CRISIL
RATINGS

RATINGS ROUNDUP

FY 2007 - 08

Basel II positive for debt market development

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Executive summary

New ratings assigned by CRISIL increased dramatically in 2007-08 (FY2008, April 1 to March 31), with the number of ratings assigned in this financial year exceeding the sum of those assigned in the previous four. This increase was driven by the rapid growth in bank loan ratings (BLRs). As of March 31, 2008, BLRs constituted 21 per cent of outstanding CRISIL ratings, up from base of zero a year ago. In FY2008, CRISIL rated bank facilities of Rs.1.92 trillion, representing close to one-eighth of the Indian banking system's corporate exposure.

Close to 60 per cent of the newly-assigned long-term BLRs are in the 'A' and 'BBB' rating categories. This is a landmark for the Indian ratings industry: so far, the lack of bond market demand for ratings below the 'AA' category led to few of these ratings being used. The rising number of BLRs has now resulted in a fuller distribution, with rating categories below 'AA' being much better populated than before; this moves CRISIL's rating distribution closer to that of the overall credit market. CRISIL believes that this shift presages a significant deepening of India's bond market, as market participants gain comfort with the debt servicing capabilities of many prominent credits that are rated below the 'AA' category.

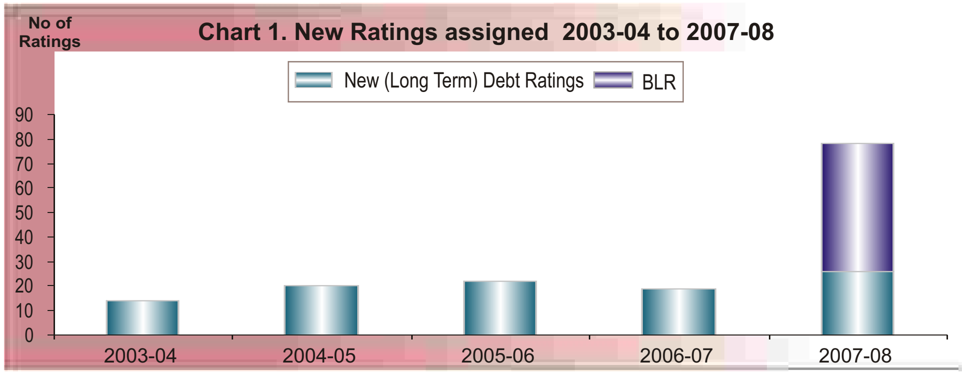
For existing ratings, CRISIL's modified credit ratio (MCR, the ratio of upgrades plus reaffirmations to downgrades plus reaffirmations) for FY2008 was at 0.97 times; in other words, downgrades outnumbered upgrades during the year. This is the first time in four years that MCR has remained below 1 time for an entire financial year. This marks a reversal after four years of steadily improving credit quality for Indian corporates. CRISIL expects corporate India will continue to face credit quality pressure because of high input costs and interest rates, coupled-for exporters-with lower realisations because of rupee appreciation.

The reversal, however, comes at a time when companies' financial risk profiles are strong after four years of good performance and capital strengthening. Additionally, the median rating of the existing CRISIL-rated population, in the 'AA' category, is high. For these reasons, CRISIL does not expect any significant increase in defaults among rated companies in the medium term, despite some expected weakening in credit quality.

This edition of CRISIL's Ratings Round-Up contains a detailed analysis of these and other trends, and has CRISIL's estimates of credit quality, going ahead, for various sectors of the Indian economy. With its comprehensive coverage across sectors, it remains an indispensable tool for analysing credit risk in the Indian economy.

Sharp rise in new ratings: BLRs lead the way

The long-term ratings assigned in FY2008 outnumber the aggregate for the previous four years (refer Chart 1).

