ICRA

Ripple effect of COVID outbreak to impact India Inc.

March 2020

Summary

- The Coronavirus (COVID-19) outbreak, which started in China in late December 2019, has now spread to about 65 countries, becoming a global emergency. China and select countries in South-East Asia have been the worst impacted, accounting for approximately 90% of the 92,000 reported cases so far.
- With key industries and services in impacted areas (especially China), coming grinding to a halt, and logistics operations to and from major areas being suspended, there are serious repercussions on several industries.
- Given that China's share of global GDP is substantial at 17%, the slowdown impact on the global economy is inevitable. Moreover, the emergence of global supply chains over the years, with China and South-East Asia being key suppliers and consumers of certain products, has implications of a potential ripple-effect across countries and industries.
- ICRA expects the ripple effect of coronavirus to have hurt India as well and we assess its impact across three areas:

  a) **Supply chain disruptions** in sectors like pharmaceuticals, electronics, renewable energy and automobiles, where there is direct or indirect import dependence on affected markets for components or sub-components.

  b) **Demand disruption and price corrections** in sectors like cut and polished diamonds, cotton yarn (textiles) and seafoods where the affected markets are large **importers from India**.

  c) **Impact on commodities** like oil & gas, metals etc. due to lower offtake by the impacted markets.

Summary

- The rapid spread of the Coronavirus across countries and the resultant disruptions in international markets have also had a ripple effect on financial markets. Equity markets have witnessed sharp correction over the past couple of weeks across the globe, and the resultant turmoil are likely to have negative credit implications, especially for entities that have high refinancing dependence over the near-term.
- In the current scenario, where demand is likely to be adversely impacted and payment cycles expected to elongate, an entity's liquidity position is of paramount importance to support its credit profile. ICRA expects entities with weak liquidity buffer relative to its upcoming debt service obligations to report significant weakening of their credit profile over the next couple of quarters. 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.
- So far the disease spread within India has been limited. Our assessment of the credit impact however may change significantly in the event of a domestic outbreak.

China accounts for largest share of India’s Imports, valued at US$70 bn

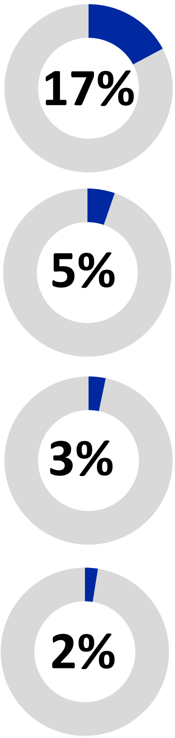
Exhibit: Share of various COVID-affected regions in India’s total imports (FY2019)

China & Hong Kong

Singapore & Malaysia

South Korea

Japan



Source: EXIM, ICRA research

28% India’s import dependence on China & South East Asia

$145 bn Value of total imports from China & South East Asia in FY2019

Key Imports - Machinery, Metals, Chemicals, Plastics

Export dependence on China & South-East Asia relatively lower

Exhibit: Share of various COVID-affected regions in India's total exports (FY2019)

China & Hong Kong	9%
Singapore & Malaysia	5%
South Korea	1%
Japan	1%

17% India's export dependence on China & South East Asia

$57 bn Value of total exports to China & South East Asia in FY2019

Key Exports – Chemicals, Plastics, Cotton, Agriculture Produce and Jewellery

Source: EXIM, ICRA research

Supply Chain Impact

Supply disruptions of key raw materials in pharmaceutical, electronics and renewable energy sectors to adversely impact production if lock-out situation persists

Supply chain disruptions to impact production in select sectors

Sector & Impact	Comments
Automotive Negative	China accounts for 27% of India's auto-component imports, valued at US$ 4.5 billion. Critical components like Safety components, Fuel injection pumps, EGR modules, Electronic components, Turbochargers etc. sourced from impacted countries. Commoditized products like LEDs, metal etc. can shift to alternative suppliers. But, high investments and gestation period for developing tooling remain prohibitive factors for immediate shift to new suppliers, especially for customized components. Currently, companies have inventory for a few weeks, but supply can be disrupted going forward, given that lack of a single critical component can impact production.
Pharmaceuticals Negative	Import dependence high at 60% for API requirement, of which China accounts for 65-70%. For some intermediates and key starting materials (KSMs), China is sole supplier. Domestic API manufacturers have supplies which should last them till mid-March, beyond which production would be adversely impacted. Even backward integrated domestic formulations manufacturers have indirect dependence on China for KSMs. Typically, inventory is maintained for 1.5-2.5 months, beyond which production would be impacted. Expectations of supply disruptions are also likely to result in an increase in prices of raw materials, impacting profitability. Restrictions imposed on exports of 26 essential APIs and Formulations are expected to have a modest impact on the sector, though specific individual entities may be negatively impacted.

Supply chain disruptions to impact production in select sectors

Sector & Impact	Comments
Electronics & Consumer Durables **Negative**	High dependency on imports from China, including completely built units as well as components. Significant proportion of critical components continue to be sourced from China, due to which production will potentially be impacted. Currently, inventory is available, and impact is expected to be felt towards end of Q4 FY2020. Product prices of consumer durables and electronics (including mobile handsets) could rise in light of supply disruptions.
Solar energy **Negative**	India imports approximately 70% of its requirement of photovoltaic (PV) modules from China. With China controlling about 80% of the global supply of solar panels, the possibility of shifting towards alternate suppliers also remains bleak. Given import dependency on China, execution timelines for ongoing utility scale/roof-top solar projects are likely to be affected with delays in delivery of PV modules. Solar PV module price levels may spike in the near term from the current level ranging between 20-21 cents/watt putting an upward pressure on expected bid tariffs as well.

