CRISIL
RATINGS
The Most Reliable Opinion on Risk

Insight

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RATINGS ROUNDUP
2003-04

Economy to remain strong in 2004-05

India's economic fundamentals are likely to remain buoyant in 2004-05 according to CRISIL's analysis of its rating trends. CRISIL's rating trends have, over the years, been lead indicators of key economic variables, especially gross domestic product (GDP). According to CRISIL's Ratings Round-Up for 2003-04,[1] GDP growth in 2004-05 is likely to exceed the average annual growth of the preceding 3 years.

In the year ended March 2004, rating upgrades outnumbered downgrades by three to one (14 upgrades and 5 downgrades) because of the strengthening business fundamentals of CRISIL-rated companies. In fact, upgrades exceeded downgrades for the first time since 1995-96. Also, for the first time in 8 years, the positive trend in credit quality was uniform across the manufacturing, finance and infrastructure sectors. Given this broad-based strengthening of credit quality, increasing capacity utilisation levels across the industrial economy and the improved environment for raising funds, CRISIL believes that there is a strong likelihood that industrial investment will pick up in 2004-05.

About the CRISIL Ratings Roundup

The CRISIL Ratings Roundup is a semi-annual publication that analyses CRISIL's rating actions during a particular period and the linkages between these actions and underlying economic trends. To the extent that ratings are an opinion on likelihood of future debt repayments, an analysis of a portfolio of debt-ratings that is statistically representative of the economy can be a useful indicator of economic prospects. This edition analyses CRISIL's rating actions in 2003-04 and compares them with previous periods. The rating actions are analysed under four broad categories – rating actions, rating stability rates, a trend analysis of credit ratios and their linkages to macro-economic factors.

Key highlights

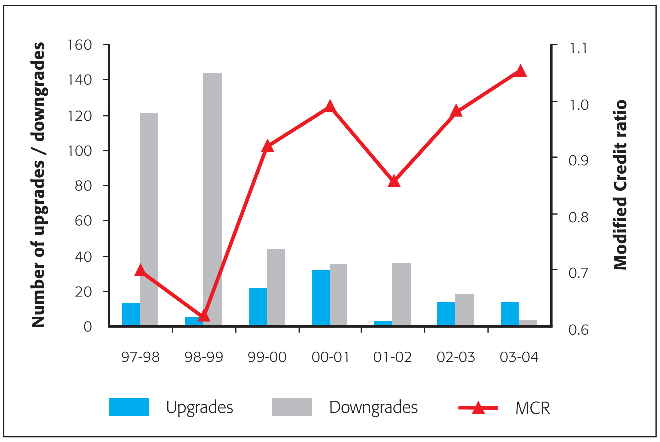
- Broad-based improvement in credit quality of CRISIL-rated companies across sectors points to strong GDP growth in FY05. GDP growth in FY05 is likely to be higher than the average annual growth rate of the past 3 years
- The commodity and financial services sectors have led to the improvement in credit quality in CRISIL's rated portfolio in FY04
- Capital investments are likely to pick up in FY05. CRISIL-rated companies are estimated to invest about 15 to 20 per cent of their networth in this year
- CRISIL's ratings in FY04 have been at their most stable level and have seen the lowest number of downgrades in the last 8 years

Sustained improvement in credit performance

CRISIL's modified credit ratio (MCR) - defined as the ratio of upgrades plus reaffirmations to downgrades plus reaffirmations - is an effective indicator of systemic credit quality and a barometer of underlying business fundamentals. CRISIL's MCR for bond ratings improved to 1.05 in FY04, its highest since 1996, from 0.98 in FY03. CRISIL's long-term ratings portfolio witnessed 14 upgrades and 5 downgrades[2] in FY04 (see Appendix 1 for CRISIL's upgrades and downgrades on long-term and fixed deposit ratings in FY04).

CHART 1

Upward trend in Modified Credit Ratio Continues



CRISIL's MCR for long-term ratings has improved continuously since FY99 except for a blip in FY02 (See Chart 1). Significantly, there has been a secular fall in the number of downgrades in this period. A similar improvement has been seen in the MCR for CRISIL's fixed deposit ratings, which increased to 1.10 in FY04 from 0.96 in FY03 as there were 12 upgrades as against three downgrades during the year.

