CRISIL RATINGS

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Insight

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RATINGS ROUNDUP

2003-04 (First Half)

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CRISIL Ratings Round-Up – First half 2003-04

The improvement in Indian economy is set to continue, going by CRISIL's rating trends for the six months ended September 30, 2003. CRISIL's credit quality trends have, over the years, been lead indicators of key economic parameters. According to CRISIL's Ratings Roundup for the first half of Fiscal Year 04, rating upgrades outnumbered downgrades by four to one as the strengthening business fundamentals of CRISIL rated companies found reflection in improved ratings.

Moreover, for the first time in the last five years upgrades exceeded downgrades across the manufacturing, finance and infrastructure sectors. The first half of FY04 also saw the lowest number of downgrades in the last eight years as an all-round improvement in business outlook boosted the credit quality of all rated entities. With steadily improving capacity utilisations across all parts of the industrial economy and a good monsoon, it is only appropriate to be positive about the country's economic prospects.

The number of upgrades in CRISIL's long-term ratings portfolio accelerated to eight in the first half of FY04 from 14 in the whole of FY03 while the number of downgrades fell sharply to two in the past six months from 19 in the previous 12 months. With interest rates likely to remain soft over the short to medium term and inflation at bay, CRISIL expects economic performance to be strong over the next 12-18 months.

Key Conclusions

Broad-based improvement in credit fundamentals

CRISIL's modified credit ratio (MCR), which is defined as the ratio of upgrades plus reaffirmations to downgrades plus reaffirmations, is an effective indicator of systemic credit quality trends. CRISIL's MCR for long-term ratings improved to 1.06 in the first half of FY04 from 0.98 in FY03. Importantly, however, the MCR was more than one across the manufacturing, finance and infrastructure sectors in H1FY04.

Although the large number of upgrades in the manufacturing sector at 14 in FY03 moderated to three in H1FY04, the sharper fall in the number of downgrades to two in H1FY04 from 12 in FY03 caused the MCR for the sector to remain strong. The financial sector saw a sharp turnaround, however, as the falling interest rate scenario pushed up margins in the lending business. This resulted in two upgrades and no downgrades in this sector in H1FY04 as compared to five downgrades and no upgrades in FY03. The infrastructure sector saw a similar improvement with three upgrades and no downgrades in H1FY04 as compared to two downgrades and no upgrades in FY03.

Ratings improvement in step with all-round strengthening of economic fundamentals

CRISIL's MCR has exhibited a strong correlation with macro-economic indicators such as the growth rates of the index of industrial production (IIP) and gross domestic product (GDP) as well as key economic variables like real interest rates. The sustained improvement in the MCR over the 18 months ended September 2003 reflects the improving outlook on GDP growth, in general, and the performance of the industrial sector, in particular. Moreover, the positive economic effects of the easy interest rate regime have contributed to the improving credit fundamentals of all rated entities, especially those in the lending business.

Rating changes at less than 10% of rating actions with 70% of the changes by one notch

The stability of CRISIL's ratings has been improving over the last five years. With less than 10% of its rating actions comprising rating changes in the first half of FY04, CRISIL's one-year stability rates appear to have settled at around the 90% mark. This compares well with the one-year stability rates of global rating agencies, which normally lie in the 80%-90% range. Moreover, the proportion of one-notch movements in the rating changes increased to 70% in H1FY04 from 66% in the previous two years and 46% in FY01.

About the CRISIL Ratings Round-Up

The CRISIL Ratings Round-Up is a semi-annual publication, which analyses CRISIL's rating actions during a particular period as well as the linkages between these actions and underlying economic trends. To the extent that ratings are an opinion on the likelihood of future 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 the first half of FY 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.

Synopsis of rating actions

CRISIL's long-term rating portfolio saw eight upgrades in H1FY04. These included:

- Two upgrades from the speculative grade: Arvind Mills Ltd. ('BB' from 'D') and Steel Authority of India Ltd. ('BBB' from 'BB').
- Two upgrades to 'AAA' from 'AA+': Tata Iron and Steel Company Ltd. and Gujarat Gas Company Ltd.
- Two upgrades in the NBFC sector: Kotak Mahindra Primus Ltd. to 'AA' from 'AA-' and Tata Finance to 'BBB' from 'BBB-'.
- Other than the two upgrades from the speculative grade, the rest were all upgrades by one notch.

There were two downgrades in the long-term ratings portfolio in H1FY04. NIIT Ltd. was downgraded to 'AA+' from 'AAA' as a consequence of the slowdown in the software services sector post March 2003 while Shamken Multifab Ltd. moved to the default category, 'D', from 'BBB+'.

