CRISIL RATINGS

The Most Reliable Opinion on Risk

RATINGS ROUNDUP

FY 2006-07

Management attitude towards risk will drive credit quality

Increasing debt levels and high interest rates pose a threat

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Management attitude towards risk will drive credit quality

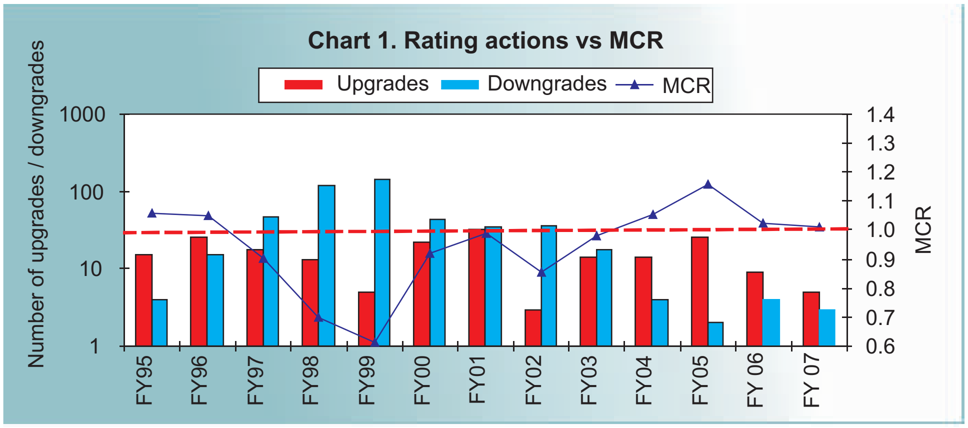
Increasing debt levels and high interest rates pose a threat

Corporate India's credit fundamentals remain strong after four years of sustained improvement, according to CRISIL's analysis of the trends in its rating actions. CRISIL's modified credit ratio (MCR) for 2006-07 (refers to financial year, April 1 to March 31) continues to be above 1 at 1.01; this is marginally below the level of 1.03 recorded in 2005-06. The trend of improving credit quality in corporate India, which started when an MCR greater than 1 was recorded in 2003-04, continued in 2006-07, but with lesser momentum. Given that CRISIL's rated portfolio covers key sectors of the Indian economy, and includes most of the top players in each segment, CRISIL's MCR stands out as a reliable indicator of systemic credit quality, and of underlying business fundamentals. The correlation of CRISIL's MCR with key economic indicators has been proven over several years (see Box 1).

The significant improvement in Indian companies' financial position over the last few years has been accompanied by a new-found confidence among corporate managers, resulting in a palpable increase in their risk appetite. With a large number of companies either announcing, or already in the process of implementing, large capacity expansions or aggressive acquisitions, the key to maintaining the current levels of credit quality depends on how well the growth is managed, and in what way it is funded.

MCR continues to decline

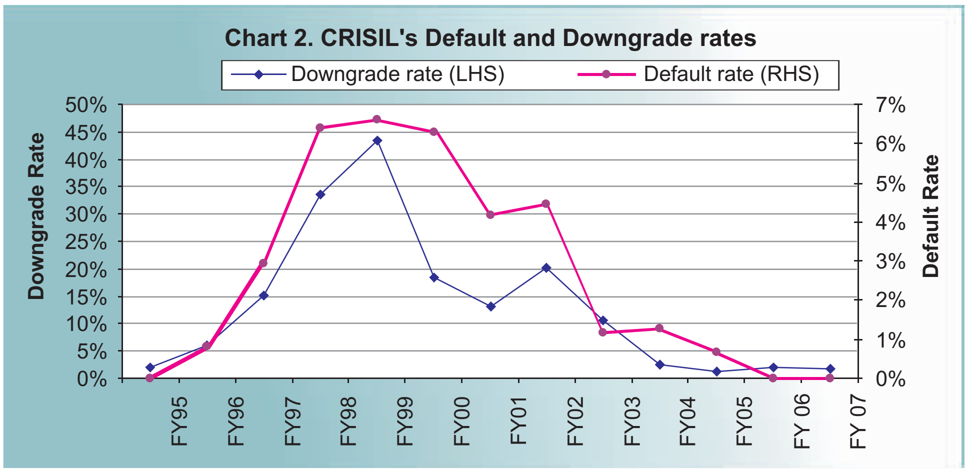
CRISIL's MCR is defined as the ratio of upgrades plus reaffirmations, to downgrades plus reaffirmations over any given period. In 2006-07, CRISIL's MCR for long-term ratings decreased to 1.01, falling steadily from an all-time high of 1.16 recorded in 2004-05 (see Chart 1). The MCR reflects five upgrades and three downgrades in CRISIL's long-term ratings portfolio[1], as against nine upgrades and four downgrades in the previous financial year. (See Annexure for CRISIL's upgrades and downgrades for long-term ratings in 2006-07.)



