Mobility in Ratings and Credit Quality: FY12 to FY15

Following years of subdued and deteriorating credit quality, FY15 signalled an encouraging improvement in India's corporate credit quality, as captured by the changes in credit ratings assigned to the various businesses and firms that have sought debt finance from the markets and financial institutions. With higher number of rating upgrades and reaffirmations to downgrades, the fiscal year gone by emerged as reversing the weak/subdued credit quality of domestic firms in the previous 3 fiscals.

These findings have been enumerated in our analysis here of the changes of credit rating assigned (upgrades, downgrades and reaffirmations) to the entities that are rated by CARE Ratings over the last 16 quarters (Q1 FY12 to Q4 FY15) or 4 years (FY12 to FY15). Credit ratings, in addition to effectively capturing the financial health of the rated entities and thereby the prevailing credit quality of the system, also provides valuable insights into the underlying economic health of the country. Moreover, given the large and diverse set of entities rated by CARE Ratings, the movement in credit ratings assigned can be regarded as being representative of the general business and economic scenario of the country. We have thus also examined here the relationship between credit quality and economic growth and based on the extent of correlation between the two seek to gain a forward guidance on the overall economic environment.

We have further segregated our analysis to showcase the changes in credit quality based on the size of the organisation (Large Enterprises and SME[1]) as well as industry-wise and thereby pin-point the segments and sectors that have seen an improvement, deterioration or stability in their credit profile.

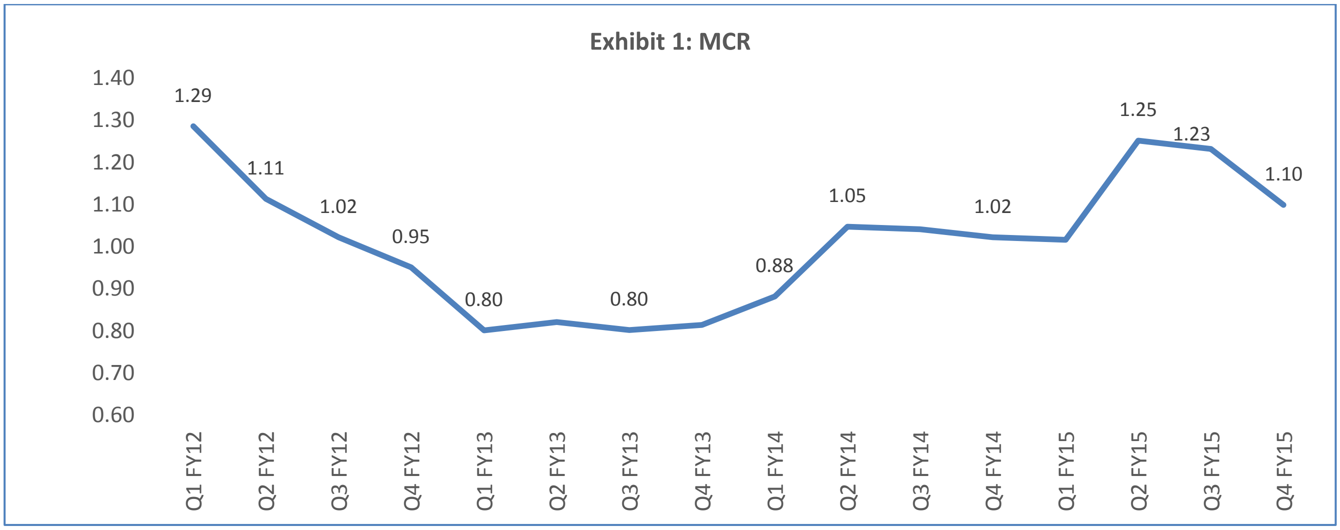
Modified Credit Ratio (MCR)

CARE's Modified Credit Ratio (MCR) helps measure mobility in ratings. It is defined as the ratio of (upgrades and reaffirmations) to (downgrades and reaffirmations). An increase in MCR denotes an increase in upgrades vis-à-vis downgrades while a decrease in MCR shows the reverse. In other words, an increase in the MCR implies stable and improving credit quality of the rated entities. An MCR closer to one indicates higher stability in ratings, with larger proportion of reaffirmations.

