# Refinancing Risk: Top 500 Corporate Borrowers

## INR11.8trn Corporate Debt at Risk; INR1.4trn Required for Refinancing during FY17

**Special Report**

India Ratings and Research (Ind-Ra) has analysed the top 500 'Corporate' borrowers for the ease with which they could refinance their upcoming debt obligations during FY17. Thereafter, the agency has bucketed them into four different categories, HER (high ease of refinancing), MER (medium ease of refinancing), ERR (elevated risk of refinancing) and Stressed (already in default). The entity-by-entity analysis identifies the sources from where potential stresses could emanate.

The names of the top 500 corporate borrowers with categorisation can be found in a separate detailed paid report. You could get in touch with us for an exclusive copy at investor.relations@indiaratings.co.in, TODAY!.

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### Analysts

Priyanka Poddar
+91 22 4000 1752
priyanka.poddar@indiaratings.co.in

Kartik Shetty
+91 22 4035 6114
kartik.shetty@indiaratings.co.in

Rakesh Valecha
+91 22 4000 1740
rakesh.valecha@indiaratings.co.in

**INR5.1trn Debt Stressed, Another INR6.7trn at Risk:** 240 of the top 500 borrowers belong to the Stressed and ERR categories and will remain exposed to significant refinancing risk during FY17, says Ind-Ra. These 240 borrowers hold about 42% of the total outstanding debt of INR28.1trn i.e. INR11.8trn, of which INR5.1trn is Stressed and another INR6.7trn falls in the ERR category. In Ind-Ra's opinion, INR4.6trn of the INR6.7trn debt in ERR could already be delinquent, while incremental stress, if any, is likely to emanate from the remaining INR2.1trn.

**ERR Refinancing Could be Challenging:** 157 ERR entities account for 33% of the estimated INR2.1trn refinancing due in FY17. The median credit metrics for the ERR category deteriorated over FY11-FY16 and public sector banks are rationing credit due to mounting losses and capital constraints. In this context, refinancing could be challenging for ERR entities whose total asset coverage ratio and/or interest cover ratio are below 1x (total 104 of 157 companies identified).

**Concentration Risks High:** Ind-Ra estimates that 80% (INR1.7trn) of the FY17 refinancing requirements stems from 100 entities out of which 33 (INR600bn) and 39 (INR527bn) entities belong to the Stressed and ERR categories, respectively. Both MER and HER together have 28 entities and account for INR542bn of the refinancing required. Also, the sectoral break-up indicates a significant concentration in leveraged sectors such as metal and mining, infrastructure and construction, oil and gas, power, real estate and telecom contributing 65% to the total debt and 53% to the total refinancing requirement.

**HER/MER to Gain**: Ind-Ra believes that entities in the MER and HER categories would gain a competitive advantage with improvements in domestic demand. These entities have stronger business and financial profiles, additional collateral or parental /group support to manage repayments. These entities have the ability to plan for the next phase of growth capex and/or investments and acquisitions, though they are unlikely to make investments before 2HFY19.

**Transition for ERR Entities Rated A and Above Could be Sharp:** HER and MER categories have a high proportion (90%) of investment grade entities (rated 'BBB- 'and above on the domestic scale), while ERR category has 39%. Some of the ERR entities benefit from improving cash flows, flexibility of offering collateral and/or group/parental support, a number of them remain exposed to downside risks. Cash flow improvements for ERR entities particularly for those in the commodity and investment linked sectors are likely to be insufficient to improve financial positions meaningfully over the next 12-24 months.

**Top Mutual Funds Well Positioned:** Ind-Ra's analysis on the exposure of 10 mutual fund houses to the top 500 corporate borrowers indicates 96% of the exposure is to HER and MER entities and only 4% is to ERR and Stressed categories. Investments in the top 15 corporates account for 66% of the total exposure of INR670bn. Ind-Ra believes it will be difficult for leveraged corporates to obtain additional funding from capital market sources even at a higher cost.

**Predictive Power of January 2014 Analysis:** Of the 20 entities identified in the ERR category in Ind-Ra's earlier report on the refinancing risk of 100 largest corporate borrowers, four are in default and other 10 are estimated to be in stress. The report has now been extended to the top 500 borrowers and the categorisation will help banks and investors in their credit decisions.

## Overview

### Basis of Analysis and the Companies Analysed

Refinancing requirement is computed as free cash flow to firm (FCFF) + cash and bank balance + current liquid investment - total debt service (current debt maturities and finance cost)

Or, total debt service if FCFF + cash and bank balance and current liquid investment are negative.

The basis of the report is to identify the refinancing risk and requirements of the top 500 non-financial corporate borrowers (listed and unlisted) in FY17, ordered by the total consolidated (wherever available) balance sheet debt for FY15. The list excludes non-banking financial corporations, banks and financial institutions, public sector units, and subsidiaries of identified holding companies. These borrowers have been placed in four different refinancing categories based on their abilities to refinance debts (Figure 1). The refinancing decision of some of these corporate borrowers may present a significant underwriting challenge to their existing lenders given continuing credit stress in the economy and the limited visibility of growth capital for public sector banks due to their capital constraints. The report is based on publicly available information.

### Categorisation of Refinancing Risk

The total debt of the top 500 corporate borrowers at FYE15 was INR28trn.

The total estimated refinancing requirement for FY17 is INR2.1trn.

For the purpose of this analysis stressed market conditions are defined as:

- Stressed funding liquidity conditions causing a sharp rise in interest rate
- Significant credit rationing exercised by the banking system in response to a spike in systemic defaults

The largest 500 corporate borrowers have been divided into the four categories from HER to Stressed based on their increasing needs and reducing abilities to refinance as below.

Figure 1

**Category Definitions and Implications**

| Refinancing category | | Assessment parameters | Implications |
|---|---|---|---|
| **HER** | High Ease of Refinancing | i)Strong FCFF and cash and liquid investment to cover debt obligation and financial charges<br>ii) Strong credit metrics<br>iii) Higher proportion of unencumbered assets than the refinance requirement<br>iv) Strong parentage and/or high financial flexibility of promoter<br>v) Strong market access | i) No repayments or repayments sufficiently covered by FCFF and cash and cash equivalents and liquid investments<br>ii) High likelihood to manage refinancing even in stressed market conditions without any additional cost<br>iii) Pricing pressure not expected |
| **MER** | Medium Ease of Refinancing | Less than three of the above factors are present; or all five are present at a lower degree | i) Moderate likelihood to manage refinancing in stressed market conditions with additional cost<br>ii) Moderate pricing pressure expected |
| **ERR** | Elevated Risk of Refinancing | i) Weak and deteriorating credit metrics; negative FCFF and inadequately covered by cash and cash equivalents and liquid investments<br>ii) Limited financial flexibility of sponsors<br>iii) Lower proportion of unencumbered asset than the refinancing requirement<br>iv) High proportion of the current maturity to total debt<br>v) Present in highly leveraged sectors such as metal and mining, infrastructure, construction, and real estate | i) To be refinanced at significantly higher cost/ stringent covenants with the requirement of additional security<br>ii) In select cases, lenders may seek capital infusions from equity holders/promoters<br>iii) Elevated challenge to manage refinancing under stressed market conditions<br>iv) Select companies in this group have significant monetisable assets which may provide comfort<br>v) May find difficulty in raising debt given the risk aversion by banks to these sectors |
| **Stressed** | | Classified by rating agencies as default or imminent default- Credit rating of C or D | n.a. |