The decline in CRISIL's overall MCR reflects a slowdown in the momentum of improving credit quality. This is in line with CRISIL's observations, in Ratings Round-Ups published since October 2005, that corporate India will find it increasingly difficult to improve its credit quality.

Downgrade rate remains low

Chart 2 depicts CRISIL's long-term downgrade rate – defined as the ratio of total downgrades in long-term ratings to outstanding long-term ratings – which continues to be low at 1.74 per cent. No CRISIL-rated instrument has defaulted over the last 27 months, the longest such period since 1995.

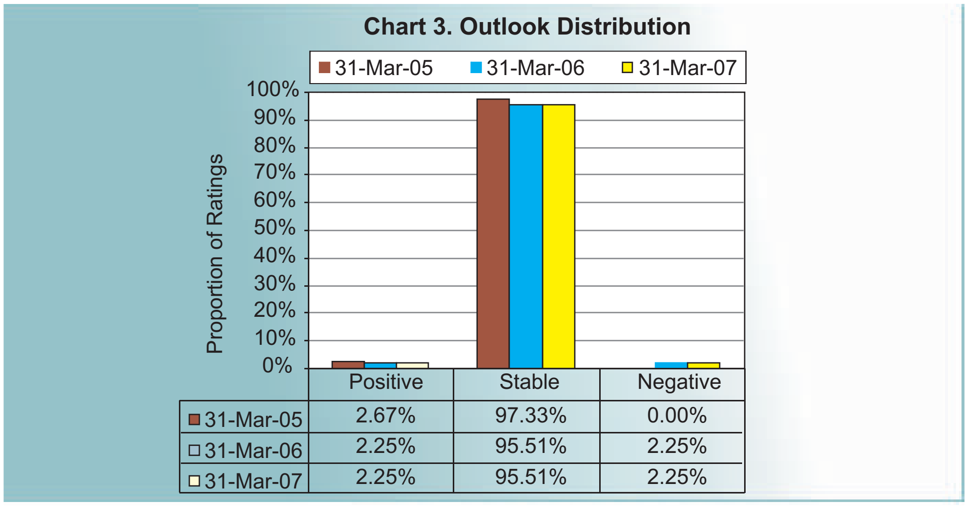


[1] CRISIL's portfolio of fixed deposit ratings featured one upgrade and three downgrades. (See Annexure)

Outlook distribution

Rating outlooks, assigned by CRISIL since September 2003, have proven to be reliable leading indicators of the likely direction of rating movements. The proportion of positive and negative outlooks also provides guidance on the likely direction of credit quality.

As on March 31, 2007, more than 95 per cent of CRISIL-rated entities had stable outlooks, reflecting CRISIL's view that no major changes are expected in the credit profiles of rated entities over the short to medium term (see Chart 3). The remaining outlooks were equally distributed on the positive and negative side.



	Positive	Stable	Negative
31-Mar-05	2.67%	97.33%	0.00%
31-Mar-06	2.25%	95.51%	2.25%
31-Mar-07	2.25%	95.51%	2.25%

