India Inc braces for impact, rushes to take forward cover

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Home-grown companies are preparing for life after the rupee fell to ₹80 versus the US greenback. Companies without a natural hedge like export earnings are rushing to take forward cover as they expect the rupee to fall gradually in the next year to as much as ₹86-87 to a dollar.

In the short and medium term, chief financial officers are advising companies to take the right kind of derivatives products depending on their exposure.

"The moment the US Federal Reserve rate hike gets over and discounted by the market, the equity market will start moving up in the US. Investors will move capital out of India to the US and the rupee will depreciate further. Besides, inflation and oil prices in India are having a negative impact. Consequently, the rupee will have a strong tendency to depreciate," says Prabal Banerjee, an advisor to top-drawer companies on international finance.

A riveting fact is that nearly 44 per cent of the funds raised by Indian corporates overseas is unhedged, according to the Reserve Bank of India's (RBI's) financial stability report of June this year, thereby increasing their liabilities as the rupee falls.

A lot of mid-sized and small companies do not take forward cover as their cost increases. According to the RBI data, the total amount of outstanding external commercial borrowings (ECBs) is $180 billion. Of this, nearly $79 billion is unhedged. Nearly 80 per cent of ECB is denominated in US dollars, with the rest debt-denominated in the euro and the Japanese yen.

Vetsa Ramakrishna Gupta, director (finance), Bharat Petroleum Corporation (BPCL), says, currency depreciation is already factored into the company's borrowings. "On a 10-year average, when we borrow in foreign currency, we factor in 3.5-4 per cent currency depreciation. We are expecting the rupee to stabilise at 80-81 levels in the next three to four months. Whatever impact was there has happened in the first quarter of 2022-23."

For some of India's oil and gas and metal companies like Reliance Industries and Vedanta that earn a portion of their revenue in exports, they have a natural cover against a weakening rupee.

BPCL executives say their procurement and pricing is based on import parity.

"There is no risk in terms of foreign currency fluctuation, inventory purchase, and pricing. The only risk is to the extent of foreign currency borrowed. We don't typically go for forward cover. Even if we do, the forward cost itself will be more than the risk involved. Even if we borrow foreign currency, we don't hedge anything," clarifies Gupta.

Analysts say a sharp depreciation in the Indian currency this year is bad news for infrastructure sector companies, given they have been raising dollar-denominated debt in the past two years.

These companies get their revenue in Indian currency. But many would be able to withstand a weakened rupee due to extensive use of financial hedges and other mitigants.

"A small subset of rated issuers could begin to face negative pressure if the dollar/rupee rate depreciates to the mid- to high 80s as a result of the residual exposure to currency risk under their chosen financial hedging strategy," observe Moody's analysts.

Companies like NTPC (formerly National Thermal Power Corporation), a government-owned electricity generator, are well positioned to manage a declining rupee because of the industry regulator's history of allowing adequate recovery of incremental costs associated with currency movements.

More than 90 per cent of NTPC's revenue comes from regulated sources. Effectiveness of regulatory protection can vary with sector and the regulator. For instance, companies such as Delhi International Airports have also used financial hedges to help manage their currency risk because their ability to recover currency losses is capped under the airport sector regulation, say analysts.