Source: Ind-Ra

## Parameters and Assumptions Used

*Parameters*

Ind-Ra has used five key credit parameters (mentioned below) to arrive at a refinancing category. A weighted average score of these parameters ranging from 0 to 10 has been used to arrive at a refinancing category. Post this, the agency notched up or down the categories or kept them unchanged to reflect any group or parent support using its parent Subsidiary criteria – bottom up or a top down approach. Ind-Ra consolidated the companies to the holding company level wherever applicable. However, the standalone credit profile of parent entities in sectors such as infrastructure, construction and power where subsidiaries (special purpose vehicles) are generally funded on a non-recourse basis have been considered to arrive at a particular category. Any material change in these parameters would reduce or increase the refinancing requirement. The five parameters are listed below:

1. EBITDA interest coverage (EBITDA/gross interest expense excluding capitalised interest) for FY15 or FY16 (wherever available)
2. Trend in cash flow from operations/gross interest expense during FY13-FY15
3. Total asset coverage ratio (total net assets excluding intangible assets/total outstanding debt)
4. Percentage of outstanding shares pledged
5. Cash headroom; if FCFF is less than the total debt obligation (current maturity plus gross interest expense), then the ability of cash and cash equivalent and current investments to cover the shortfall

FCFF is reported operating cash flow minus maintenance capex. Reported depreciation is assumed to be the maintenance capex under the assumption that these borrowers may not undertake significant new capex given their already leveraged balance sheets.

*Key Assumptions*

The analysis is based on the assumption that the current level of economic activity and interest rate does not change materially on either side in FY17. Furthermore, the total debt service (current maturities and finance cost) for these borrowers in FY17 is expected to remain at FY16 levels, and FCFF and internal accruals will not change materially given the agency's expectation of moderate growth in EBITDA levels (7%-9%) and a limited increase in borrowing levels in FY17. The study focuses on the ease with which refinancing requirements may be met. Furthermore, based on our analysis, some of the ERR category corporates could already be in the SMA-0 or SMA-1 or SMA-2 category and in a sense already stressed. However given the lack of publicly available data, these corporates have been categorised in the ERR category. Ind-Ra estimates 60% of the ERR category corporates to be in SMA0, SMA1, or under some form of restructuring.

Figure 2

### Definition of SMA

| SMA sub-categories | Basis for classification |
|---|---|
| SMA-0 | Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress |
| SMA-1 | Principal or interest payment overdue between 31-60 days |
| SMA-2 | Principal or interest payment overdue between 61-90 days |

Source: RBI

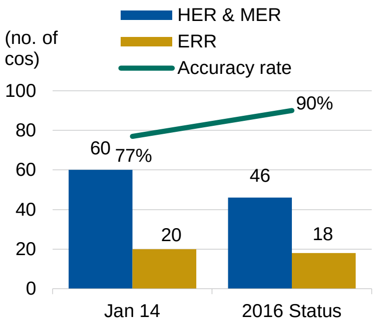
## Actuals versus Estimated – Top 100 Borrowers

Ind-Ra in its earlier report on refinancing risk of the top 100 borrowers had analysed the 100 largest corporate borrowers of domestic banks. For FY15, these top 100 borrowers (66% of total debt of 500 borrowers) had a refinancing requirement of INR1.3trn. While the categorisation remains broadly similar across the categories, as expected many of the ERR identified entities slipped into the Stressed category. Of the 20 entities identified to be in the ERR category, four are presently in default and another 10 are estimated to be in stress. Most of the identified ERR category corporate borrowers witnessed a significant erosion in their balance sheets in FY15 which is likely to have continued in FY16.

In the earlier report, corporates had been bucketed into five categories: No refinancing Risk (NRR), HER, MER, , ERR and Stressed. NRR category did not map fully to the credit risk-based rank ordering (credit distinction) of the same set of companies and Ind-Ra had considered FY15 debt obligation as the primary tool to arrive at this category. For example, it is possible to have corporates in the NRR category on account of their lower debt obligations during the year but whose credit profiles may be weaker than that of typical companies in the HER or MER categories. However, we have removed this category to better reflect refinancing capabilities of corporates this time.

Figure 3

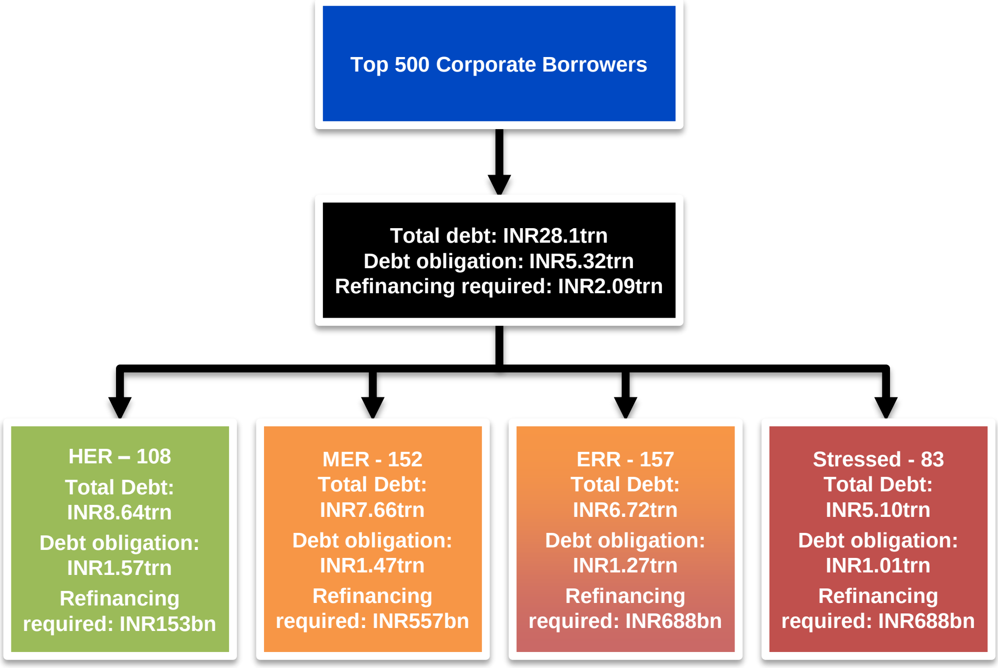
### Actuals Close to Estimated




Source: Ind-Ra's analysis

Figure 4

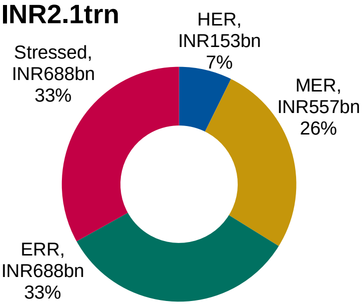
**Refinancing Requirement Matrix for FY17**




Source: Ind-Ra's analysis

Figure 5

**Refinancing Requirement: INR2.1trn**




Source: Ind-Ra's analysis, Ace Equity

## Top 500 Borrowers Require INR2.1trn Refinancing - 66% with ERR and Stressed Entities

Ind-Ra estimates the top 500 corporate borrowers to have a total refinancing requirement of INR2.1trn in FY17. The total consolidated debt of these 500 borrowers was INR28.1trn at FYE15. Of the 500 borrowers, 240 corporates are either Stressed or identified in the ERR category. The total debt outstanding in these two categories is INR11.8trn, or 42% of the total debt. However, these two categories account for 66% (INR1.4trn) of the total refinancing of INR2.1trn due in FY17. In FY16, these entities are estimated to have refinanced between INR1.3trn-INR1.5trn.