The fixed deposits (FD) rating portfolio also witnessed eight upgrades and two downgrades. Of the eight upgrades, three were from the speculative grade and an equal number was for companies rated in the 'FAA' category at the beginning of FY04. Four of the eight upgrades in the FD portfolio were in the financial services sector, which saw no downgrades. This reinforces the conclusion of a sharp improvement in the sector's credit fundamentals.

The two downgrades in the FD portfolio were in the manufacturing sector with EIH Ltd. (to 'FAA-' from 'FAA') suffering from the downturn in the hotel industry and passenger car dealership Sai Service Station Ltd. (to 'FA-' from 'FA') being affected by the increasing incidence of customer discounts in this business.

A key feature of the rating changes in the first half of FY04 was the fact that 70% of the changes across the long-term and FD portfolio were by one notch alone. The comparative figure was 67% in the previous two years and 46% in FY01.

CRISIL's ratings maintain trend of improving stability

CRISIL's long-term ratings portfolio witnessed 112 rating actions on continuing ratings in the first half of FY04. This comprised eight upgrades, two downgrades and 102 reaffirmations. This translates to a reaffirmation level of 91% of all rating actions against about 88% in H1FY03 and 86% in all of FY03. If we exclude continuing 'D' ratings, the stability rate was 88% in H1FY04 as compared to 84% in H1FY03 and 81% in FY03. This is comparable to the trend in global rating agencies. For instance, around 10% to 20% of Standard & Poor's portfolio has witnessed rating changes annually, over the last few years.

An analysis of the stability rates of long-term ratings across the manufacturing, finance and infrastructure sectors reveals that stability rates have been comparable across sectors. Moreover, the improving trend in stability rates of CRISIL ratings that commenced in FY99 has been similar across the three sectors[1].

The stability trend in the FD ratings portfolio too was similar with eight upgrades, two downgrades and 50 reaffirmations in H1FY04. This reaffirmation level of about 83% was slightly lower than the 87% of FY03. (See Appendix 1 for CRISIL's upgrades and downgrades for long-term and FD ratings in H1FY04).

CHART 1

CRISIL stability rates

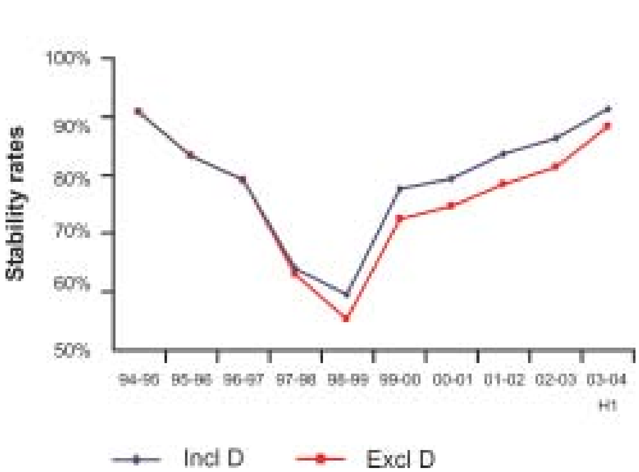
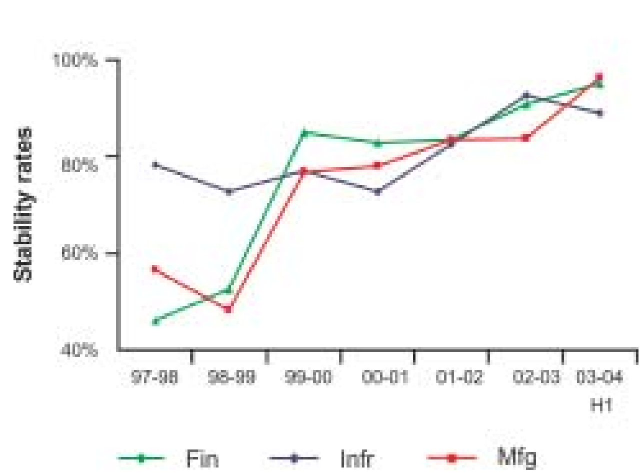


CHART 2

Sector-wise stability rates



[1] Entities in service industries have been classified as "Manufacturing" for the purpose of analysis