Rating performance reflected in credit spreads

The MCR is inversely correlated to credit spreads over G-Sec yields (See Chart 2). An upturn in the economy, which is reflected in higher upgrades than downgrades, pushes down credit spreads over the short to medium term. Accordingly, a strong MCR in FY04 was accompanied by the lowest-ever credit spreads.

Lower interest rates aided revival in credit performance

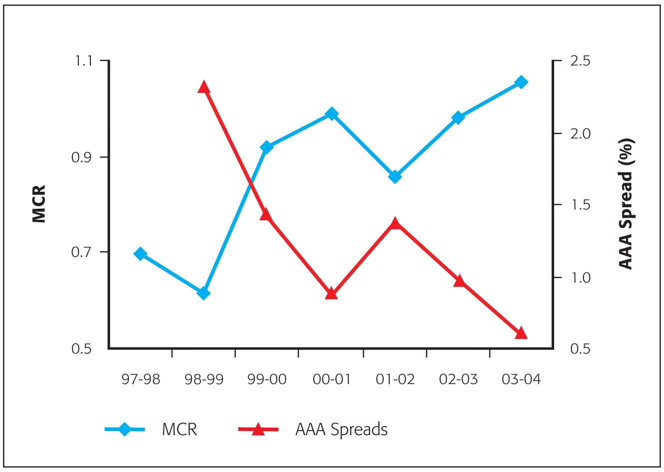
The MCR also displays a near-perfect inverse correlation with the real interest rate (interest rates adjusted for inflation). High real interest rates reflect the increasing cost of borrowings for corporates in relation to product prices. Thus, a high real interest rate impacts their profitability and interest coverage

[1] Refers to the financial year, April 1 to March 31.

[2] Including one downgrade on a rating (Hindustan Copper) that was not continuous throughout the year. This rating has not been included while computing stability rates and credit ratios.

CHART 2

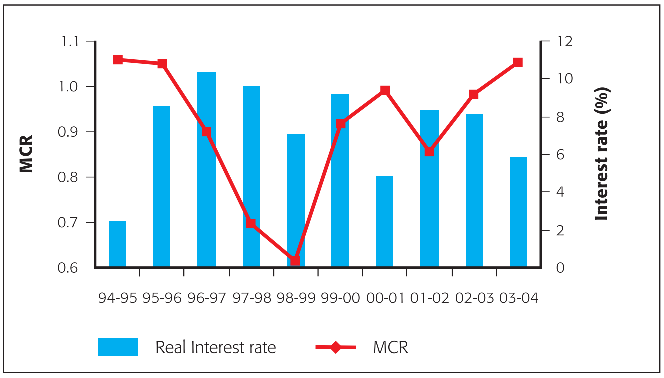
Rating perfomance reflected in credit spreads



levels, and indeed their competitiveness. The improvement in the MCR in FY04 is partly a reflection of the fall in real interest rates over the last year (See Chart 3).

CHART 3

Modified Credit ratio vs. Real Interest rate



Source: CRISIL Centre for Economic Research, CMIE Review of Indian economy

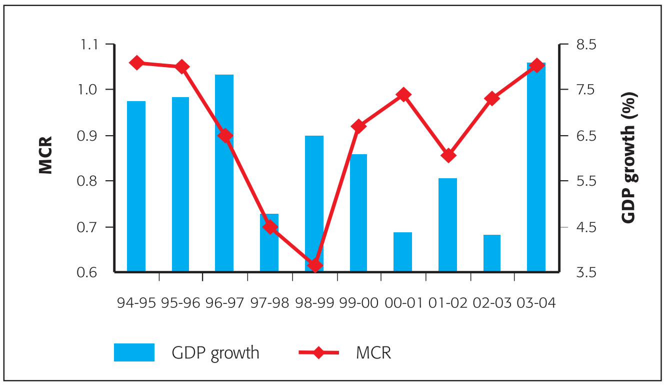
GDP growth in FY05 to be higher than 3-year average

CRISIL's MCR has been a lead indicator of GDP growth over the last 3 years. In view of this, the improved MCR in FY04 implies that GDP growth in FY05 is likely to be strong. In fact, it is likely that GDP growth in 2004-05 would exceed the average annual growth of the last 3 years.