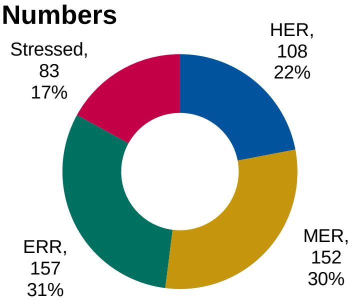
Out of the balance, 108 entities are classified under the HER category (31% of total debt and 7% of the total refinancing) and 152 entities in the MER category (27% of total debt and 27% of the total refinancing).

The agency expects overall debt obligation (current maturing and interest) for FY17 to remain at the FY16 levels of INR5.3trn on stable interest rates and stable working capital requirements coupled with low capex activities. Nearly 39% of this amount is expected to be up for refinancing in FY17.

Ind-Ra's analysis also indicates funding of INR603bn in addition to the refinancing requirement of INR2.1trn to reflect the cash shortfall in case of corporates with negative FCFF.

Figure 6

**Category-wise Break-up in Numbers**




Source: Ind-Ra's analysis, Ace Equity

## 48% or 240 Corporates Fall under ERR and Stressed Categories

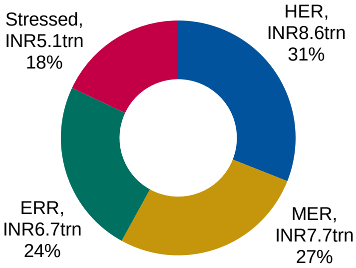
*Number-Wise Profiling*

We expect 48% (240 corporates) of the top 500 corporate borrowers to fall into the ERR (157) and Stressed (83) categories in FY17, largely driven by subdued profitability and large debt obligation during the year. Other 22% (108 companies) may fall into the HER category, and 30% (107 corporates) in the MER category.

We believe that if the weak demand conditions persist in FY17 particularly in the stressed sectors such as infrastructure and construction, metal and mining, real estate, power textile and shipping corporates in the ERR category will be affected the most with risk of migrating to the Stressed category. In the Stressed category, 43% corporates belong to infrastructure and construction, and metals & mining sectors, and another 7% belong to sugar and pharma sectors each. In the ERR category, 50% corporates primarily belong to the infrastructure and construction, metals & mining, real estate, textile and power. Muted real estate demand (on the residential side), delayed power projects (with low demand from state electricity boards), low metal prices and cheaper imports, impacted these industries in FY15 and FY16. According to Ind-Ra, spending by the government as highlighted in the Union Budget is critical for the growth of infrastructure sector in FY17, which consists of 15% of Stressed and ERR category corporates. Lower-than-expected government spend amid the already leveraged balance sheets of these corporates, limited asset sale options, and the significant exposure of banks that may have reached their internal funding exposure limits for the sector may make it difficult for these corporates to access the debt markets. Companies in the HER and MER categories belong to the sectors such as auto and automotive supplier, pharmaceutical, cement and chemicals having adequate cash flows to cover their debt obligations.

Figure 7

**Debt-wise Break-up of Categories**



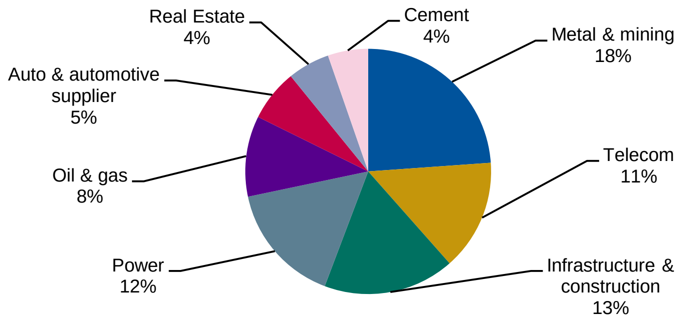

Source: Ind-Ra's analysis, Ace Equity

*Debt-Wise Profiling*

The ERR category corporates contributed around INR6.7trn to the total debt in FY15; Stressed entities (INR5.1trn), MER (INR7.7trn) and HER (INR8.6trn). The total consolidated debt stood at INR28.1trn at FYE15. Around 70% of the total debt outstanding belongs to nine industries namely, metal & mining, telecom, infrastructure & construction, power, telecom, oil and gas, auto and automotive supplier, and real estate, and cement. Four sectors namely, infrastructure and construction, metal & mining, power and telecom alone account for nearly 50% of the total debt.

Figure 8

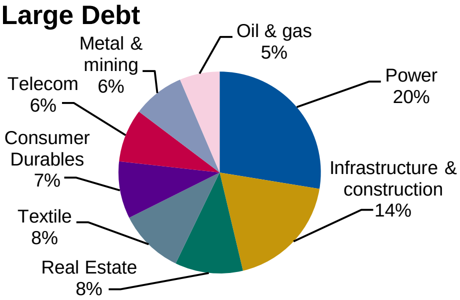
**8 Sectors Account for 75% of Debt of Top 500 Corporates**




Balance 25% of debt is spread out among 19 sectors each having total debt below 4%
Source: Ind-Ra's analysis, Ace Equity

Figure 9

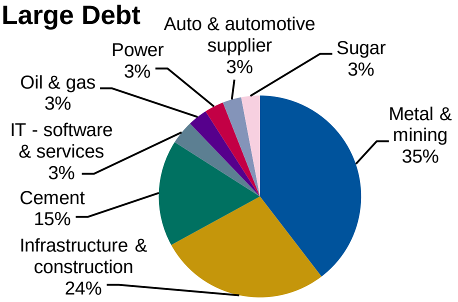
**ERR – Leading Sectors with Large Debt**




Rest 26% is spread out among 19 sectors each having total debt below 5%
Source: Ind-Ra's analysis, Ace Equity

Figure 10

**Stressed – Leading Sectors with Large Debt**



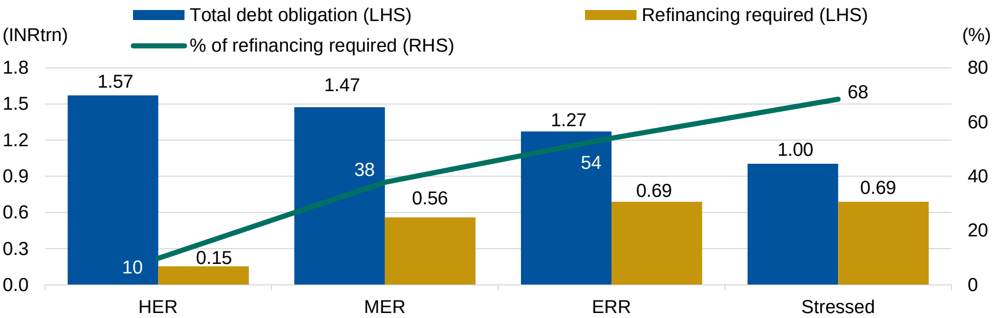

Rest 12% is spread out among 19 sectors each having total debt below 3%
Source: Ind-Ra's analysis, Ace Equity

*Refinancing-Wise Profiling*

Ind-Ra has estimated the annual debt obligations of the ERR and Stressed corporates to be INR2.3trn in FY17; however, their refinancing requirement is estimated to be 60% or INR1.4trn for FY17. Furthermore, some of the solvent entities in the MER category benefitting due to strong parentage/group support (33 of 152 entities) particularly in stressed sectors could find it challenging to raise additional funds due to public sector banks' existing burden of impaired assets and lack of certainty about the full and timely recapitalisation. Figure 11 shows that for the total debt obligation (current maturity and interest) of INR5.3trn in FY17, refinancing requirement for the ERR and Stressed categories is the maximum.