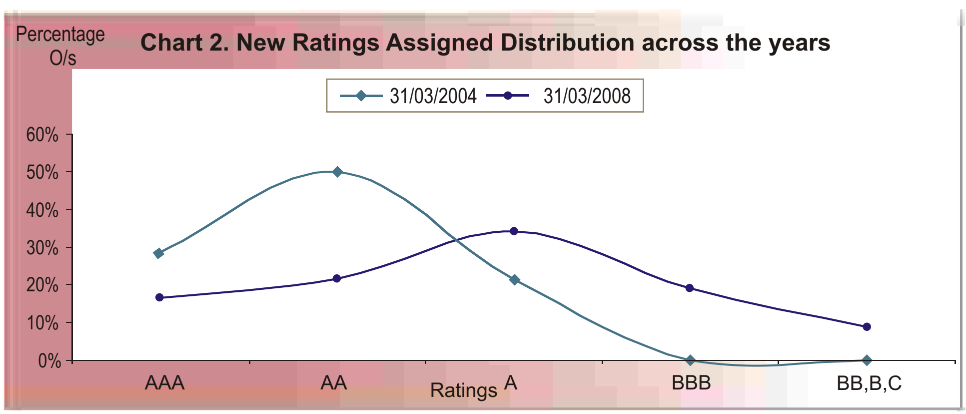


The increase in the number of ratings assigned is mainly due to Bank Loan Ratings, which have gathered momentum in FY2008. Under the Reserve Bank of India's guidelines on capital adequacy (based on Basel-II norms), bank loans availed by corporates need to be rated to become eligible for capital relief[1]; therefore, in response to suggestions from their bankers, many corporates are getting their bank loans rated. The rated bank facilities (both long-term and short-term, of both previously-rated and newly-rated companies) aggregate Rs. 1.92 trillion, representing about 13 per cent of the total corporate exposure of the Indian banking system. CRISIL has in all rated 27 types of bank facilities. (Please refer Box 1)

More than 80 per cent of the Bank Loan ratings assigned in FY2008 were in the last three months (between January and March 2008). CRISIL expects the increase in BLR volume to continue into FY2009. Anticipating the volume of BLR requests, CRISIL had invested in building capacity well in advance, and is therefore fully equipped to deal with the rating requests that it expects to receive in FY2009.

New ratings lead to a fuller distribution

The most significant observation from the recently-assigned BLRs is that a large proportion of these ratings are in the 'A' and 'BBB' categories. This is a marked departure from the trend observed in bond ratings, where there is a perceived lack of demand for paper rated below the 'AA' category, and fresh ratings below that level would generally not elicit investor interest. The shift in the distribution of fresh ratings assigned is evident from the distribution curves in chart 2.

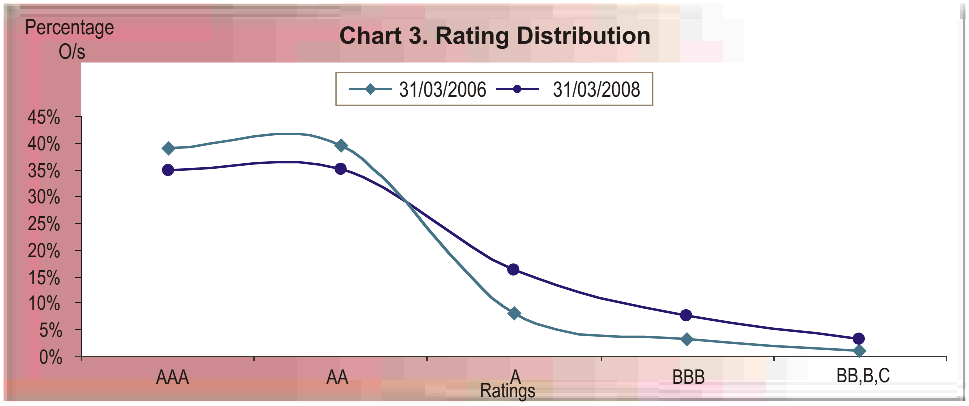


As can be seen in the 'new ratings assigned' distribution curve for FY2004, half of all new issuers were rated in the 'AA' category, a reflection of the perceived bond market preference. The curve for FY 2008 is far more balanced because of the addition of BLRs, with a low number of ratings on the extremes of the rating scale, and a much greater proportion of ratings near the median of the rating scale. This reflects the more diverse portfolio of banks, which lend to various categories of corporate borrowers.