While a change in MCR has typically led to a corresponding change in the GDP growth in the following year, the relationship has been particularly strong over the last 3 fiscal years. For example, the sharp improvement in the credit ratio in FY03 (see chart) has been followed by significantly higher GDP growth in FY04 (estimated to be close to 8 per cent). In keeping with this, the improvement in the MCR in FY04 portends a continuation of the strong GDP growth in FY05.

CHART 4

Modified Credit Ratio vs. GDP growth



Source: CRISIL Centre for Economic Research, CSO

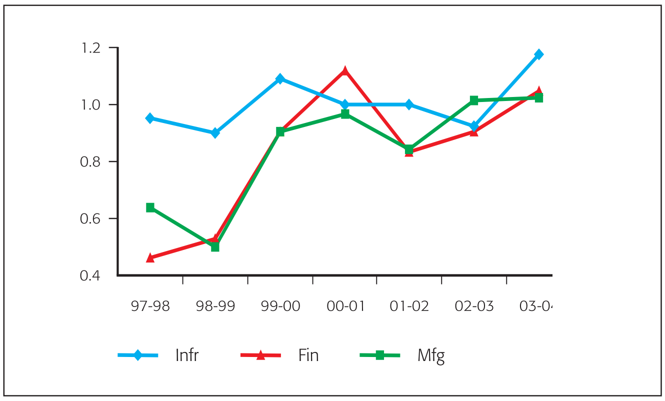
Credit ratios increase to more than one across all sectors

With upgrades exceeding downgrades across the manufacturing,[3] finance and infrastructure sectors, the MCR rose above 1 in all three sectors for the first time in almost a decade. In fact, the infrastructure and finance sectors did not see any downgrades in FY04. This indicates that improving economic fundamentals have begun to support the credit profiles of rated entities across sectors.

The infrastructure sector's MCR was particularly strong with four upgrades and no downgrades in FY04 as compared to two downgrades and no upgrades in FY03.

CHART 5

Improvement in MCR across all sectors



Strong performance in commodities and financial services sectors

The commodity and financial services sectors saw a particularly strong improvement in credit quality in FY04. These sectors accounted for 7 of the 14 bond rating upgrades in this year. In addition, 8 of the 12 fixed deposit rating upgrades were from these sectors. The commodity sector upgrades were driven by higher product prices and the expectation that prices would hold their present levels in the medium term. The financial sector upgrades reflected the benefit of higher margins in the lending business as the cost of funds declined more than the yields on loans.

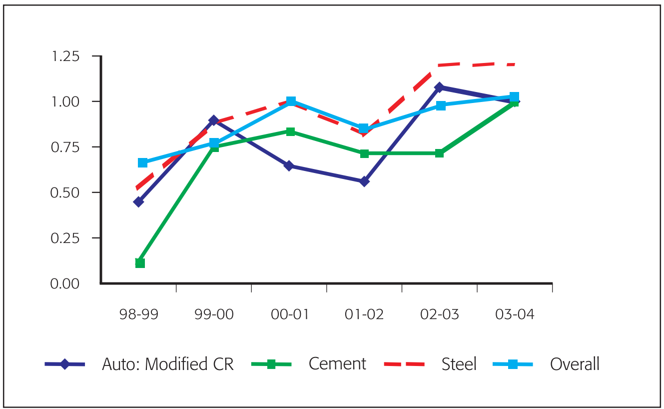
[3] Entities in service industries have been classified in the manufacturing segment for the purpose of this analysis.

Manufacturing sector sustains improved performance

The manufacturing sector's credit quality improved in FY03 after almost a decade of decline. Upgrades outnumbered downgrades in the sector for the second successive year in FY04, reversing the trend of higher downgrades seen continuously between 1996 and 2002. Although upgrades declined to 8 from 14 in FY03, downgrades fell faster to 5 in FY04 from 12 in FY03, leading to an improvement in the sector's MCR. Moreover, this improvement was fairly broad-based across key sectors like steel and automobiles.