Figure 11

**Requirement Skewed Towards ERR and Stressed**

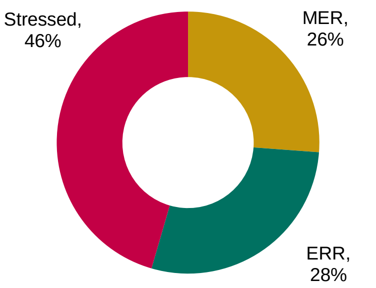



Source: Ind-Ra's analysis, Ace Equity

Figure 12

**Infrastructure & Construction**

*Break-up by refinancing requirement*

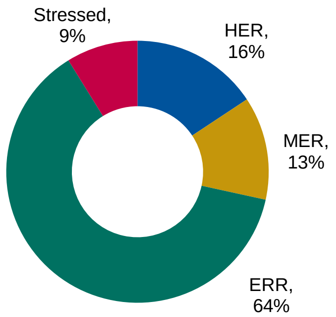



Source: Ind-Ra's analysis

Figure 13

**Power**

*Break-up by refinancing requirement*




Source: Ind-Ra's analysis

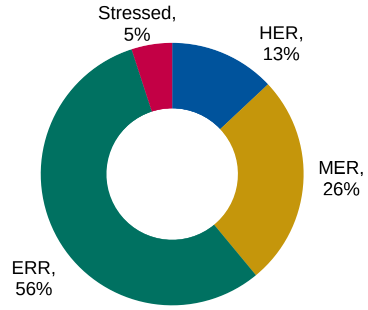
*Industry-Wise Refinancing Requirement*

The top five sectors by debt such as metal and mining, infrastructure and construction, oil and gas, power and telecom are likely to account for 47% of the total refinancing requirement. Industries such as cement, real estate, shipping and textile might have a higher share of refinancing required in FY17 than the share in the total debt. Refinancing wise, companies under the ERR and Stressed categories have maximum exposure to sectors such as metal and mining, real estate, infrastructure and construction, power, shipping, cement, textile and telecom. Some of the better placed entities in the HER category have higher refinancing exposure to sectors such as pharma, telecom, power, real estate and diversified, insulating them from the weakening macro environment.

Figure 14

## Real Estate

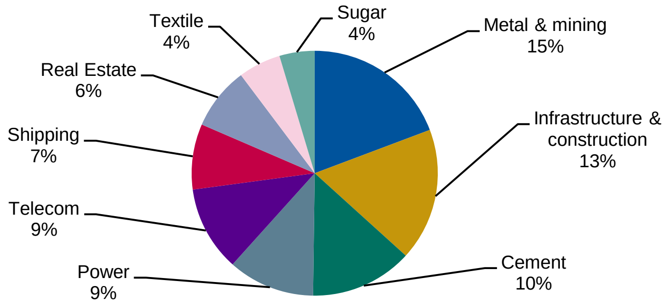
*Break-up by refinancing requirement*




Source: Ind-Ra's analysis

Figure 15

## 9 Sectors Account for 76% of Total Refinancing Requirement

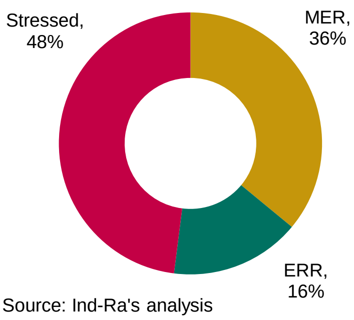



Balance 24% of the requirement is spread out among 18 sectors each having refinancing requirement below 4%
Source: Ind-Ra's analysis, Ace Equity

Figure 16

## Metal & Mining

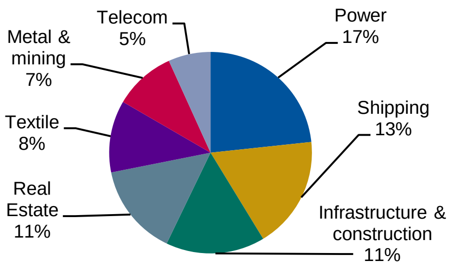
*Break-up by refinancing requirement*




Source: Ind-Ra's analysis

Figure 17

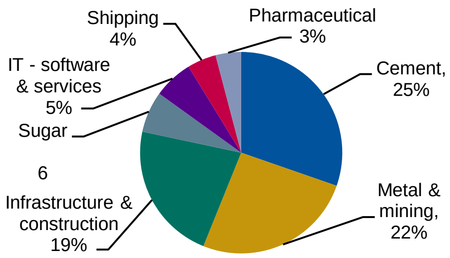
## ERR – Sectors with Large Share of Refinancing Requirement




Rest 27% is spread out among 20 sectors each having refinancing requirement less than 4%
Source: Ind-Ra's analysis, Ace Equity

Figure 18

## Stressed – Sectors with Large Share of Refinancing Requirement



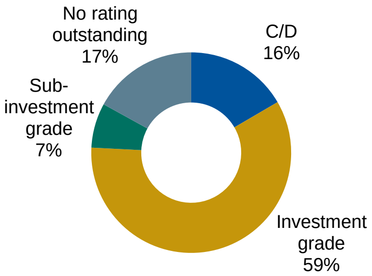

Rest 16% is spread out among 20 sectors each having refinancing requirement less than 4%
Source: Ind-Ra's analysis, Ace Equity

### *Credit Rating Wise Profiling*

415 entities or 83% of the 500 corporates have an outstanding rating by credit rating agencies. Of these, 296 entities (59% of 500 companies) are in the investment grade on the domestic scale ('BBB-' and above), 36 entities or 7% are in sub investment grade (BB+ and below) and 83 entities (17%) are in default category rated C or D by rating agencies. HER and MER have a high proportion (90%) of investment grade entities, while ERR category has 39% in the investment grade. Some of the entities in the MER and HER categories also benefit on account of parental or group support.

