FINANCING CHALLENGES

Devendra Kumar Vyas elaborates on the impact of COVID-19 pandemic on infrastructure and financing sector and the challenges faced by NBFCs.

India was already struggling with a slowdown when COVID-19 pandemic struck, and now it faces a period of significant economic disruption as the country has been locked down since March 23 to decelerate the spread of the virus.

There are deep impacts of the lockdown across all the sectors of the economy, albeit with varying degrees of severity. While, there has been direct and severe impact on services sector, especially segments such as retail, aviation and entertainment; manufacturing sector has also suffered due to production shutdowns, labour and supply chain disruptions - especially for companies exposed to international trade as well as falling consumption.

Infrastructure sector, which was already buckling under immense stress, has been among the worst hit with stoppages in toll collections, distribution companies struggling to pay power generation companies, and complete shutdown of air travel hitting airport operators. The dramatic fall in demand across most infrastructure segments has further compounded the sector's woes.

Impact on infrastructure sector

Even though the growth in construction sector slouched between 2011 and 2015 with demand for construction equipment witnessing a complete collapse, the sector managed to grow post-2015 and the signs were good until the lockdown imposed across the country due to the COVID-19 virus outbreak. COVID-19 has posed unprecedented challenges and in many cases business continuity plans are being put to test for the first time. It is being believed that the coronavirus outbreak's impact on the infrastructure and construction segment is expected to be worse than that of the 2008 financial crisis-led economic slowdown. The lockdown has resulted in various infrastructure project sites staring at closure mainly due to an effect on the labour movement and supply chain disruptions. Construction halt, revocation of toll collection, labour crunch and severe working capital pressure – these nightmares for any infrastructure company have now become a reality.

The more imminent challenge for the construction players remains working capital management. Operational issues owing to the lockdown have also slowed down outstanding payments to the contractors by the principal. In most places milestones have failed owing to lockdown and hence milestone based payments also cannot be received.

Having said that, India's long-term growth story remains intact. The government realises that economic growth cannot be achieved without a growth in infrastructure. Worldwide, redoubling of investment in infrastructure is a key strategy to counter the impacts of a downturn. The government has begun the exercise of creating a national infrastructure pipeline with a vision to invest Rs 100 trillion in infrastructure over the next five years. Already highway projects worth approximately Rs15 trillion have been identified. Once these investments materialise, we will soon see positive impacts in sectors such as cement, steel and automobiles, besides of course the infrastructure and construction equipment sectors.

The good news is that we are already witnessing the Government's intent of reviving infrastructure. The Ministry of Road Transport and Highways (MoRTH), in consultation with the National Highways Authority of India (NHAI), is drawing up a 10-point agenda to get the construction activity up and running once the national lockdown is lifted. Even as lockdown is partially lifted, MoRTH is in talks with the state governments to restart highway construction projects where migrant labourers can be gainfully employed. We see construction activity already starting in UP.

Impact on NBFC sector

Non-banks largely cater to the self-employed borrower segment in the retail space, where the cash flows are expected to be more volatile in the current situation vis-à-vis their salaried counterparts. Other non-banks (non-retail) which mostly have exposures to entities or SMEs with relatively moderate risk profiles, is likely to witness an increase in their credit risk in the current scenario. Further, most of these borrowers have limited funding avenues and typically don't have banking relationships for their credit requirements. Non-banks, which are already facing funding constraints and an expected increase in delinquencies, are likely to focus more on collections at least in the near term. Therefore, lack of additional credit funding could have a significant negative impact on these borrowers as their cash flow mismatches would compound with the passage of time. If the COVID-19 related movement and business

restrictions continue for a longer period (2-3 months) vis-à-vis the current expectation of a few weeks, the impact would be more adverse.

The biggest challenge in coming months will be redeeming bonds and meeting other loan obligations at a time when cash flows will be hard to come by. According to industry experts, corporate bonds worth approximately Rs 920 billion and commercial papers worth around Rs 780 billion are coming up for repayments towards the end of May.

While all non-banks are facing significant headwinds because of the currently evolving situation, their ability to keep the asset quality under control would be the key differentiator. Deterioration in the asset quality could further throttle the fund flow to the sector as bank credit to the sector is already high and funding from other sources like mutual funds, insurance, FIIs, etc, are likely to be quite muted vis-à-vis the levels witnessed so far in the current fiscal.

On March 27, RBI, had, in its first COVID-19 package, announced a three-month moratorium on term loans. However, NBFCs faced a double whammy because they have been offering moratorium to customers despite not getting one themselves from their lender-banks, putting significant pressure on liquidity profiles of many NBFCs. It is only in May first week that banks have agreed to pass on moratorium to NBFCs – that too case to case basis. Further, risk aversion of banks towards NBFCs was evident from the poor auction results of Targeted Long Term Repo Operations, which were far off from their desired intent.

Meanwhile, the NBFC sector has sought one-time restructuring of loans to tide over the crisis. They have also demanded an extension of the RBI's moratorium to them, relaxation on provisioning norms and additional funding from SIDBI and NABARD through refinance mechanism.

In conclusion, the current situation is one that has a deep impact on key segments of the economy and is unlike anything we have seen in recent times. The global nature of the pandemic, coupled with its high intensity and long duration, will fundamentally alter the business landscape through changing trade flows, asset prices and consumption patterns. This will impact all key stakeholders, including banks, financial institutions, investors and corporates. The need of the hour is to put in place a comprehensive action plan that addresses potential impact, from short-term cash flow concerns to longer term balance sheet adjustments.

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