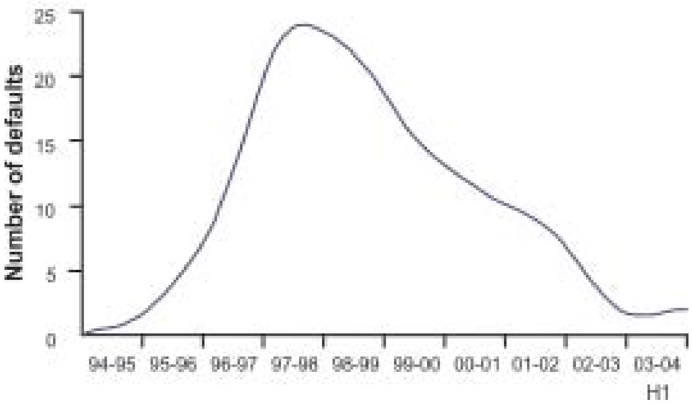
Improvement in credit trajectory sustained in H1FY04

Falling number of defaults

The number of defaults in CRISIL's long-term ratings has not only been low but it has also been declining consistently since 1998.

CHART 3

Defaults



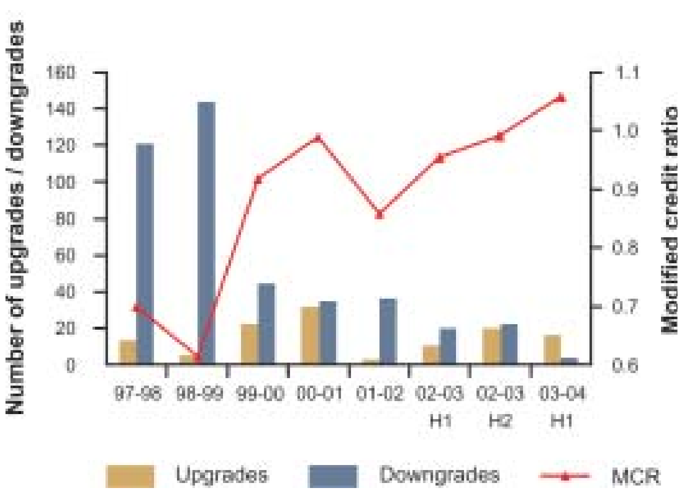
In the above graph, the number of defaults in this year's semi-annual period has been annualised in order to compare with other data points.

The first half of FY04 saw one default while FY03 saw two. This represents a considerably lower rate of defaults compared to the levels witnessed in the late 1990s. Moreover, in both periods, the number of new defaults was accompanied by an equal number of instruments in the default category ('D') being upgraded to higher ratings. Thus, the net default rate in the long-term portfolio (fresh defaults net of companies upgraded from 'D') has been zero in the last three semi-annual periods. CRISIL's FD portfolio saw no defaults during the first six months of FY04 as against one default in FY03.

Rising credit ratios and a steep reduction in downgrades

CHART 4

Upward trend in modified credit ratio continues



The MCR is considered to be a good measure of the trajectory of credit fundamentals. The simple credit ratio (ratio of upgrades to downgrades), also a useful indicator, is far more volatile, especially in situations where the number of rating changes is small.

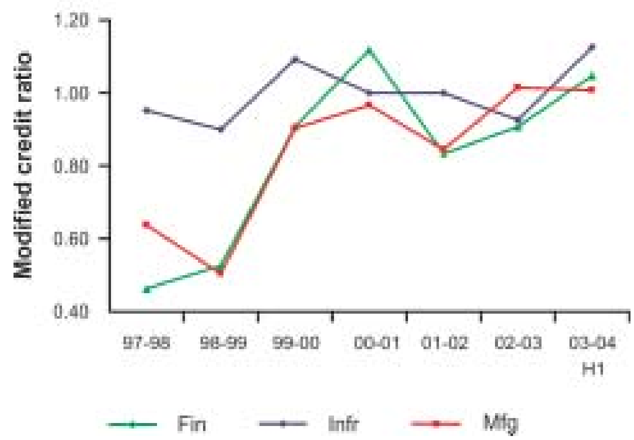
For the first time in the last five years, CRISIL's MCR for long-term ratings crossed one to touch 1.06 in H1FY04. In contrast, the MCR was 0.98 in FY03. (The MCR has improved continuously since FY99 except for a blip in FY02.) A similar improvement was seen in the MCR for CRISIL's FD ratings to 1.12 in H1FY04 from 0.98 in H1FY03 and 0.96 in FY03. The most interesting feature of H1FY04 was, however, the sharp fall in the number of downgrades, which touched the lowest mark in the last eight years. This indicates that improving economic fundamentals have begun to support the credit profile of all rated entities.