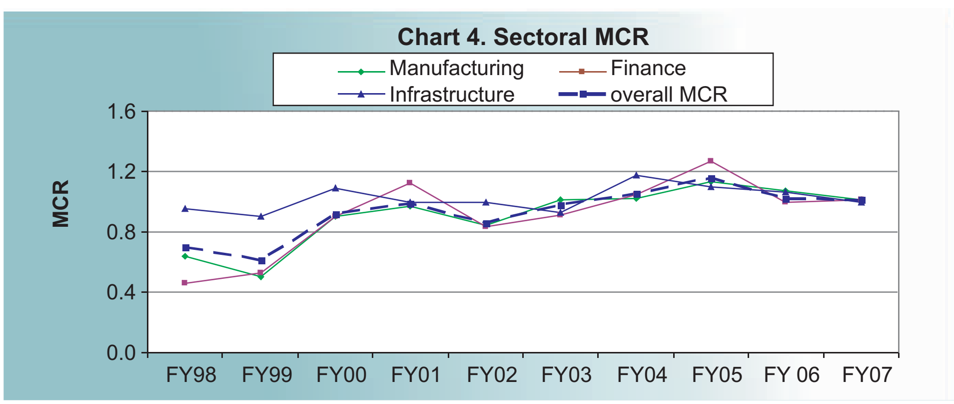
Rating watch

CRISIL places ratings on watch when an event of significance has occurred which has the potential to impact the rating, but the impact cannot be accurately assessed at that time. As on March 31, 2007, CRISIL had six ratings on watch (see Annexure). Five of the ratings were under watch due to acquisitions/projects that are large compared to the current size of operations.

Sectoral view

CRISIL's rating portfolio consists of entities belonging to all sectors of the Indian economy. The following paragraphs present CRISIL's opinion on the prospects for credit quality in the manufacturing, infrastructure, and financial sectors. On the positive side, the opinion factors in the strong improvement in credit fundamentals across the corporate spectrum; on the other hand, it also takes note of the increasing risk appetite of corporate India, in an economic environment characterised by increasing interest rates.

As in earlier years, the manufacturing sector accounted for the bulk of the rating actions during 2006-07, with four upgrades and three downgrades. One financial sector entity, BoB Housing Finance Ltd, was upgraded to 'AAA' giving the financial sector an MCR of 1.02. There were no upgrades or downgrades among companies in the infrastructure sector, which resulted in a sectoral MCR of 1.00 for the infrastructure sector during 2006-07. Chart 4 gives the MCR trends in these three sectors.



Manufacturing and infrastructure sectors: Large growth plans in an increasing interest rate environment

The manufacturing sector has witnessed a steady improvement in its financial profile, aided by four years of sustained economic growth. This sustained improvement in financial strength has encouraged a large number of companies to announce very large expansion/acquisition plans. The planned capacity expansions in some industries and estimates of the capital expenditure involved are given in Table 1.

Table 1: CRISIL's estimates of outlay for planned capacity expansions

Industry	Units	Current Capacity pa	Capacity pa in 2012	Percentage increase expected	Additional investment in Rs. bn.
Steel	million tonnes	40	110	175	1680
Petroleum Refining	million tonnes	125	200	60	1310
Cement	million tonnes	150	240	60	390
Aluminium	million tonnes	1	1.65	65	120
Electrical power	Giga-watts	110	185	68	3000
Telecom	Million subscribers	166	327	97	1230
Automobiles Passenger cars/commercial vehicles and two wheelers	Million units	13	19	46	450
Total					8160

Source: CRISIL Ratings

Based on the leverage normally used in projects in different sectors, CRISIL estimates that the extent of debt funding would be about Rs.6000 billion – an amount much larger than the total assets of the largest bank in India today.

Apart from these expansion plans, corporate India has also displayed a growing appetite for inorganic growth. The total acquisitions already made or announced during 2006 (refers to calendar year, January 1 to December 31) were Rs.434.0 billion (see Table 2). In the first two months of the current year, 80 additional deals valued at over Rs.1000 billion have been announced.