Figure 19

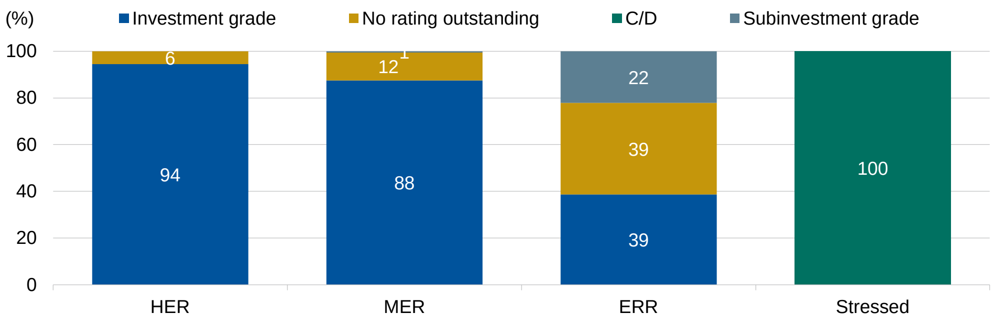
## Rating Distribution of Top 500 borrowers




Source: Ind-Ra's analysis, Ace Equity

Figure 20

## Category-wise Rating Distribution

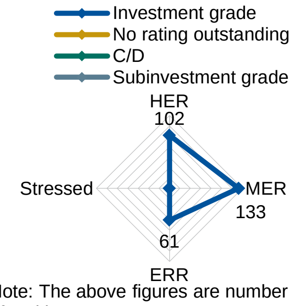



Source: Ind-Ra's analysis, Credit Rating rationales

Ind-Ra believes transition risks for the ERR category entities rated at A and above (20%) would be significant given their weak financial performance. Further disclosure risks remains a concern for the ERR category entities which does not have any rating outstanding from a rating agency.

Figure 21

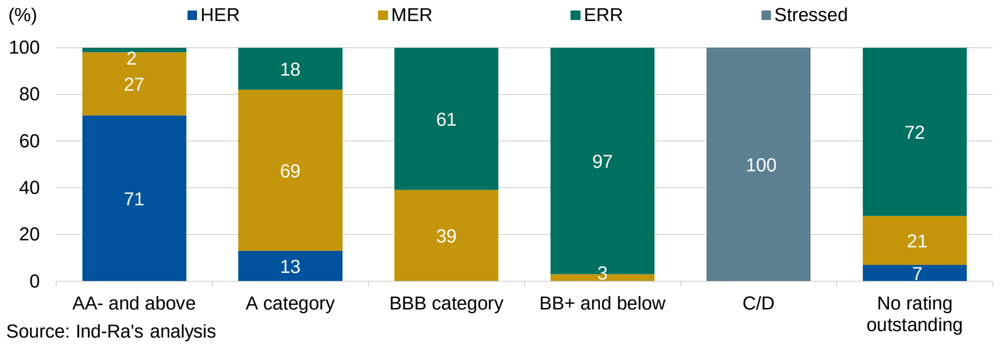
### Category Dispersion in Investment Grade




Note: The above figures are number of entities
Source: Ind-Ra's analysis, Ace Equity

Figure 22

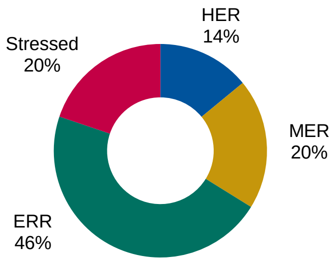
### Majority of ERR Fall in the Lower End of the Investment Grade Spectrum




Source: Ind-Ra's analysis

Figure 23

### Funding Requirement Above Debt Refinancing



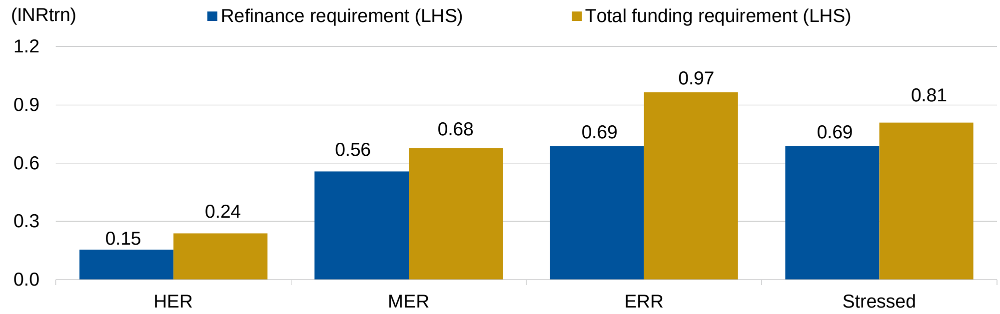

Source: Ind-Ra's analysis, Ace Equity

## INR603bn Additional Shortfall Funding – 66% with ERR and Stressed categories

The agency estimates an INR0.6trn shortfall funding requirement over and above the debt refinancing requirement of INR2.1trn to meet operational cash shortfalls during FY17. ERR and Stressed category companies are expected to contribute 66% (INR400bn) to the funding requirement indicating a large number of corporates reporting negative FCFF, necessitating need for incremental funding required to cover the shortfalls in free cash flow.

Figure 24

### Refinancing and Overall Funding Requirement




Source: Ind-Ra's analysis, Ace Equity

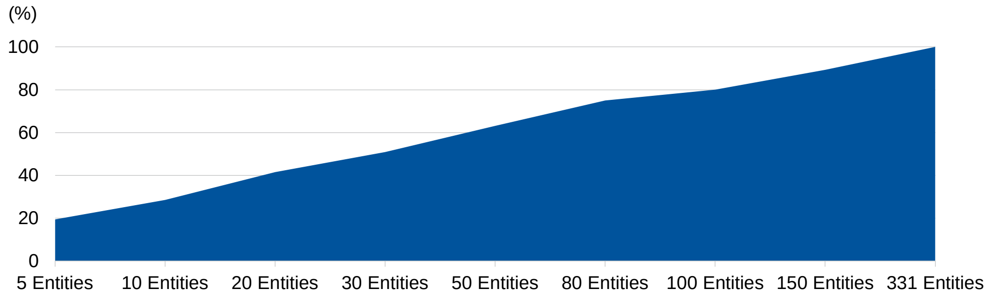
## High Concentration Risk

The agency estimates that 42% (INR866bn) of the total refinancing requirement will come from 20 corporates, indicating the weak cash flows and poor profitability of these corporates. This if looked for 100 corporates is 80% (INR1.7trn) of the refinancing requirement. We also expect these 20 entities to contribute 39% to the total funding requirement (cumulative of shortfall in FCFF and debt refinancing) in FY17.

Figure 25

### 63% of Refinancing Requirement Emanates from 50 Corporates

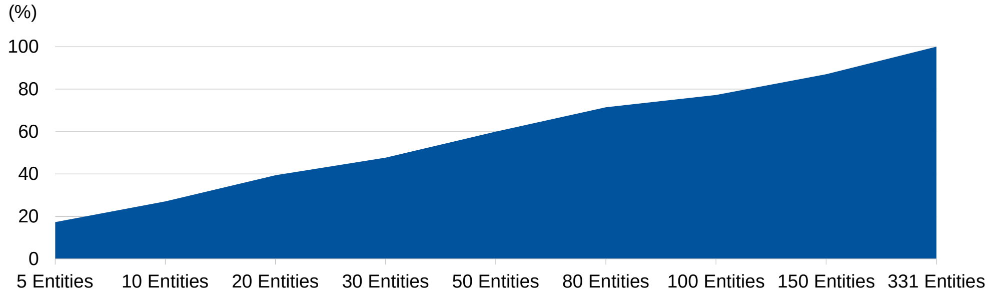
Total refinancing requirement: INR2.1trn




Source: Ind-Ra's analysis, Ace Equity

Figure 26

**50 Entities Account to 60% of Total Funding Requirements**
Total funding shortfall: INR2.6trn




Source: Ind-Ra's analysis, Ace Equity

## Trends in Key Parameters Used to Differentiate Categories

We expect some of the weaker corporates in the ERR category to slip into the Stressed category in FY17 on a further fall in operating profits and margins and weakening of cash flows, while interest rates holding up. The median credit metrics deteriorated for the ERR and Stressed category companies over FY11-FY16 because the increase in debt was more than the increase in operating profits. This was due to a drop in nominal GDP growth rates driven by low or negative Wholesale Price Index inflation as elaborated in Ind-Ra's Corporate Risk Radar report. To avoid outliers, the agency has used median data to analyse the results. Further, the financial data for FY16 is not available for many companies; however, Ind-Ra believes FY16 metrics to be at the levels of FY15.