CHART 6

Sectoral Modified Credit Ratio

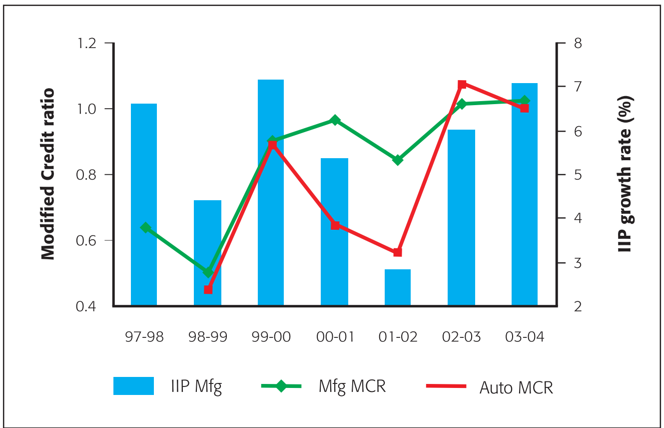


Manufacturing sector's MCR shows strong correlation with IIP growth

The Index of Industrial Production's (IIP) growth rate shows strong linkages with CRISIL's MCR for the manufacturing sector, especially with industries such as automobiles. Since the manufacturing sector has been a significant beneficiary of the industrial revival in the last 18 months, its MCR saw the strongest improvement from FY03.

CHART 7

Sectoral MCR vs. IIP manufacturing growth



Source: CRISIL Centre for Economic Research

Improved credit performance across sectors aided by recovery in capital markets

The MCR improved because of better business conditions, a lower interest rate regime, and higher equity mobilisation. The recovery in the primary equity market enabled corporates to tap equity funds to strengthen their balance sheets. At over Rs. 70 billion till February 2004, equity mobilisation was more than double that in the previous year. A strengthening rupee also enabled corporates to take advantage of low-cost foreign currency borrowings.

Capital investments expected to pick up, especially in power, metals and telecom

The steady increase in capacity utilisations across all parts of the industrial economy and the improving environment for raising funds are expected to result in higher industrial investment in FY05. The capital expenditure of 18 large CRISIL-rated clients (who together accounted for about 40 per cent of the total networth of all CRISIL-rated entities as at March 31, 2003) is likely exceed about Rs. 250 billion in FY05. This is equivalent to about 20 per cent of their consolidated networth as at March 31, 2003.

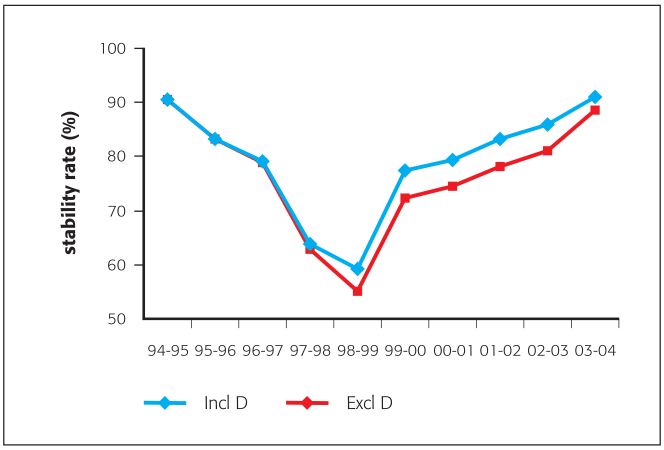
If this capex level were to be projected to the entire portfolio, it would be around 15 per cent of the aggregate networth or Rs. 450 billion. This is roughly equal to two-thirds of the National Highway Development Programme's ongoing road development plan, which is being implemented in two stages and over 8 to 10 years. Thus, higher industrial investment is likely to supplement infrastructure spending as a driver of economic growth in the medium term. The power, metals and telecom sectors are likely to see significant investments.