Table 2: Acquisitions announced by corporate India

	2005		2006	
Type of Acquisitions	No of Deals	Value (Rs. bn)	No of Deals	Value (Rs. bn)
Domestic	79	260.6	73	127.3
Foreign	77	133.1	114	306.7
Total	156	393.7	187	434.0

Source: Media reports, CRISIL estimates

The implications of these capital expenditure plans and acquisitions are:

1. The debt funding for these expansion plans can weaken the debt protection measures of the entities implementing the expansion
2. Large expansions will result in overcapacities, which could depress prices and therefore affect profitability of all players in these sectors
3. If the interest rates continue to increase, it will also add to profitability pressures and weaken the credit protection measures
4. Any delays in implementing the planned projects or in integrating acquired businesses with existing operations could also add to credit quality pressures
5. Any economic downturn could further exacerbate the pressures on credit quality

A key risk, therefore, would be the funding pattern for the planned growth; debt-funded growth in a regime of high interest rates has the potential to adversely affect the credit quality of corporate India over the medium term. The extent to which this actually happens will depend on the companies' decisions to press ahead with expansions, or defer them, in the light of macroeconomic conditions. Hence, management attitude towards risk will be a key driver of future credit quality. CRISIL will continue its surveillance on its rated portfolios, and take appropriate rating actions on any signs of weakening in specific credits.

Financial sector: Increasing interest rates herald a slowdown

The increase in interest rates, as well as recent Reserve Bank of India actions to reduce liquidity in the system, will lead to a slowdown in credit growth. Banks will find it difficult to pass on their increased cost of funds as borrowers increasingly look at alternate sources, such as overseas borrowing and convertible bonds. CRISIL believes that the profitability of financial sector entities may be affected, going forward. The increase in interest rates may also lead to an increase in delinquencies, especially in the retail portfolio of financial sector entities; this is, however, unlikely to significantly affect the credit profile of the entities, as a majority of financial sector entity ratings will continue to draw support from their parents. This support is derived from the Government of India for public sector banks, and from foreign parents in case of multinational banks and non-banking finance companies (NBFCs).

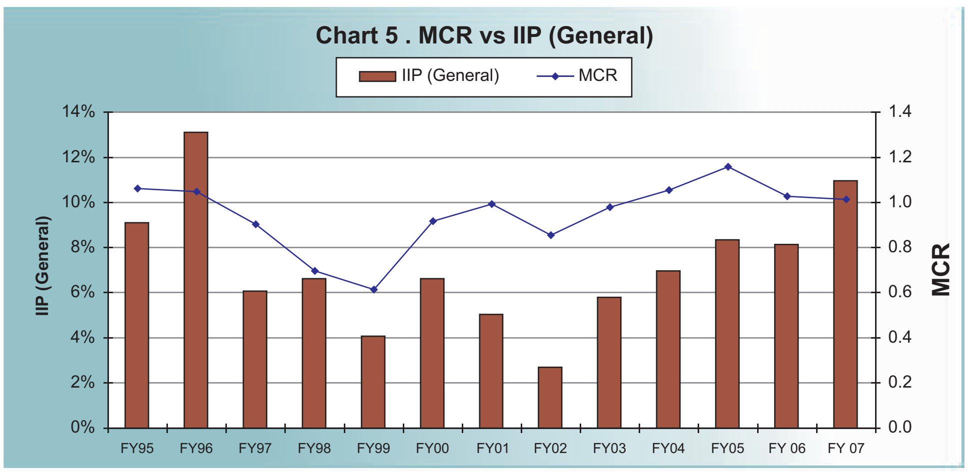
Conclusion

Corporate India has built a strong financial position based on four years of sustained good performance. The confidence that comes from such a strong position has increased the risk appetite of company managements. CRISIL believes that this increased risk appetite, combined with higher interest rates, is likely to exert pressure on the credit quality of Indian companies. Going forward, the MCR may fall below one in the short term when the ratings on watch gets resolved. In the medium term, CRISIL believes that the ability to prudently manage large growth plans, and their funding patterns, will be the key rating driver for a large number of companies.