[1] Please refer CRISIL's publication "CRISIL BANK LOAN RATINGS - QUESTIONS FREQUENTLY ASKED BY BANKS".

Impact of New Ratings

With a large number of ratings making their debuts in the 'A' category and below, the overall rating distribution spectrum has also changed. Chart 3 depicts the percentage of ratings outstanding in March 2006 and March 2008.

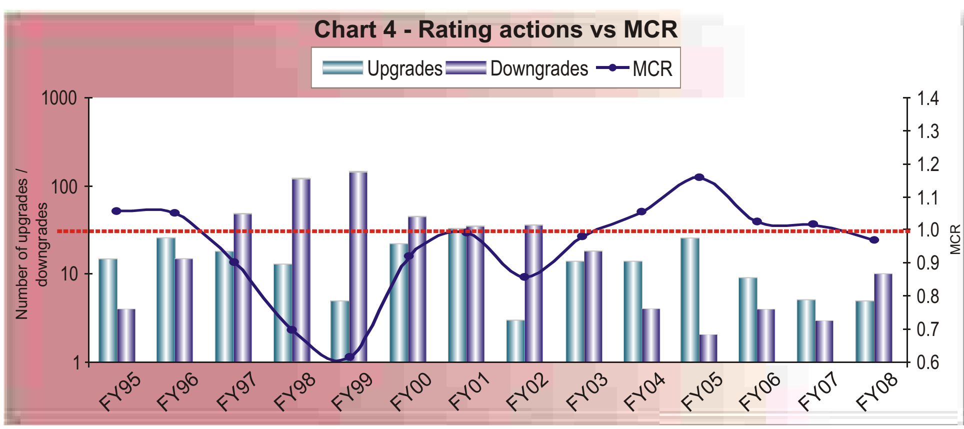


The bond market's minimal appetite for risk has been one of key reasons for its remaining small and under-developed. The addition of new 'A' and 'BBB' category ratings in large numbers, resulting in a more even distribution of ratings, is expected to give the Indian bond market a much-needed boost. Many BLRs in these rating categories pertain to companies that have been in existence for more than a decade, and have been regularly servicing their debt obligations. CRISIL believes that this will give capital market investors confidence in the safety of entities rated 'A' or lower, spurring appetite for their bonds. Such increased investment in hitherto ignored issuances would lead to a deepening of the bond market. CRISIL believes that the credit rating of bank loans is an important development that can significantly aid in the expansion of the Indian bond market.

MCR continues to decline

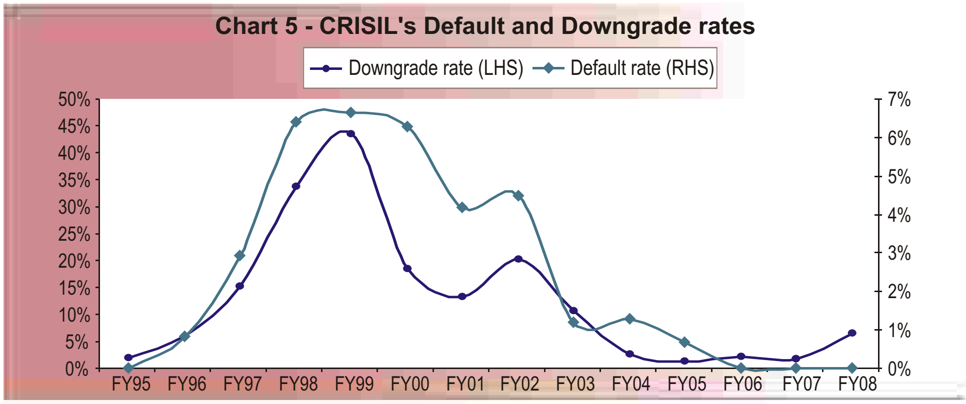
On existing credit ratings, there has been continued pressure on credit quality as predicted by the Ratings Round-Up for the six months ended September 30, 2007. This pressure is reflected by an increase in the downgrade rate, and in MCR remaining below 1 time.