CRISIL's ratings maintain trend of improving stability

CRISIL's long-term ratings portfolio witnessed 197 rating actions on continuing ratings in FY04, about 90 per cent of which were reaffirmations

CHART 8

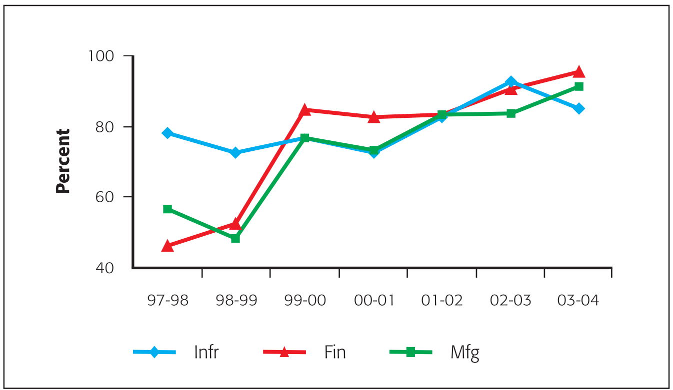
CRISIL stability rates



(about 85 per cent in FY03). If we exclude continuing 'D' ratings, the stability rate was 88 per cent in FY04 as compared to 81 per cent in FY03. The fixed deposit ratings portfolio too was equally stable with about 85 per cent of the ratings being reaffirmed (89 per cent in FY03).

CHART 9

Sectoral-wise stability rates



The trend of improving stability rates of long-term ratings that began in FY99 continued in FY04, except in the infrastructure sector, where stability rates fell due to a large number of upgrades.

Slowdown in pace of rating changes

There were only 19 rating changes (14 upgrades and 5 downgrades) in FY04 as against 33 (14 upgrades and 19 downgrades) in FY03 and 42 (4 upgrades and 38 downgrades) in FY02. CRISIL expects this trend to continue given that it has a stable outlook on about 86 per cent of its rated portfolio. Even if the positive and negative outlooks play out in FY05 in line with international trends (about 25 to 30 per cent of the positive and negative outlooks of Standard and Poor's result in rating changes), the number of rating changes in FY05 is expected to be low. Moreover, the intensity of rating changes has eased with the proportion of one-notch movements in the rating changes increasing to 78 per cent in FY04 from 66 per cent in the previous 2 years and 46 per cent in FY01.

Defaults subside in last 2 years

The number of defaults in CRISIL's long-term ratings has declined consistently since the late nineties, when there were around 20 to 25 defaults annually in the long-term portfolio. In contrast, there have only been two defaults each in the last 2 financial years.

In addition, over the last 2 years, instruments in the default category ('D') have been upgraded to higher ratings — one in FY04 (Arvind Mills Limited) and two (Kalyani Steels and Lupin Laboratories) in FY03. Thus, the net default rate in the long-term portfolio (fresh defaults net of companies upgraded from 'D') was one in FY04 and zero in FY03. CRISIL's fixed deposit portfolio saw no defaults in FY04 as against one default in FY03.

The default level in FY04 has thus been the lowest since FY96. In tandem with high stability rates, this amounts to the best credit performance in almost a decade. CRISIL's stability rates have, in fact, exhibited a near-perfect inverse correlation with the number of defaults as a percentage of outstanding ratings. The steady improvement in the stability of CRISIL's long-term ratings is validated by the corresponding fall in the number of defaults on outstanding ratings. This inverse correlation between stability rates and defaults is also evident in the portfolio of Standard and Poor's, as seen below.