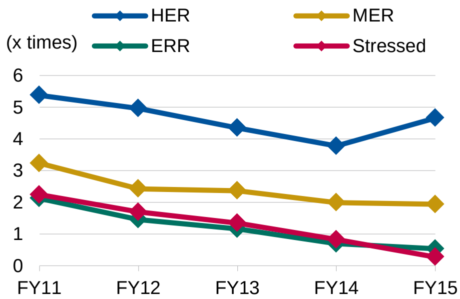
Banks have been rationing credit due to their capital constraints, higher non-performing assets and challenges of the post default recoveries. We believe fulfilling the total refinancing requirement of INR2.1trn in FY17 could be challenging particularly for entities whose total asset coverage ratios are below 1x. There are 75 such corporates of the total 500, of which 57 are in the ERR and Stressed categories. It will also be challenging for the entities with interest cover ratio below 1x. There are 193 such companies, of which 156 are in the ERR and Stressed categories.

### *Interest Cover improving for HER Category and deteriorating for ERR Category*

Ind-Ra does not expect a significant improvement in interest cover in FY17 as deleveraging for borrowers particularly in ERR and Stressed categories could take another three to four years. The median interest cover of the 500 borrowers in the ERR and Stressed categories was below 1x over FY14-FY16. Although it improved for the HER category (FY16: 4.83x, FY15: 4.66x, FY14: 3.78x) and remained stable for the MER category during the same period (2.05x, 1.93x, 1.99x), the levels were below those during FY11-FY12. Median interest cover improved for 112 companies and deteriorated or remained same for another 388 companies across categories in FY16 from FY15.

Figure 27

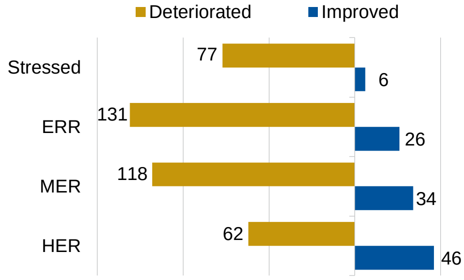
**Sharp Decline in Coverage for ERR and Stressed**




Source: Ind-Ra's analysis, Ace Equity

Figure 28

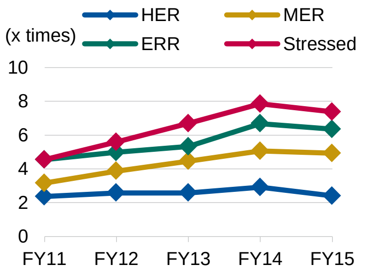
**FY16 Coverage Shows Deteriorating Trend**




Note: Above figures are in number of entities
Source: Ind-Ra's analysis, Ace Equity

Figure 29

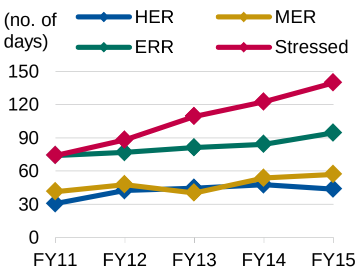
**Significant Rise in Leverage Levels for Stressed Category Corporates**




Source: Ind-Ra's analysis, Ace Equity

Figure 30

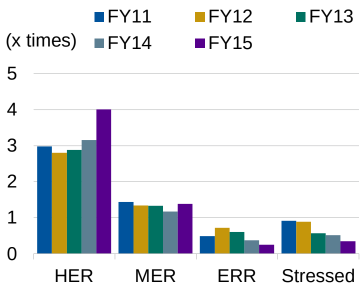
**Steep Rise in Cash Cycle for Stressed Category Corporates**




Source: Ind-Ra's analysis, Ace Equity

Figure 33

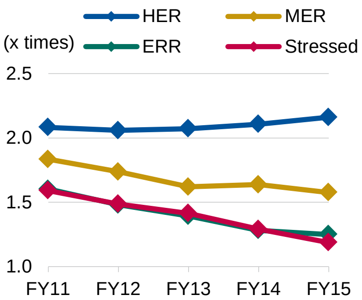
**CFO/Int Coverage Shows Drop in ERR & Stressed**




Source: Ind-Ra's analysis, Ace Equity

Figure 34

**Asset Cover Decline Except for HER**




Source: Ind-Ra's analysis, Ace Equity

*Net leverage deteriorating for ERR category corporates*

Ind-Ra expects net leverage to deteriorate for the ERR category corporates in FY17 given the subdued profitability and delay in deleveraging. While the median net leverage across categories marginally improved in FY15 and for FY16 the level is likely to have been at the FY15 levels, it remained significantly higher for entities in the ERR (6.4x) and Stressed (7.4x) categories. Barring the HER category, where the net leverage has been maintained at 2.5x-3x historically, it was higher across categories over FY13-FY15 than the FY11-FY12 levels given lower profitability and higher overall debt.

*Working Capital Cycle longest for ERR and Stressed category corporates*

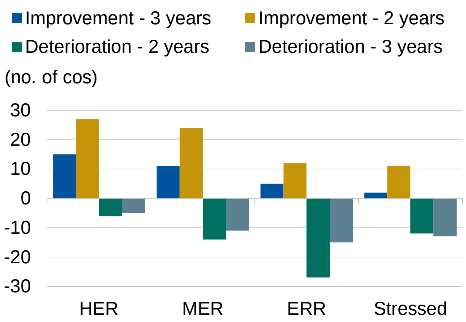
Median working capital cycle was the longest for the borrowers in the ERR and Stressed categories and deteriorated in FY15. The same is likely to have continued in FY16, For the MER and HER category corporates, it is significantly shorter than that for the ERR and Stressed corporates and showed a stabilising trend over FY14-FY15, showcasing higher financial flexibility.

*CFO erosion in ERR to continue*

Corporates in ERR category could continue to witness an erosion in their CFO in FY17 given their already weak credit profiles. Median CFO (cash flow from operations) interest cover improved for the HER and MER category companies in FY15 from FY14 levels. However, the category median ratio deteriorated and was below 1x for entities in the ERR and Stressed categories. CFO is generally negative for the ERR and Stressed category companies, while a weaker ratio in the MER category (1.4x) is mainly due to a bunch of corporates in this category having a strong parentage or group support. We expect CFO of the stronger corporates in the MER and HER categories to improve with an improvement in the operating profitability and macroeconomic conditions.