CRISIL's MCR for long-term ratings has remained at less than 1 time for the entire fiscal year (FY2008) for the first time in the past four years. MCR reduced to 0.97 times in FY2008 from 1.01 times in FY2007. The MCR reflects **five** upgrades and **ten** downgrades in CRISIL's long-term ratings. (see Annexure for CRISIL's upgrades and downgrades for long-term ratings in FY2008).



Rapidly Increasing Downgrade Rate

CRISIL's long-term downgrade rate (the ratio of total downgrades in long-term ratings to outstanding long-term ratings) has increased to 6.49 per cent in FY2008 from 1.74 per cent in FY2007 (see Chart 5).

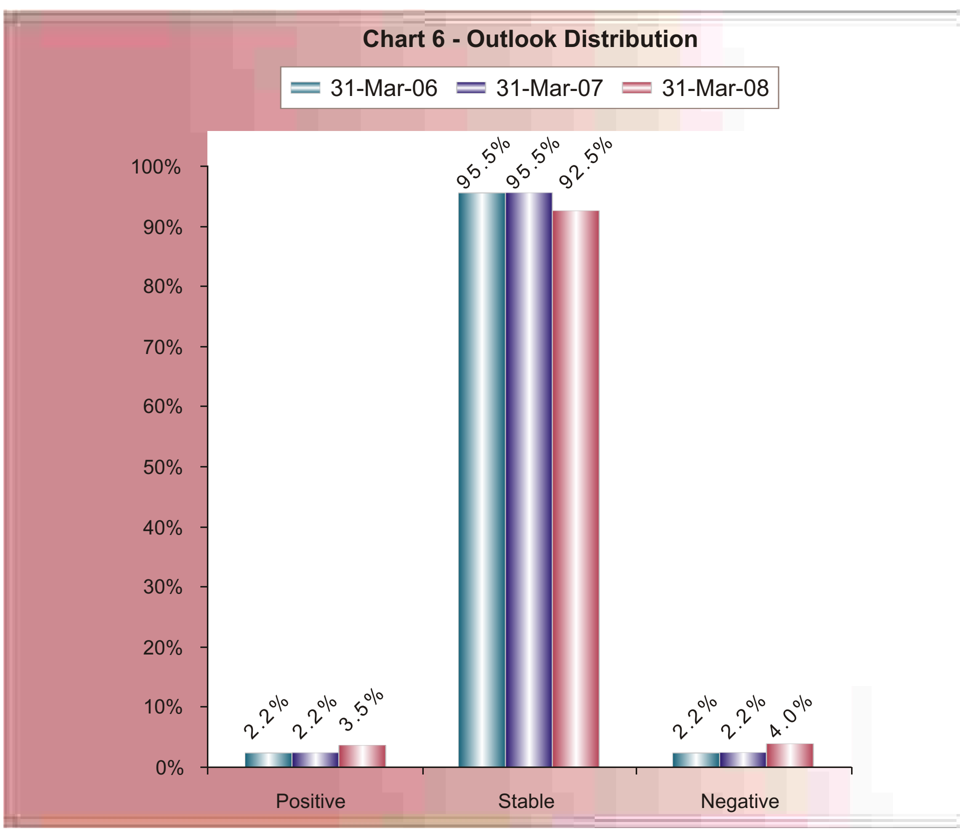


The downgrade rate, which is the highest for the past four years (it was at 10.65 per cent in FY2003), is a further indication that corporate India's credit quality has weakened. Over the past few years, CRISIL has observed a strong correlation between the MCR and economic indicators such as IIP growth. A decline in MCR to 0.97 along with a decline in the IIP growth rate to 8.7 per cent and increase in real interest rate to 2.8 per cent are in line with the strong correlation of CRISIL's MCR with the IIP growth rate and real interest rates.