Box 1: CRISIL MCR has strong correlation with IIP and real interest rates

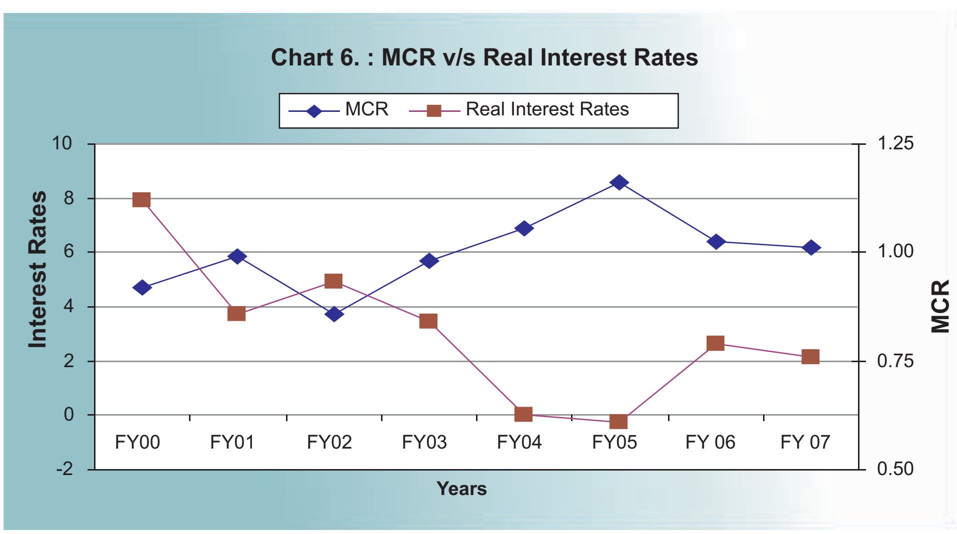
Strong correlation with IIP

CRISIL's MCR is a sensitive measure of industrial performance and the prospects of the Indian economy, as it covers a wide range of sectors and key players in each sector. This is reflected in the consistently high degree of correlation between CRISIL's MCR and India's Index of Industrial Production (IIP) as shown in Chart 5.



Real interest rates and MCR

Real interest rates and CRISIL's MCR have historically demonstrated a perfect inverse correlation - MCR declines when real interest rates rise and vice-versa as can be observed from Chart 6. The last 24 months have seen an increase in real interest rates mirrored by a declining MCR. High real interest rates, which are not expected to decline in the near term, will add to credit quality pressures.



ANNEXURE

CRISIL's Long-Term Rating Upgrades in the Financial Year 2006-07

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	BoB Housing Finance Limited	Housing Finance	AA+	Positive	AAA	Stable
2	DCM Shriram Industries	Organic Chemicals	D	-	BBB-	Stable
3	Jagran Prakashan Limited	Printing and Publishing	AA-	Positive	AA	Stable
4	NIIT Technologies Limited	IT Services	AA-	Stable	AA	Stable
5	Titan Industries Limited	Watches and Clocks	A	Stable	A+	Stable

CRISIL's Long-Term Rating Downgrades in the Financial Year 2006-07

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	India Glycols Limited	Organic Chemicals	AA-	Stable	A+	Negative
2	Insilco Limited	Industrial Intermediary	AA-	*	A+	Stable
3	Madras Cements Limited	Cement	AA-	Stable	A+	Stable

* Insilco Limited was on AA- Rating Watch and was subsequently downgraded on 19-09-2006

CRISIL's Fixed Deposit Ratings Upgrades in the Financial Year 2006-07

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	Kirloskar Brothers Limited	Engineering	FAA	-	FAA+	Positive

CRISIL's Fixed Deposit Ratings Downgrades in the Financial Year 2006-07

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	Fenner India Limited	Automobile Ancillary and Engineering	FAA	-	FAA-	Stable
2	India Glycols Limited	Organic Chemicals	FAA	Stable	FAA-	Negative
3	Madras Cements Limited	Cement	FAA	Stable	FAA-	Stable

CRISIL's Rating Watch as on 31st March 2007

Sr. No	Company	Industry	Rating	Watch
1	Lanco Kondapalli Power Private Ltd	Power	A	Rating Watch (Developing Implications)
2	Torrent Power Limited	Power	AA-/FAA	Rating Watch (Developing Implications)
3	Tata Power Company Limited	Power	AAA	Rating Watch (Developing Implications)
4	Essel Mining and Industries Ltd	Mining	AA	Rating Watch (Negative Implication)
5	Hindalco Industries Limited	Aluminium	AAA	Rating Watch (Negative Implication)
6	Tata Steel Limited	Steel	AAA/FAAA	Rating Watch (Negative Implication)

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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. Since credit rating is an opinion on likelihood of timely future debt repayments, an analysis of rating actions in a large and diverse portfolio of rated companies, can be useful indicator of economic prospects. This edition analyses CRISIL's rating actions in FY 2006-07.