Demand Impact

Near-term pressures on volumes and prices expected for sectors like cut and polished diamonds, shrimps and cotton yarn which have high export dependence on China

Sector-wise Impact

Sector & Impact	Comments
Gems & Jewellery Negative	While China accounts for ~14% of polished diamond consumption, a larger proportion of exports from India (35%) are routed via Hong Kong. The problem was compounded as the shutdown occurred during the peak sales period in China, with retail shutdowns in some areas and limited retail footfalls in others. Liquidity position of CPD players expected to be impacted given possible delays in realizing payments from customers. Increased inventory levels and supply glut situation to potentially lead to price corrections as well.
Textiles Negative	30% of the cotton yarn produced in India is exported, of which China accounts for one-third. The lockout situation in China has trickled down into lower demand for yarn, and consequently, yarn realizations have corrected 2-3% since beginning of Feb'20. Even though domestic cotton fiber prices continue to be competitive globally, further correction in international prices amid demand-side uncertainties would render domestic spinners uncompetitive (spread has reduced to 4% from 9% in Feb'20). Over the long term, downstream segments like apparels could benefit from increased demand from export markets as customers look at diversifying their supply base.

Sector-wise Impact

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Sector & Impact	Comments
Seafood Negative	China is the largest producer, importer and consumer of farmed shrimp and is hence, a key price-mover globally. About 21% of India's shrimp exports (in value) are to China. The Chinese New Year is a critical period of heightened consumption in Chinese markets which typically clears channel inventory, but was disrupted this year. With the contraction in Chinese demand for seafood, and the supply glut situation, correction in shrimp prices is a given. It is likely that shrimp exports would be diverted to other markets like USA, at a cost; however, competition from other key exporters like Ecuador would be intense.
Aviation Negative	Aviation sector to be impacted by discontinuation of flights to COVID-affected areas, and cancellation in travel plans by passengers due to fear of infection/travel bans. Also international travelers are likely to be discouraged by screening and travel advisories in general. If travel restrictions are extended to include impacted more countries which are impacted by the spread of the disease in addition to China and Hong Kong, 20-25% of India's international passenger traffic, and 28-30% of India's international freight would be impacted. Of this, the impact on domestic airlines would be 5-6 million pax. However, correction in ATF prices (20% decline since COVID outbreak), which is the single-largest cost element for airlines, due to slump in global crude prices would support profitability.

Sector-wise Impact

ICRA

Sector & Impact	Comments
Hotels Negative	• Direct exposures of India to Chinese travellers is currently low (2.67% in CY2018). Also, over the years India's domestic travellers have increased significantly – foreign tourist arrivals stood at 10.9 million in CY 2019, while domestic tourist numbers stood at 1,855 million in CY 2019. However, upscale leisure destinations like Kerala, Goa, Rajasthan continue to have large dependence on foreigners. • Travel restrictions, screening at airports and general advisory against travel is negative for the hotel industry. Also, if the spread of the diseases sustains, we may see a significant impact in the MICE segment. • Overall, the occupancies and ARR are likely to be adversely impacted in the near term, prolonging the recovery in the industry. • Travel and tourism is expected to have a relatively long tail recovery, potentially running into few quarters. • However, if the spread of the disease sustains over a longer period, ICRA would review the credit outlook on the industry.

Commodity Price Impact

Domestic players in steel and oil & gas sectors to benefit over near-term due to the disruptions in Chinese market

Correction in commodity prices to address the global demand-supply situation

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Sector & Impact	Comments
Steel Positive	- Given risk of delayed deliveries due to bottlenecks in production, logistics and port-handling capacity, as well as risk of transmission from import consignments, traders remain averse to booking fresh steel shipments from affected countries. - Domestic steelmakers have used this as an opportunity to effect two price hikes since Feb'20, given likely decline in steel imports to India in Q1 FY2021. - Indian mills have opportunity to increase market share in exports to key markets as well, given restrictions in trade flows from Korea, China and Japan. - However, in case of a prolonged outbreak leading to global recession, adverse long-term impact on global steel demand and prices far outweigh short-term opportunities.
Iron Ore Neutral	- Although seaborne iron-ore prices declined from US$ 98/MT in mid-Jan'20 to US$ 80/MT in early Feb'20, it has recovered to some extent to US$ 84/MT subsequently. - Apart from high shutdown costs for blast furnaces in China leading to healthy mill run rates, supply side factors like lower production guidance from Vale (due to heavy rains in Brazil) and production cutbacks from Rio Tinto (due to infrastructure damage from cyclone Damien) have supported the recovery in iron ore prices.

Correction in commodity prices to address the global demand-supply situation

Sector & Impact	Comments
Metcoal Neutral	- High shutdown costs for blast furnaces have prevent Chinese mills from cutting output in line with the weakness in domestic demand following COVID outbreak. Consequently, demand for hard coking coal frim China has not been impacted. - However, prices of seaborne metcoal has risen over recent weeks on account of disruptions in supply through the land route. About 50% of China's coking coal imports are through the land route from Mongolia, which has been suspended post the COVID outbreak, atleast till mid-Mar'20. Coupled with delayed mine restarts in China, the increased dependence on seaborne metcoal has spiked the prices by 20% since Dec'19.
Oil & Gas (Refining) Positive	- With the demand for oil and petroleum products having slowed down significantly post the COVID outbreak in China, international crude oil prices have declined. - Distressed cargoes are being offered to large consumers such as India, with refining companies in China forced to reduce throughput and cancel contracts. - However, profitability of upstream companies is likely to be impacted, as realisations on crude sales would decline. Additionally, domestic gas prices are also likely to correct, given that prices at various international gas hubs have corrected.

Thank You!

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