Outlook distribution - rise in negative outlooks

Rating outlooks, assigned by CRISIL since September 2003, have proven to be reliable lead indicators of the likely direction of credit quality. The proportion of negative outlooks has been increasing since FY2005 and is currently at an all-time high of 4 per cent, indicating that pressures on credit quality are more immediate than before (Refer Chart 6). As on March 31, 2008, nearly 93 per cent of CRISIL-rated entities had stable outlooks.

Many of the rating actions in 2007-08 were event-driven, and were, therefore, not preceded by outlook changes. Events such as announcement of large debt-funded capital expenditure, and debt-funded acquisitions, were the prime reasons for rating changes in the past twelve months.



CRISIL places ratings on watch when an event of significance has occurred that has potential to impact the rating, but the impact cannot be accurately assessed at the time. As on March 31, 2008, CRISIL had four long-term ratings on watch, compared to six as on March 31, 2007 (see Table 1).

Table 1: CRISIL's long-term ratings on watch

	March 31, 2008	March 31, 2007
Rating Watch with Positive Implications	0	0
Rating Watch with Developing Implications	3	3
Rating Watch with Negative Implications	1	3

Strees on credit quality, but low likelihood of defaults

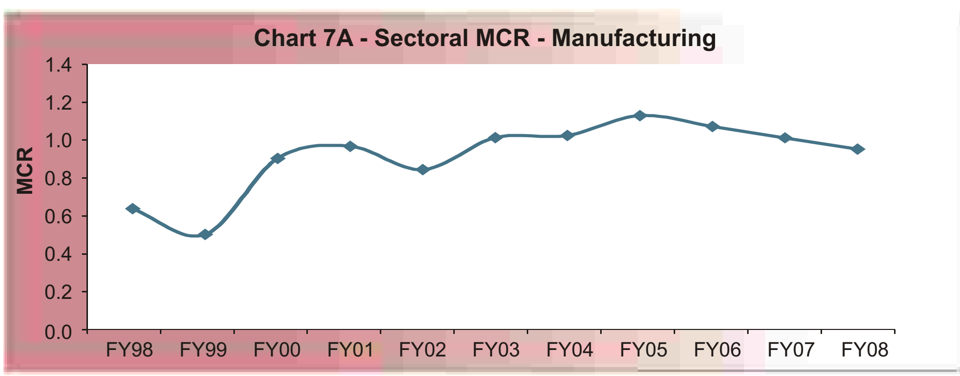
CRISIL sees increasing stress on credit quality, but does not believe that this will be significant enough to drive credits to default. The majority of CRISIL-rated companies still carry high investment grade ratings, and the downgrades may typically be not more than one or two notches.

