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RATINGS ROUNDUP

FH 2006-07

Credit quality pressure to accentuate

Downgrades exceed upgrades in the manufacturing sector

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Credit quality pressure to accentuate

Downgrades exceed upgrades in the manufacturing sector

CRISIL's semi-annual study of rating actions indicates that pressure on credit quality is increasing. CRISIL's modified credit ratio (MCR, the ratio of upgrades plus reaffirmations to downgrades plus reaffirmations) has declined during the period April - September 2006 to 1.00, from a level of 1.03 during FY06.

This is in line with CRISIL's expectation - first published in its Ratings RoundUp in October 2005 - of a downward trend in creditworthiness. The expected weakening is also indicated by the number of negative outlooks, which has exceeded the number of positive outlooks for the first time since CRISIL started assigning outlooks in 2003.

The next question for lenders and investors is, in which sector is this weakening most apparent? And what is driving this trend?

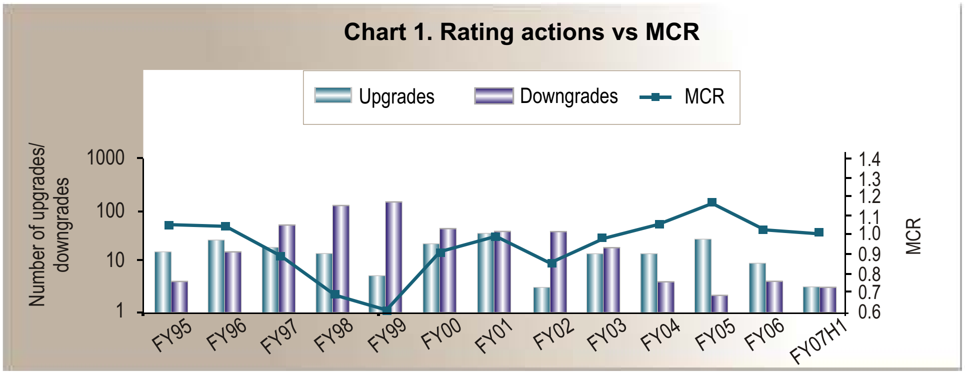
In the manufacturing sector, for the first time in four years, CRISIL's MCR dropped below 1.00, to 0.98, an indication that the sector's credit fundamentals are showing signs of strain. Going forward, increasing input prices, large capital expenditure, and higher interest rates, are likely to accentuate the credit quality pressures on this sector. However, the impact will be muted given the currently strong credit profile of corporate India in general.

The infrastructure and financial sectors, on the other hand, report stable and marginally increasing MCRs respectively. The expectation of rating stability in these sectors reflects favourable government policies for the infrastructure sector, and parent support for financial sector entities; both these factors are expected to continue to operate.

This commentary highlights CRISIL's opinion on the shape and magnitude of the credit quality pressures, and their possible impact over the medium term.

MCR continues to decline

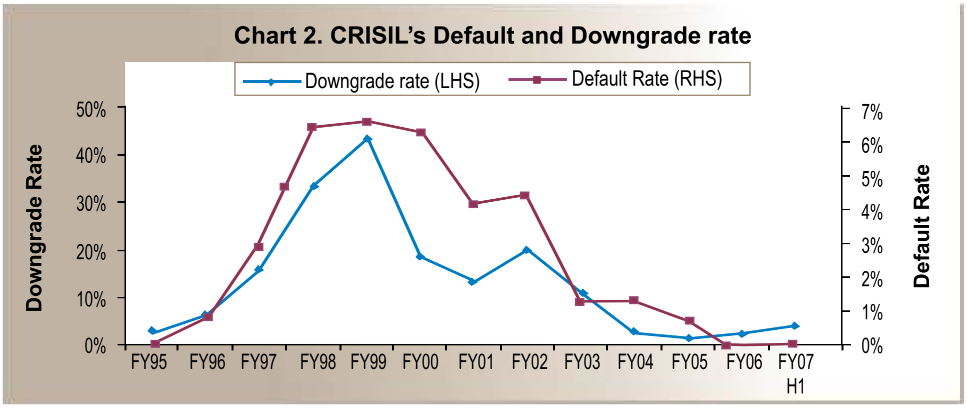
CRISIL defines its modified credit ratio (MCR) as the ratio of upgrades plus reaffirmations to downgrades plus reaffirmations over any given period. In H1/FY07 (April 2006 to September 2006), CRISIL's MCR for long-term ratings decreased to 1.00, falling from a level of 1.03 recorded in FY06. The MCR reflects three upgrades and three downgrades in CRISIL's long-term ratings portfolio[1]. (See Annexure for CRISIL's upgrades and downgrades for long-term ratings in H1/FY07).



