Fertilizers	1.35	0.62	2.53	0.02	0.07	4	22
Steel	1.20	0.84	1.29	0.10	0.18	8	140
Telecomm-Service	1.03	(0.37)	(4.42)	0.03	0.15	-	3
Textiles	0.88	0.42	0.11	0.08	0.24	12	365
Construction	0.55	0.55	0.97	0.15	1.19	23	364
Capital Goods - Electrical Equipment	0.43	(0.05)	(0.91)	0.88	1.32	5	100
Hotels & Restaurants	0.36	2.13	2.30	0.13	2.03	-	57
Realty	0.24	0.24	1.03	0.39	2.73	6	160

Source: Cline - Latest available around 1800 listed entities; SBI Research; CRISIL-all agencies period April to June 2020

- However, the pandemic has resulted in unprecedented rating downgrade across sectors. For example, in Capital Goods (Capital Goods and Engineering) we have seen a massive 870 downgrades as compared to only 50 upgrades in Q1FY21. Construction, Textile, Steel, Reality, Auto Ancillary, Gems and Jewellery etc. have reported huge downgrades during the period as compared to very small or no upgrades. We had 182 rating upgrades and 2996 rating downgrades, for the select sectors (see table below), during this time.

CURRENT RATING UPGRADES / DOWNGRADES HAVE STRIKING SIMILARITIES DURING THE TAPER TANTRUM

- Interestingly, we compared the rating behaviour of corporates during 2013-14 and at present scenarios (Q1 FY21). It was observed that sectors such as Sugar, Steel, Construction, Capital Good Electrical Equipment etc. (see table), had a credit ratio of below one during 2013-14 and at present also the credit ratio for the sectors are in a very bad shape.
- Further, it is important to note that sectors such as Fertiliser, Textile, Consumer Durable, Reality etc. had a credit ratio of more than one during 2013-14 but at present situation, we have already witnessed significant deterioration of the ratio in such sectors also.
- Thus in terms of rating downgrades, it seems the current crisis is unprecedented and it is important to look at corporates within sectors that have adequate balance sheet strength.

Sectorwise Credit Ratios during 2013-14 and Q1FY2021

Sectors	2013-14			April to June 2020		
	Upgrades	Downgrades	Credit Ratio	Upgrades	Downgrades	Credit Ratio
Sectors where credit ratio is below 1 in 2013-14 and Current Credit ratio						
Sugar	15	25	0.60	5	14	0.36
Steel	113	162	0.70	8	140	0.06
Construction	141	209	0.67	23	364	0.06
Capital Goods - Electrical Equipment	50	89	0.56	5	100	0.05
Hotels & Restaurants	24	52	0.46	-	57	-
Automobile	3	7	0.43	-	6	-
Capital Goods-Non Electrical Equipment	343	497	0.69	45	770	0.06
Auto Ancillaries	74	81	0.91	5	95	0.05
IT - Software	23	30	0.77	3	62	0.05
Cement	7	18	0.39	-	5	-
Pharmaceuticals	35	66	0.53	12	51	0.24
Diamond, Gems and Jewellery	66	73	0.90	-	79	-
Sectors where credit ratio is 1 and above in 2013-14 and Current Credit ratio						
Gas Distribution	2	2	1.00	1	-	-
Healthcare	110	60	1.83	22	109	0.20
Non Ferrous Metals	25	20	1.25	1	30	0.03
Consumer Durables	37	19	1.95	1	71	0.01
Tyres	9	4	2.25	-	12	-
FMCG	307	167	1.84	29	481	0.06
Fertilizers	16	8	2.00	4	22	0.18
Telecomm-Service	6	6	1.00	-	3	-
Textiles	342	124	2.76	12	365	0.03
Realty	102	91	1.12	6	160	0.04

Source: CRISIL - numbers for all rating agencies; SBI Research

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