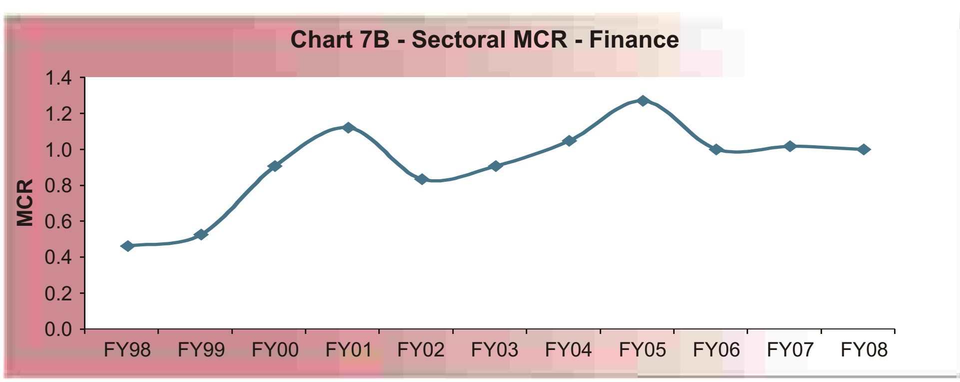
Sectoral overviews

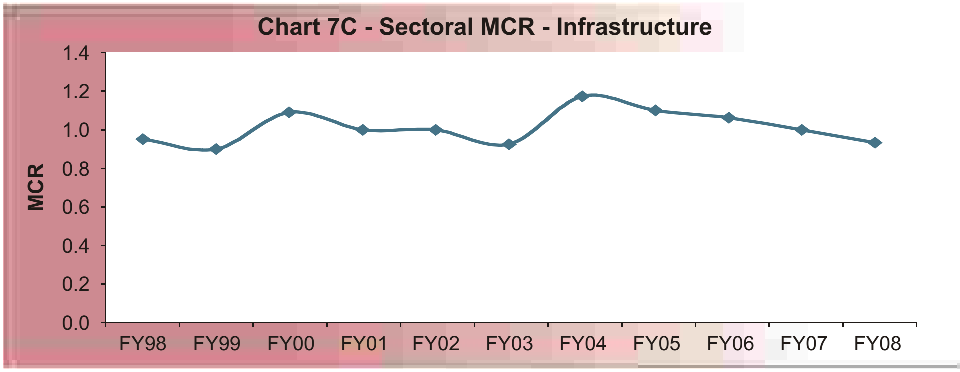
All sectors of the Indian economy are represented in CRISIL's rating portfolio. This section presents CRISIL's opinion on the prospects for the manufacturing, infrastructure, and financial sectors with regard to credit quality. The opinion factors in the increased risk appetite of India's corporates, and the fact that the operating environment is gradually becoming more challenging; these factors could have an impact on credit quality. However, these entities have built up strong financial positions over the past few years, which is a positive for credit quality.

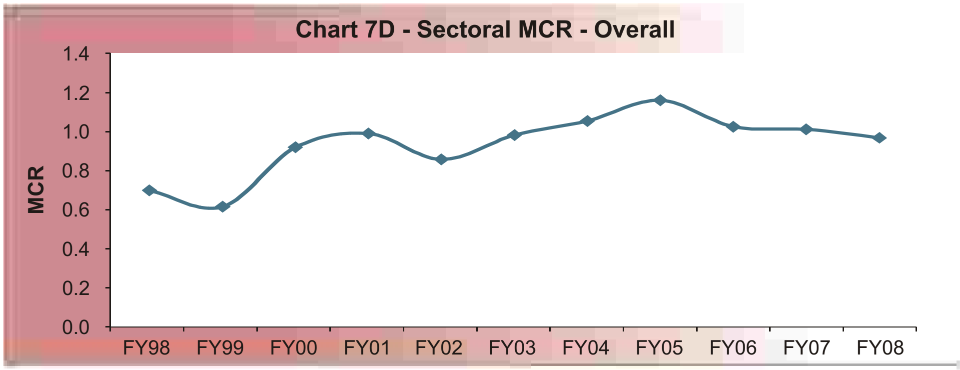
CRISIL continues to factor in derivative exposures of issuer entities while assigning credit ratings. The potential impact, if any, of derivative-related write-downs and losses is carefully assessed and addressed while assigning the rating.

The manufacturing sector accounted for the bulk of rating actions in FY2008, with 5 upgrades and 8 downgrades; this resulted in an MCR of 0.95 times for the sector. Two infrastructure companies were downgraded, resulting in an MCR of 0.93 times for the sector. Several of these downgrades were the result of large, debt-funded capacity expansion plans. There were no upgrades or downgrades for companies in the financial sector, resulting in a sectoral MCR of 1 time in FY2008 (see Charts 7A to 7D for sector-wise trends in MCRs).