Figure 31

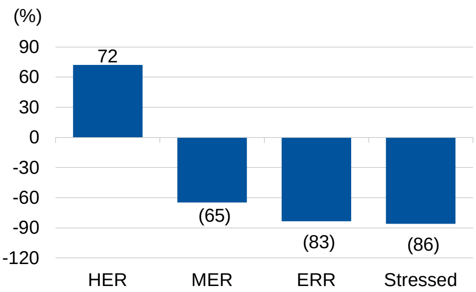
**3 Year Trend in CFO/Int Coverage**




Source: Ind-Ra's analysis, Ace Equity

Figure 32

**Cash Headroom Weak for all Categories Except HER**




Source: Ind-Ra's analysis, Ace Equity

*Promoter Flexibility: Total Asset Coverage Ratio Deteriorating for MER, ERR and Stressed corporates*

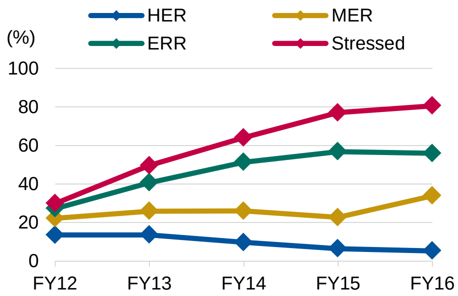
While companies in the HER category have the highest asset-cover ratio, companies in the Stressed category have the lowest asset-cover ratios. This ratio marginally improved for the HER category in FY15 but deteriorated for the MER, ERR and Stressed corporate borrowers. A low ratio limits the availability of secured loans and also affects market access with respect to debt funding. It also reduces support for refinancing activities in stressed market conditions.

*Stressed and ERR category Borrowers having significant portion of Pledged Shares*

The Stressed and ERR categories have the most significant portion of promoter holdings which is already pledged. This results in the absence of a direct control on operations and limits their overall decision making in the company. While borrowers in the ERR category have a lower proportion of promoter shares pledged than those in the Stressed category, the promoters' flexibility in the former category to bring in cash is much lesser than the founders of borrowers in the HER and MER categories.

Figure 35

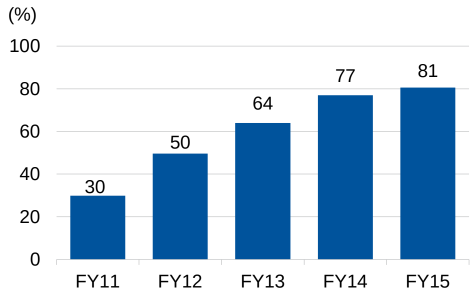
**Pledged Share Increasing at Alarming Rate**




Source: Ind-Ra's analysis, Ace Equity

Figure 36

**Pledged Share by Stressed Entities at all Time High**




Source: Ind-Ra's analysis, Ace Equity

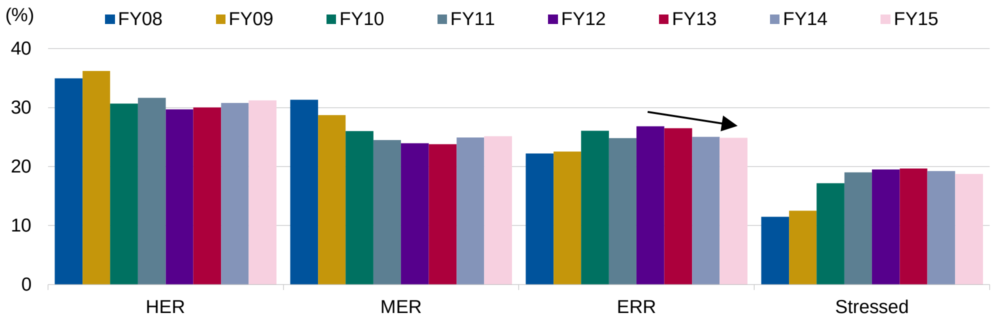
## Refinancing and the Indian Banking System

Credit Rationing by Domestic Banks to ERR Category Corporates

Banks have been rationing credit particularly to ERR category corporates. The banking sector exposure to the ERR (FY15: 24.9%, FY12: 26.8%) and stressed (18.7%, 19.5%) groups has remained muted since FY12, while the exposure to the HER (31.2%, 29.7%) and MER (25.2%, 24%) categories has increased.

Figure 37

**Category-wise Bank Loan Proportion**

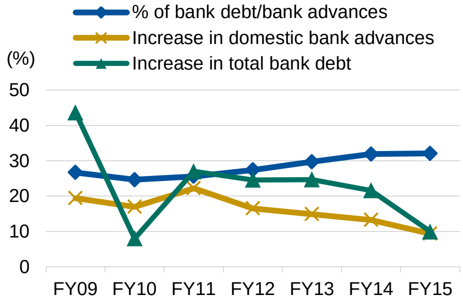



Source: Ind-Ra's analysis, Ace Equity

The total domestic bank advances grew 9.4% yoy in FY15, after growing at an average of 20% over FY06-FY15. The total non-financial corporate consolidated bank debt of the top borrowers grew 10% yoy in FYE15 to INR21trn (FY14: 21.6%) and was 32.1% (31.9%) of the total bank advances of INR65.3trn (INR60trn). At similar debt levels, we expect it to be 25%-30% of the FY17 bank advances. The expected decline will be due to a lower appetite of banks for the ERR and Stressed category corporates, particularly in industries such as infrastructure and construction, metal and mining, and real estate.

Figure 38

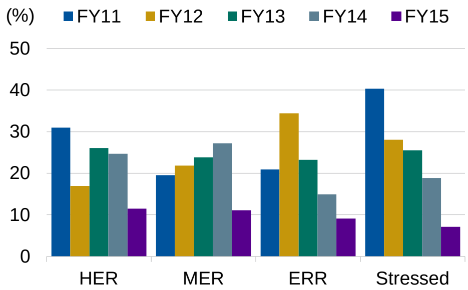
**Growth in Domestic Bank Advances Lowest in 10 Years**




Source: Ind-Ra's analysis, Ace Equity, RBI

Figure 39

**Category-wise YoY Bank Loan Growth**




Source: Ind-Ra's analysis

We have excluded non-banking debt across categories consisting of convertible and non-convertible debentures, fixed deposits from public, commercial paper, and external commercial borrowings and foreign currency debt, and intercorporate deposits and unsecured loans from promoters/group.

## Reduced Dependence on Domestic Banking

Corporates in the HER, and MER categories are becoming less dependent on the domestic banking system (Figure 36). Given their credit metrics and higher market access, they have the ability to access domestic capital markets or significantly tap foreign currency markets. However, categories such as ERR and Stressed being significantly leveraged continue to have a high dependence on the domestic banking system.

To reduce significant concentration risk of banks arising out of their exposure to highly leveraged, large Stressed corporates, The Reserve Bank of India proposed a framework, whereby an incremental exposure above INR250bn in FY18 to corporates would necessitate a higher provisioning. Based on Ind-Ra’s analysis, 27 corporates accounted (48% of total bank debt) for over INR250bn debt at FYE15. Of this, 11 corporates are likely to be in the ERR and Stressed categories (16% of total bank debt). This will reduce the stress on the banks and increase their exposure to other sources of debt such as bond market issuances. However, it would be difficult for significantly leveraged corporates to obtain additional funding from capital market sources even at a higher cost.