Credit ratios increase to more than one across all sectors

For the first time in almost a decade, the manufacturing, infrastructure and finance sectors saw their respective MCRs rise above one.

CHART 5

Sharp improvement in finance, manufacturing



The financial sector witnessed a sharp turnaround as the falling interest rate scenario added to the margins in the lending business. This resulted in two upgrades and no downgrades in this sector in H1FY04 as compared to five downgrades and no upgrades in FY03.

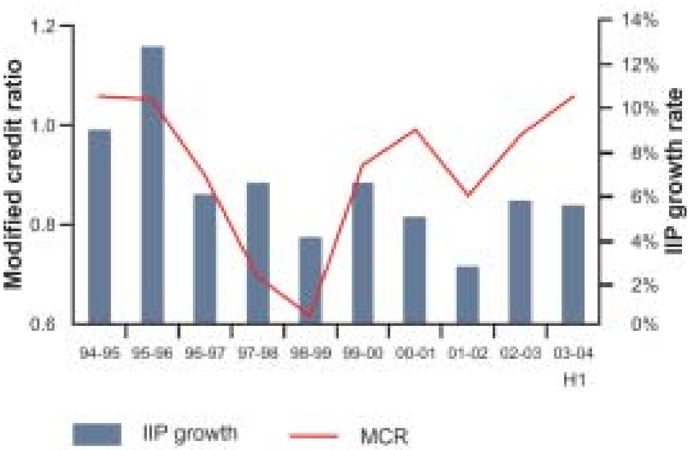
The infrastructure sector's MCR too improved with three upgrades and no downgrades in H1FY04 as compared to two downgrades and no upgrades in FY03. Although the manufacturing sector saw fewer upgrades at three in H1FY04 as compared to 14 in FY03, this was more than offset by the sharp fall in downgrades to two in H1FY04 from 12 in FY03, causing the sector's MCR to remain strong.

CRISIL's modified credit ratio continues to show a strong correlation with economic trends

In the past, sharp changes in the IIP's growth rate have tended to coincide with movements in the credit ratio. This trend continued in H1FY04 as well.

CHART 6

Modified credit ratio vs. IIP growth

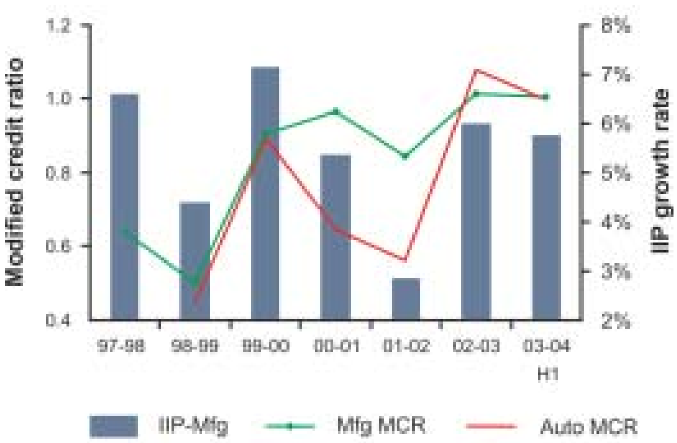


Source: CRISIL's Centre for Economic Research

In fact, the manufacturing sector IIP growth rate has also corresponded closely with CRISIL's MCR for this sector. Since the manufacturing sector was one of the earliest beneficiaries of the industrial revival in the last eighteen months, its MCR saw the strongest turnaround in FY03. Also, as in the past, the automobile sector's MCR continued to exhibit the strongest correlation with the IIP in H1FY04.

CHART 7

Sectoral MCR vs. IIP manufacturing growth

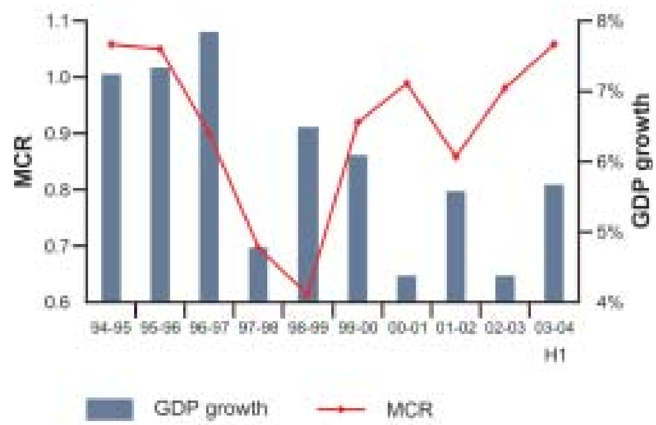


Source: CRISIL's Centre for Economic Research

CRISIL's MCR has led the GDP growth rate over the last few years. The improvement in the credit ratio in FY03 appears to have been followed by an improvement in GDP growth in FY04. GDP growth in the first quarter of FY04 is estimated at 5.7% from the 4.3% in FY03. More importantly, the improvement in the MCR in FY04 may portend a continuation of strong 6% plus GDP growth in FY05.