Manufacturing and Infrastructure Sectors

As predicted by the Ratings Round-Up for the six months ended September 30, 2007, segments like automobiles, auto-ancillaries and sugar continue to post weak results. In the auto-ancillary sector, CRISIL believes a demand slowdown will result in pressure on players' profitability. The prices of key inputs (steel, non-ferrous metals, energy) have remained upward-bound, adding to the pressure on profitability. The sugar industry continues to post losses, but there has been some improvement in realisations in the past six months, a trend that is likely to continue over the next six to eight months.

With aluminum prices reaching record highs of around USD3300/tonne at the London Metals Exchange (LME), some moderation of demand appears likely. CRISIL expects the price of aluminium to moderate, owing to reduced global demand as a result of a slowdown in the US housing sector, and large capacity additions in India and China.

The outlook for cement continues to be positive on the whole. Cement companies have seen a recent run of improved realisations on the back of buoyant prices. However the realisations may decline to some extent as new capacities become operational over the medium term.

Export-dependent sectors like textiles may face pressure on their profitability because of the appreciating rupee and a general slowdown of global demand, along with increasing interest costs. The software sector may face pressure because of recessionary conditions in the US, coupled with rupee appreciation.

In the infrastructure sector, CRISIL expects large debt-funded capacity expansions and government policy directions to drive rating changes over the medium term. The overall outlook for power utilities and equipment manufacturing units is positive, despite uncertainty with regard to fuel pricing and procurement. Competition in the telecom sector is likely to intensify with the entry of new players with diversified interests. Established nationwide players, and players with strong infrastructure, are better equipped to face this challenge than the smaller operators are. With the entry of new players, per-minute tariff wars will intensify, resulting in an overall reduction in tariffs.

The infrastructure sector has not witnessed large acquisitions, but the scale and size of capacity expansions has increased significantly; this can have an impact on credit quality.

Financial sector - global pressures affect India

In the aftermath of the global credit crisis, global financial institutions have faced severe pressures on earnings. Consequently, the ratings of their Indian subsidiaries too could come under pressure, as most of the ratings are notched up for parentage leading to potential revisions in ratings or outlooks. This could mark a reversal in trend of highly stable ratings in financial sector over the last 60 months, during which period the sector witnessed hardly any downgrades.

The Indian banking sector could face profitability pressure over the next six months, given the continued high cost of funds, and the inability to pass on the increase in interest costs entirely to borrowers. The banking sector could also face some pressure on the asset quality, on account of loans to the retail segment and to small and medium enterprises (SMEs). However, the ratings of India's financial entities are likely to remain largely stable, backed by the substantial capital raised by them in the past twelve months, and by parent support.

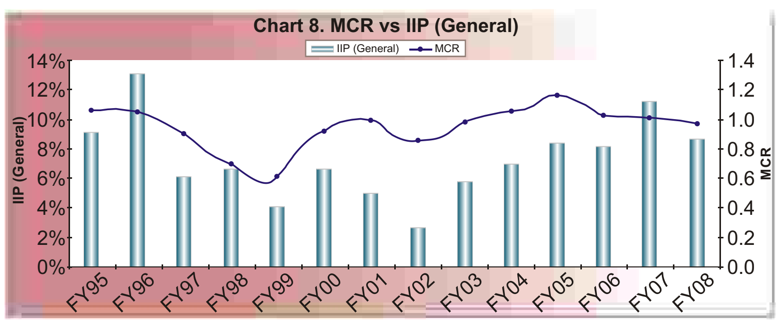
Box 1:

As per the *Macroeconomic and Monetary Developments, Third Quarter Review 2007-08* published by the Reserve Bank of India, the amount of advances outstanding in the banking system towards the industry, non banking finance companies (NBFCs), real estate companies, and trade, was about Rs.10.5 trillion as on February 15, 2008. Assuming that the non-fund based limits and the unutilised portion of the fund-based limits is about 50 per cent of the fund-based exposures, the total banking system's corporate sector exposure is estimated at Rs.16 trillion.