The decline in MCR to 1, after three years above that level, indicates that the phase of sustained improvement in credit quality for CRISIL-rated entities is over. This reversal in trend - anticipated by CRISIL in its October 2005 issue of Ratings Round Up, and reiterated in the April 2006 issue - is likely to be accentuated as rated entities face increasing pressure on credit quality.

Downgrade rate continues to rise

CRISIL's long-term downgrade rate - defined as the ratio of total downgrades in long-term ratings to outstanding long-term ratings - increased to 3.68 per cent for H1/FY07, up from 2.09 per cent recorded for FY06. This highlights the beginning of the weakening of credit profiles. However, no default was recorded in H1/FY07, making it 21 months since a CRISIL-rated paper defaulted.



[1] CRISIL's portfolio of Fixed Deposit ratings featured no upgrades and three downgrades. (See Anenxure)

Real interest rates continue to increase and can impact credit quality

Real interest rates and CRISIL's MCR have historically demonstrated an inverse correlation - MCR declines when real interest rates rise and vice-versa. The last 18 months have seen a sustained 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. CRISIL believes that the MCR will continue to remain at 1.00 or lower over the short to medium term.

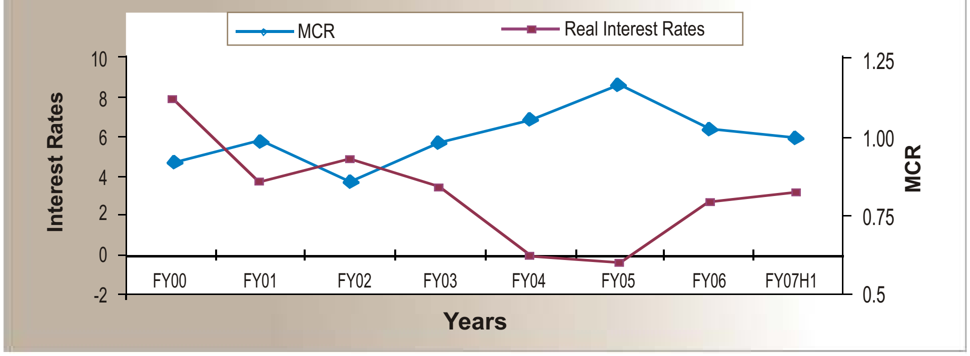
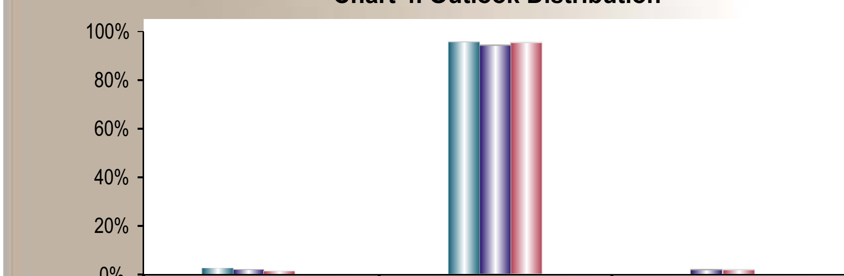


Chart 3. MCR v/s Real Interest Rates

Most ratings will remain stable

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 at September 30, 2006, the proportion of long-term ratings with positive outlooks had declined to 1.67 per cent of all long-term ratings (from 2.25 per cent as at March 31, 2006), while ratings with negative outlooks stood at 2.22 per cent (2.25 per cent at March-end). The higher proportion of ratings with negative outlooks confirms the negative trend of credit quality. However with more than 96 per cent of entities having stable outlooks at the end of September 2006, CRISIL does not expect major changes in the credit profiles of rated entities over the short to medium term.