CHART 8

Modified credit ratio vs. GDP growth

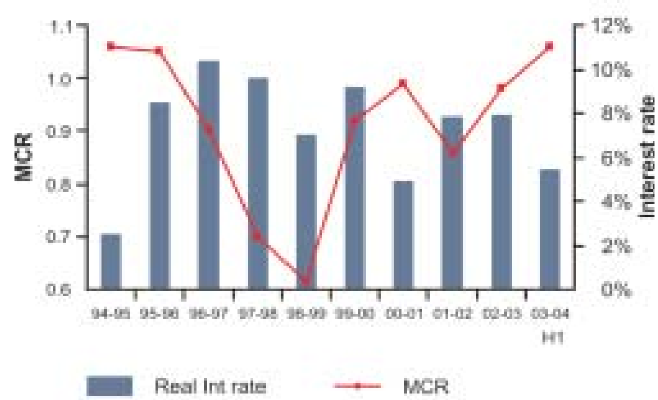


Source: CRISIL's Centre for Economic Research, CSO, CMIE Review of Indian economy

The MCR displays a strong inverse correlation with the real interest rate (interest rates adjusted for inflation). Higher real interest rates reflect the increasing cost of borrowings for corporates in relation to product prices. The increase in interest outflows following a rise in the real interest rate immediately affects profitability and interest coverage levels. A sustained high real interest rate, as witnessed between 1995 and 1998, also impacts the companies' competitiveness in both the export market and against imports. The improvement in the MCR in H1FY04 is partly a reflection of the fall in real interest rates over the last six months.

CHART 9

Modified credit ratio vs. Real interest rate



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

Appendix I

CRISIL Long Term Rating Upgrades / Downgrades in first six months of 2003-04:

UPGRADES

Sl No	Company	Sector	Industry	From	To
1	Bharti Cellular Limited	Infrastructure	Telecom	A+	AA-
2	Coal India Limited	Infrastructure	Mining	AA-	AA
3	Gujarat Gas Company Limited	Infrastructure	Oil and Gas	AA+	AAA
4	Kotak Mahindra Primus Limited	Finance	NBFC	AA-	AA
5	Steel Authority of India Limited	Manufacturing	Steel	BB	BBB
6	Tata Finance Limited	Finance	NBFC	BBB-	BBB
7	The Arvind Mills Limited	Manufacturing	Textile	D	BB
8	The Tata Iron And Steel Company Limited	Manufacturing	Steel	AA+	AAA

DOWNGRADES

Sl No	Company	Sector	Industry	From	To
1	NIIT Limited	Manufacturing	IT Services	AAA	AA+
2	Shamken Multifab Limited	Manufacturing	Textile	BBB+	D

CRISIL Fixed Deposit Rating Upgrades / Downgrades in first six months of 2003-04:

UPGRADES

Sl No	Company	Sector	Industry	From	To
1	Bharat Forge Limited	Manufacturing	Auto-ancillary	FA-	FA
2	Bhartiya Samruddhi Finance Limited	Finance	NBFC	FB+	FA-
3	BOC India Limited	Manufacturing	Industrial and other gases	FAA	FAA+
4	DHFL Vysya Housing Finance Limited (Erstwhile Vysya Bank Housing Finance Ltd)	Finance	Housing Finance	FA	FAA-
5	Gruh Finance Limited	Finance	Housing Finance	FAA-	FAA+
6	Lakshmi General Finance Limited	Finance	NBFC	FAA	FAA+
7	Saw Pipes Limited	Manufacturing	Steel and steel products	FB+	FA-
8	Steel Authority of India Limited	Manufacturing	Steel	FB	FA

DOWNGRADES

Sl No	Company	Sector	Industry	From	To
1	EIH Limited	Manufacturing	Hotel	FAA	FAA-
2	Sai Service Station Limited	Manufacturing	Miscellaneous	FA	FA-