Box 2: CRISIL MCR has strong correlation with IIP and Real interest rates

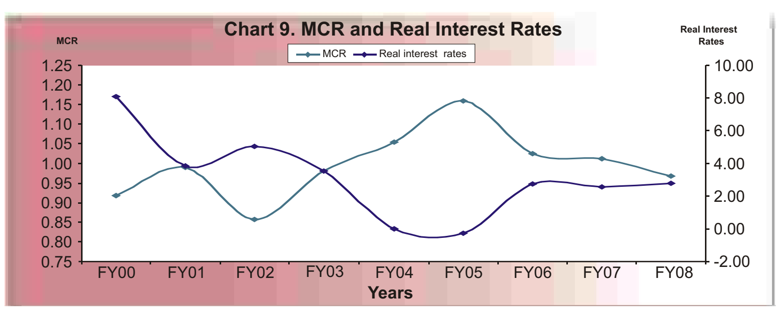
Strong Correlation with IIP

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 Chart 8 indicates.



Real interest rates and MCR

Real interest rates and CRISIL's MCR have historically demonstrated a strong inverse correlation - MCR declines when real interest rates rise, and vice-versa, as can be observed from Chart 9. Real interest rates have increased over the past 36 months, mirrored by a declining MCR. The high real interest rates are unlikely to reduce over the near term, and will add to credit quality pressures.



APPENDIX - 1

CRISIL's Long-Term Rating Upgrades in FY 2008

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	Soma Textiles and Industries Ltd	Textile	BB+	Stable	**BBB-**	**Stable**
2	ACC Limited	Cement	AA+	Stable	**AAA**	**Stable**
3	Titan Industries Limited	Gems, Jewellery & Watches	A+	Stable	**AA-**	**Stable**
4	UltraTech Cement Limited	Cement	AA+	Stable	**AAA**	**Stable**
5	Sterlite Industries (India) Limited	Metals	AA		**AA+**	**Stable**

CRISIL's Long-Term Rating Downgrades in FY 2008

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	DCM Shriram Industries Limited	Diversified	BBB-	Stable	**BB+**	**Negative**
2	EID Parry (India) Limited	Diversified	AA	Stable	**AA-**	**Stable**
3	Electrosteel Castings Limited	Castings	AA	Stable	**AA-**	**Stable**
4	Hindalco Industries Limited	Aluminium	AAA	-	**AA**	**Stable**
5	India Glycols Limited	Petrochemicals	A+	Negative	**A**	**Negative**
6	Indian Farmers Fertiliser Co-operative Limited	Fertilisers	AA	Stable	**AA-**	**Stable**
7	Tata Steel Limited	Steel	AAA	-	**AA+**	**Stable**
8	Essel Mining and Industries Limited	Mining	AA	-	**AA-**	**Negative**
9	Tata Power Company Limited	Power	AAA	-	**AA**	**Stable**
10	Tata Motors Limited	Automobiles	AA+	-	**AA-**	**Stable**

CRISIL's Fixed Deposit Rating Upgrades in FY2008

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	The Jammu and Kashmir Bank Ltd	Banking	FAA	Stable	**FAA+**	**Stable**
2	Jindal Saw Limited	Steel	FA+	Stable	**FAA-**	**Stable**

CRISIL's Fixed Deposit Rating Downgrades in FY2008

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	India Glycols Ltd	Organic Chemicals	FAA-	Negative	**FA+**	**Negative**
2	The Dhampur Sugar Mills Limited.	Sugar	FA	Stable	**FB**	**Negative**

CRISIL's Long-Term Ratings on Watch as on March 31, 2008

Sr. No	Company	Industry	Rating	Watch
1	Gujarat Paguthan Energy Corporation Private Limited	Power	AA	Rating watch with negative implications
2	GE Money Financial Services Limited	NBFC	AAA	Rating watch with developing implications
3	Global Trade Finance Limited	NBFC	AA	Rating watch with developing implications
4	Gujarat Gas Company Limited	Industrial Gas	AAA	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 FY 2007-08.