CHART 10

S&P stability and default rates

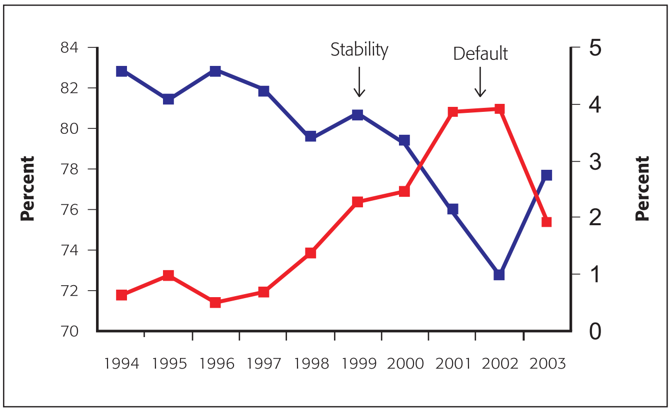
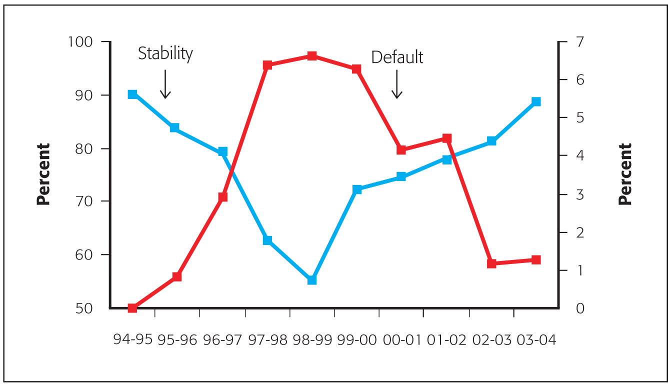


CHART 11

CRISIL stability and default rates



CRISIL's rating performance in line with global standards

Both the stability and default rates of CRISIL's long-term ratings are comparable to those of Standard & Poor's.[4] With less than 10 per cent of its rating actions comprising rating changes in FY04, CRISIL's 1-year stability rates appear to have settled at around the 90 per cent mark. This compares well with the 1-year stability rates of global rating agencies, which normally lie in the 80 to 90 per cent range.

	Upgrades		Downgrades		Rating changes/Number of ratings at beginning of year (%)	
	S & P	CRISIL	S & P	CRISIL	S & P	CRISIL
1994-95	183	15	250	4	17.1	9.5
1995-96	259	26	286	15	18.6	16.7
1996-97	293	18	239	47	17.1	21.1
1997-98	315	14	301	95	18.1	32.5
1998-99	286	10	518	126	20.5	42.6
1999-00	249	13	589	82	19.3	35.4
2000-01	306	30	657	30	20.7	18.9
2001-02	258	4	896	38	24.1	17.7
2002-03	255	14	1095	19	27.3	14.0
2003-04	319	14	786	5	22.2	9.1

Source: S&P Research: Corporate Defaults in 2003 Recede From Recent Highs

Synopsis of rating actions

A key feature of the rating changes in FY04 was the fact that 78 per cent of the changes in the long-term portfolio were by one notch alone. The comparative figure was 67 per cent in the previous 2 years and 46 per cent in FY01.

CRISIL's long-term ratings portfolio saw 14 upgrades in FY04 apart from 12 upgrades in the fixed deposit ratings portfolio. These included:

- Five upgrades from the speculative grade to the investment grade, including one upgrade from 'D': The long-term ratings of The Arvind Mills Ltd. ('BBB-' from 'D') and Steel Authority of India Ltd. (SAIL, 'BBB' from 'BB') were upgraded as were the fixed deposit ratings of SAIL, Saw Pipes Limited and Bhartiya Samruddhi Finance Limited (Bhartiya Samruddhi).
- Three upgrades to 'AAA' from 'AA+': Tata Iron and Steel Company Ltd. (Tisco), Larsen and Toubro Ltd.[5] and Gujarat Gas Company Ltd.
- Five upgrades in the commodity sector (Tisco, SAIL, Gujarat Gas Company Limited, Essel Mining and Industries Limited and Coal India Limited). In addition, the fixed deposits of three companies linked to commodity industries (Saw Pipes Limited, SAIL and BOC India Limited) were also upgraded.
- Two long-term rating upgrades in the non-banking finance sector: Kotak Mahindra Primus Ltd. (to 'AA' from 'AA-') and Tata Finance (to 'BBB' from 'BBB-') apart from five upgrades in fixed deposit ratings.

