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Infomerics Valuation And Rating Pvt. Ltd.

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INDUSTRY OUTLOOK

TLTRO 2.0 – WELL INTENDED BUT ROAD BLOCKS AHEAD

18 April 2020

Among other measures announced by RBI on 17th April 2020, TLTRO 2.0 aimed at providing liquidity support to mid and small sized NBFCs and MFIs needs attention.

TLTRO 1.0

TLTRO 1.0 generated huge interest from the banking system with bids coming over 3.35 times of the notified amount. RBI successfully conducted the auctions of Rs.1 lakh crore within 21 days of its announcement on 27th March 2020 with a proviso that the successful bidders have to deploy the proceeds 50% in the primary market & 50% in the secondary market in investment grade bonds, NCDs & Commercial Papers within 15 days (1st TLTRO) and 30 days from the 2nd TLTRO onwards. Details of the auctions are furnished below:

Date of auction	Notified Amount (Rs. In crore)	Amount of bids (Rs.in crore)	Amount allotted (Rs.in crore)	Bid to Cover Ratio (no of times)
27-03-2020	25,000	60,500	25,009	2.40
03-04-2020	25,000	99,760	25,016	3.99
09-04-2020	25,000	1,13,470	25,016	4.50
17-04-2020	25,000	61,415	25,009	2.46

As was expected, large banks utilized the opportunity provided to them on a platter, for a clear arbitrage of more than 2.50% for three years on top notch bonds. The top-notch issuers like HDFC, PGC, PFC etc also found the opportunity ripe for them to raise resources through primary issuances of bonds. In the corporate sector Reliance Industries Ltd, L&T, Mahindra & Mahindra etc were also able to raise substantial funds through issuance of NCDs of three years. As the yields had gone through the roof during the third week of March 2020, before RBI came out with its monetary policy on 27th March 2020, well ahead of the schedule, forcing many of the issuers to either avoid or defer the issuances. The long-term yield on corporate bonds has fallen by 150 – 200 bps[1] since then. Mutual funds that were faced with severe liquidity problems arising due to year end redemption pressure could slightly breathe as they could get exit from some of the bonds in the secondary market. The volume in the secondary market has also picked up suggesting effective utilization of these funds by the successful bidders.

TLTRO 2.0

The TLTRO 2.0 announced by RBI on 17th April 2020 could be a different ball game for the participants as the funds are targeted only at the NBFC sector.

The funds availed under TLTRO 2.0 shall be deployed in investment grade bonds, commercial paper (CPs) and non-convertible debentures (NCDs) of Non-Banking Financial Companies (NBFCs).

At least 50 percent of the total funds availed shall be apportioned as given below:

(a) 10 per cent in securities/instruments issued by Micro Finance Institutions (MFIs);

(b) 15 per cent in securities/instruments issued by NBFCs with asset size of Rs.500 crore and below; and

(c)25 per cent in securities/instruments issued by NBFCs with assets size between Rs.500 crores and Rs.5,000 crores.

2. The asset size shall be determined as per the latest audited balance sheet of the investee institution/company[2].

If all auctions are successful, the participating banks shall be required to invest Rs.12,500 crore in the above mentioned (a) & (b) categories. RBI has already announced an auction of Rs.25,000 to be conducted on 23rd April 2020 with a direction that the proceeds are to be deployed within 30 days from that date. However, there is no direction as to whether these funds are to be invested in primary or secondary market. Since the objective is to make available funds to the sectors mentioned above, it is deduced that the funds should flow directly to the issuers through primary route.

While the objective of RBI in announcing the relief measure, providing liquidity support for small and midsized NBFCs is appreciated, it may face some hurdles in implementation, particularly in respect of these two categories.

1. Banks can make investments only in those securities which adhere to the SEBI regulations with respect to the disclosure norms for issue of debt securities. Even in case of investment in non-SLR debt securities which are not listed, banks shall ensure that the disclosure standards prescribed by SEBI are adhered to[3].
2. Since rating & listing norms are mandatory, additional intermediation costs are incurred towards rating fee, trusteeship charges, fee for merchant bankers, depository charges & listing fees. Additionally, strengthening of corporate governance, accounting standards and disclosures as per SEBI standards become mandatory. Hence, these types of companies prefer to raise funds mostly from banks or from close groups of friends/relatives or from promoter groups. Bringing them suddenly to the debt market platform would be a big challenge, but a great opportunity for the intermediaries.
3. The investing banks will also prefer the loan mode as pricing of the loans is a lot more easier based on their internal matrix, control over their borrowers will be better through multiple feedback data & close interactions with the management can bring vital operational issues of the companies while in the case of NCDs, the banks as investors have little role in the aforesaid activities.
4. Many of the banks have fixed higher threshold for investment in long term debt instruments MFIs & NBFCs like minimum credit rating of A. Most of the MFIs and small sized NBFCs may fall under just above investment grade of BBB & very few would be fall within the threshold investment limit of the investor banks.
5. In 2019-20, BBB+ or lower rated companies got hardly 1% of the amount raised in the debt market (1% of apprx Rs.6.40 lakh crore). Another 1% was raised by companies within the A category. Hence, the total amount subscribed by all the class of investors in A rated or less papers during 2019-20 was hardly Rs.12,500 crore, which the banking system alone is now tasked to invest within 30 days of the respective auctions.
6. RBI has signaled space in further easing of the monetary policy while assessing the inflation trends suggesting the market to expect further rate cuts in future. The bond issuers may not get the benefit as they would have already locked into the interest rates on the bonds while banks may reduce their lending rates on loans, in line with the policy rates in vogue. The issuers, therefore are at a disadvantage at this juncture.
7. If any cues can be taken from the reported deals on the exchange platforms of NSE & BSE during the current month, A rated NCDs are traded anywhere between 11% to 13% and even higher based on the underlying nature of the security. As traded level of the NCDs has a bearing on the pricing of the instrument in the primary market, including the cost of intermediation, the cost of raising funds through NCD route may be relatively expensive for the lower rated companies.
8. In times of stress, like the current situation, the forbearance accorded by the regulator for the bank loans, in certain times, is not extended to their investments. The attendant risk perception for debt instruments, therefore, is higher.
9. In these times of uncertainty where the income and livelihood of the unorganized sector is badly affected, where most of these small MFIs & NBFCs operate, the financial viability of many of them can come under severe stress. As fault lines are already drawn , whether the banks as prudent lenders and the borrowing MFIs & small sized NBFCs, realizing that underlying credit worthiness is fast depleting, would be in a position to take advantage of this window of RBI is to be seen.

Issue of commercial papers by these companies is another option, but given the uncertain short term prospects of the economy, the utilization will be limited.

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