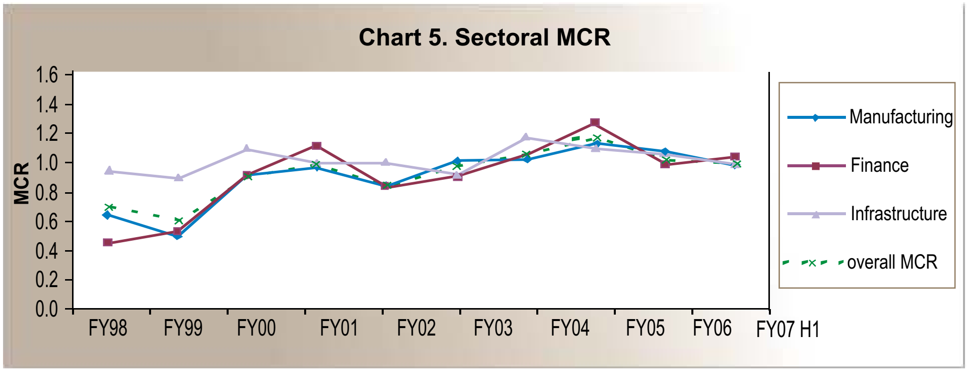
Chart 4. Outlook Distribution



	Positive	Stable	Negative
31-Mar-05	2.67%	97.33%	0.00%
31-Mar-06	2.25%	95.5%	2.25%
30-Sept-06	1.67%	96.1%	2.22%

Sectoral Analysis

The manufacturing sector, which continued to account for the bulk of the rating actions in H1/FY07, recorded a sectoral MCR of 0.98, significantly lower than the 1.07 recorded in FY06. Ratings in the infrastructure sector were stable with an MCR of 1.00. MCR for the financial sector improved to 1.04 for H1/FY07, from 1.00 in FY06.



Manufacturing sector- High input prices and interest rates to affect financial position

The manufacturing sector's MCR dropped below 1 for the first time in four years. The sector accounted for two upgrades and all the three downgrades during H1/FY07, and recorded a sectoral MCR of 0.98, significantly lower than the 1.07 recorded in FY06. This is in line with CRISIL's expectations, enunciated in the Ratings RoundUp of April 2006.

The increase in input prices, higher level of capital expenditure, and continuing high interest rates, will be immediate challenges for the manufacturing sector. While a large number of industries in the sector continue to show strong performance due to buoyant demand, higher interest rates could lead to a slowdown in demand growth for consumer goods. Further, the increasing number of debt-funded acquisitions is also likely to have an adverse impact on the financials of these companies. Going forward, CRISIL expects manufacturing sector entities to continue to face pressure on their credit profiles. The impact will, however, be muted, given the strong credit profiles corporate India has built over the last three years.

Infrastructure sector- Oil prices and government policy to determine stability

The credit quality of infrastructure sector entities remained stable, with no upgrade or downgrade during H1/FY07. The volatility in oil prices, and timeliness and adequacy of government action, will be key determinants of the credit profiles of public sector oil companies. CRISIL expects ratings of infrastructure sector companies to be stable over the short to medium term; the outlook for the power and road sectors is expected to improve with policy reforms planned by the Government of India.

Finance sector-Parent/Government support to drive stability

The financial sector recorded one upgrade, that of BoB Housing Finance Company, consequent to its announcement of an intended merger with its parent, Bank of Baroda. This improved the financial sector MCR for H1/FY07 to 1.04 from 1 recorded in FY06.

The credit profiles of financial sector entities will continue to receive the benefit of support from Government of India (GoI) or strong foreign parents, lending stability to their overall credit risk profiles. Increasing interest rates pose new challenges to the financial sector, with potentially higher interest spreads on the lending business counterbalanced by somewhat higher market risk and credit risk. Overall, CRISIL expects ratings of financial sector entities to be stable over the short to medium term.

Conclusion

CRISIL believes that the pressure on credit quality will accentuate over the next 18 months. The decrease of overall MCR to 1, after being above 1 for three years, and the fall of the manufacturing sector MCR below 1 after four years, indicate increasing credit quality pressures. The strong financial position built up by rated entities over the past four years is likely to provide them resilience to absorb these credit quality pressures in the short to medium term.

ANNEXURE

CRISIL's Long-Term Rating Upgrades in the first half of Year 2006-07

Sl. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	BoB Housing Finance Limited	Housing Finance	AA+	Positive	AAA	Stable
2	Jagran Prakashan Limited	Printing and Publishing	AA-	Positive	AA	Stable
3	NIIT Technologies Limited	IT Services	AA-	Stable	AA	Stable

CRISIL's Long-Term Rating Downgrades in the first half of Year 2006-07

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

* Rating watch with negative implications

CRISIL's Fixed Deposit Ratings Downgrades in the first half of Year 2006-07

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

** Rating watch with developing implications

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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 H1/FY 2006-07.