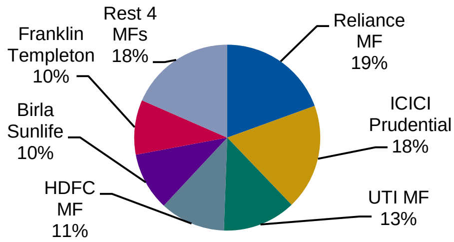
## Top 10 Fund House Exposures in Top 500 Corporates at INR670bn

The top 10 mutual funds houses have an exposure of INR670bn in the top 500 corporates according to April 2016 asset under management data. Based on our analysis, 45% or INR302bn is in the HER category whereas MER and ERR categories account for 51% and 4%, respectively. The exposure in the Stressed category is negligible at 0.3%. The top 15 corporates account for around two-thirds of the total exposure by all 10 fund houses, of which six are in MER and the rest nine in the HER category. Five fund houses Reliance Capital Asset Management (Reliance Mutual Fund), ICICI Prudential Life Insurance Company Ltd, Birla Sun Life Asset Management Company, Templeton Asset Management India Pvt Ltd and UTI Asset Management Company account for 75% of the investments in the top 500 corporates by the top 10 fund houses.

Figure 40

### Top 10 Mutual Funds' Exposures in 500 Corporates

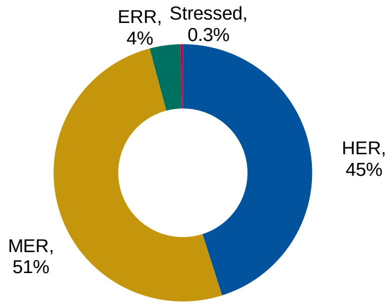
*Cumulative exposure of INR670bn*




Rest includes SBI MF (8%), Kotak MF(5%) DSP Blackrock (3%) & IDFC MF (2%)
Source: Ind-Ra's analysis, Company website

Figure 41

### Category-wise Break-up of Exposures (as per Debt)

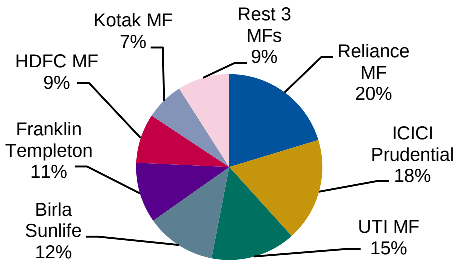



Source: Ind-Ra's analysis, Company website

Figure 42

### MF Exposure in Top 15 Corporates

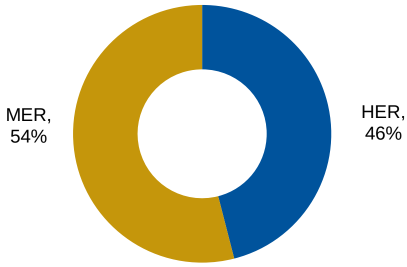
*Cumulative exposure of INR438bn*




Rest includes SBI MF (5%), DSP Blackrock (2%) & IDFC MF (2%)
Source: Ind-Ra's analysis, Company website

Figure 43

### Category-wise Distribution of Top 15 Corporates (as per Debt)




Source: Ind-Ra's analysis, Company website

## Annexure 1

Figure 44
### Name of Top 10 Borrowers

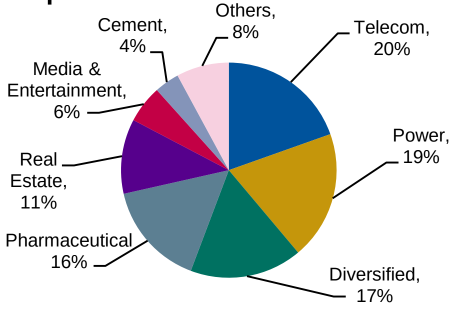
| | Refinancing category | Rating/Outlook./Rating Watch |
|---|---|---|
| Reliance Industries Ltd. | HER | IND AAA/Stable |
| Tata Steel Ltd. | MER | IND AA/Rating Watch Evolving |
| Vedanta Ltd. | MER | IND AA/negative |
| Jaiprakash Associates Ltd. | Stressed | - |
| Bharti Airtel Ltd. | HER | - |
| Hindalco Industries Ltd. | HER | - |
| Tata Motors Ltd. | HER | - |
| Vodafone India Ltd. | HER | - |
| Larsen & Toubro Ltd. | HER | - |
| GMR Infrastructure Ltd. | ERR | - |

Source: Ind-Ra

## Annex 2

Figure 45

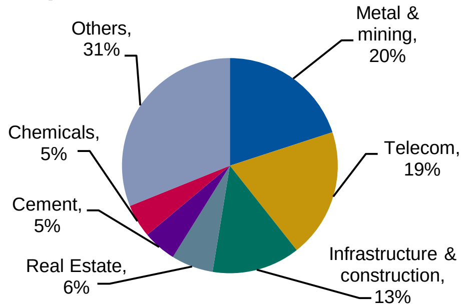
### HER – Break-up of Refinancing Requirement




Source: Ind-Ra's analysis

Figure 46

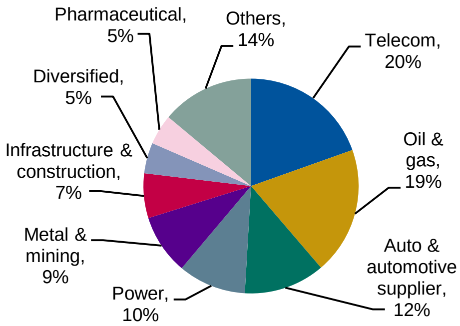
### MER – Break-up of Refinancing Requirement




Source: Ind-Ra's analysis

Figure 47

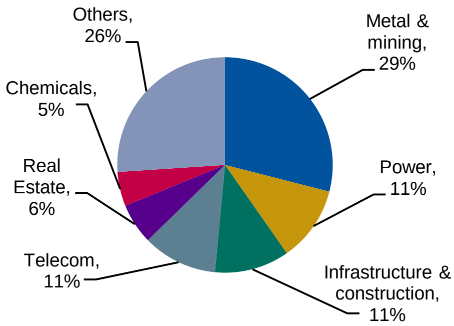
### HER – Sector-wise Break-up of Debt




Source: Ind-Ra's analysis

Figure 48

### MER – Sector-wise Break-up of Debt

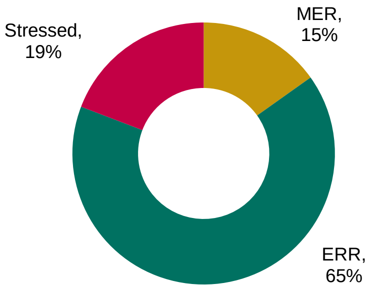



Source: Ind-Ra's analysis

Figure 49

### Shipping

*Break-up by refinancing requirement*

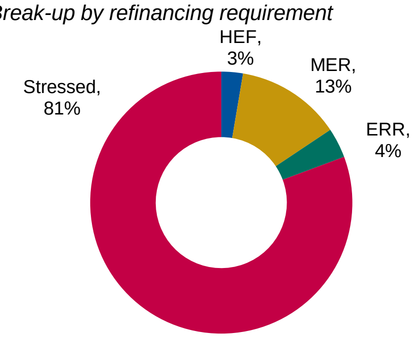



Source: Ind-Ra's analysis

Figure 50

### Cement

*Break-up by refinancing requirement*




Source: Ind-Ra's analysis

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