Five long-term ratings were downgraded as were three fixed deposit ratings:

- All these downgrades were in the manufacturing sector.
- Three of the downgrades were to the speculative grade (all long-term ratings), including two defaults. Hindustan Copper Limited and Shamken Multifab Limited defaulted during the year and their ratings were revised to 'D'.
- The prominent long-term rating downgrades included those of NIIT Ltd (downgraded to 'AA+' from 'AAA' because of the slowdown in the software services sector post-March 2003), Escorts Ltd. (downgraded from 'BBB' to 'C' because of liquidity concerns) and Excel Industries (downgraded from 'A' to 'A-' because of a weakening financial profile).
- All three fixed deposit rating downgrades (Bata India Limited, EIH Limited and Sai Service Station Limited) were one-notch changes. Competitive pressures in their respective industries led to the downgrades of each of these companies.

[4] For this comparison, CRISIL's stability rates have been adjusted to eliminate the effect of continuing defaulted ratings. Standard and Poor's measures stability excluding defaulted ratings.

[5] Post-demerger of its cement business

CRISIL's Long-Term Rating Upgrades and Downgrades in 2003-04

UPGRADES

Sl No	Company	Sector	Industry	From	To
1	Bharti Cellular Limited	Infrastructure	Telecom	A+	AA-
2	Century Enka Limited	Manufacturing	Textiles	AA	AA+
3	Coal India Limited	Infrastructure	Mining	AA-	AA
4	Essel Mining and Industries Limited	Infrastructure	Mining	A+	AA-
5	Gabriel India Limited	Manufacturing	Auto Ancillary	BBB+	A-
6	Gujarat Gas Company Limited	Infrastructure	Oil and Gas	AA+	AAA
7	Kotak Mahindra Primus Limited	Finance	NBFC	AA-	AA
8	Larsen and Toubro Limited	Manufacturing	Engineering	AA+	AAA
9	Max India Limited	Manufacturing	Diversified	BB	BB+
10	Steel Authority of India Limited	Manufacturing	Steel	BB	BBB
11	Tata Finance Limited	Finance	NBFC	BBB-	BBB
12	The Arvind Mills Limited	Manufacturing	Textile	D	BBB-
13	The Tata Iron And Steel Company Limited	Manufacturing	Steel	AA+	AAA
14	Thomson Press (India) Limited	Manufacturing	Media	AA	AA+

DOWNGRADES

Sl No	Companys	Sector	Industry	From	To
1	Escorts Ltd.	Manufacturing	Tractors	BBB	C
2	Excel Industries Ltd.	Manufacturing	Agrochemicals	A	A-
3	NIIT Limited	Manufacturing	IT services	AAA	AA+
4	Shamken Multifab Limited	Manufacturing	Textile	BBB+	D
5	Hindustan Copper Limited	Manufacturing	Metals	C	D

CRISIL's Fixed Deposit Rating Upgrades and Downgrades in 2003-04

UPGRADES

Sl No	Company	Sector	Industry	From	To
1	Ballarpur Industries Limited	Manufacturing	Paper and paper products	FA	FA+
2	Berger Paints Limited	Manufacturing	Paints	FAA+	FAAA
3	Bharat Forge Limited	Manufacturing	Auto-ancillaries	FA-	FAA-
4	Bhartiya Samruddhi Finance Limited	Finance	NBFC	FB+	FA-
5	BOC India Limited	Manufacturing	Industrial and other gases	FAA	FAA+
6	DHFL Vysya Housing Finance Limited (Erstwhile Vysya Bank Housing Finance Ltd)	Finance	Housing Finance	FA	FAA-
7	Gruh Finance Limited	Finance	Housing Finance	FAA-	FAA+
8	Kirloskar Oil Engines Limited	Manufacturing	Diesel Engines	FA	FA+
9	Lakshmi General Finance Limited	Finance	NBFC	FAA	FAA+
10	Saw Pipes Limited	Manufacturing	Steel and steel products	FB+	FA-
11	Steel Authority of India Limited	Manufacturing	Steel	FB	FA
12	Vibank Housing Finance Limited	Finance	Housing Finance	FAA	FAAA

DOWNGRADES

Sl No	Company	Sector	Industry	From	To
1	Bata India Limited	Manufacturing	Leather and leather products	FAA	FAA-
2	EIH Limited	Manufacturing	Hotels	FAA	FAA-
3	Sai Service Station Limited	Manufacturing	Miscellaneous	FA	FA-

CRISIL

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