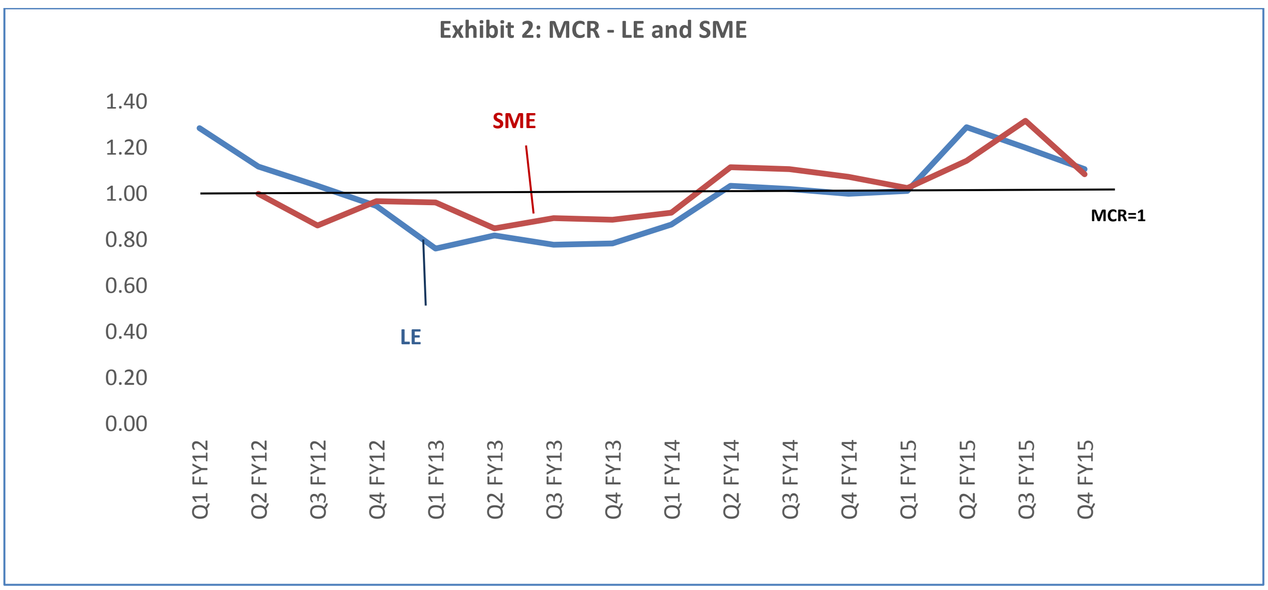
There has been a notable improvement in the credit quality of domestic rated entities/firms in FY15 as evidenced by the increases in CARE's MCR for the year. The MCR for FY15 rose to a 4-year high of 1.14 from 1.01 in FY14. The ratio had dropped to a low 0.81 in FY13 from 0.99 in FY12. Although faring favourably on a year-on-year basis as well on a quarterly basis, the last quarter of FY15 did witness a moderation in the ratio (to 1.10) following the encouraging readings for Q2 FY15 (1.25) and Q3 FY15 (1.23,) where the MCR touched the highest levels in over 3 years. Despite having declined, the MCR in Q4 FY15 has been higher than that recorded in the other 8 quarters to Q1 FY15, reflecting the improving financial health of the rated entities.

[1] CARE defines SME (Small and Medium Enterprise) as entities that have a turnover up to Rs. 100 cr and a debt size of Rs. 50 crs

Exhibit 1 below captures the movement in MCR over the last 16 quarters. The ratio has progressed steadily since Q2 FY14, with the ratio of over 1, reflecting the stability at the system level.



Source : CARE Ratings



Credit Quality – Large Enterprise (LE) and SME

Comparing the annual movement in MCR of the Large Enterprises and SME segments, it can be seen that while there has been an improvement in the ratio in case of LEs as well as SMEs in FY15, the improvement has been more pronounced in the case of LEs. The MCR of for LEs has risen from 0.99 in FY14 to 1.14 in FY15 while in case of SMEs it has risen from 1.06 in FY14 to 1.13 in FY15. The large enterprises have recorded a MCR of above 1 since Q2 FY14, reflecting stable and improving credit conditions. Likewise, the SME segment too has recorded an MCR of above 1 in the corresponding period. However, comparing the trend in MCR for both the segments (exhibit 2) it can be seen that the fluctuations in the credit quality of the SME segment have been more pronounced in the last 2 quarters of FY15 (the MCR moved from 1.32 in Q3 FY15 to 1.08 in Q4 FY15).

There has been a significant increase in the number of upgrades in the LE segment in FY15. In absolute number, 645 entities have seen their ratings being upgraded during the year, compared to the 343 entities that saw a rating upgrade in FY14. The comparative figures for upgrades for the SME segment have been 300 in FY15 and 174 in FY14.

Trend in Rating Movement

The trend in rating movements in CARE rated entities shows that upgrades have been outnumbering downgrades, in the last 2 years. Also, a higher number of entities have had their ratings being reaffirmed. In FY15, 945 entities saw their ratings being upgraded (compared with 517 in FY14), 501 entities had their ratings downgraded (487 in FY14) and 2783 entities had their ratings being reaffirmed (2461 in FY14).

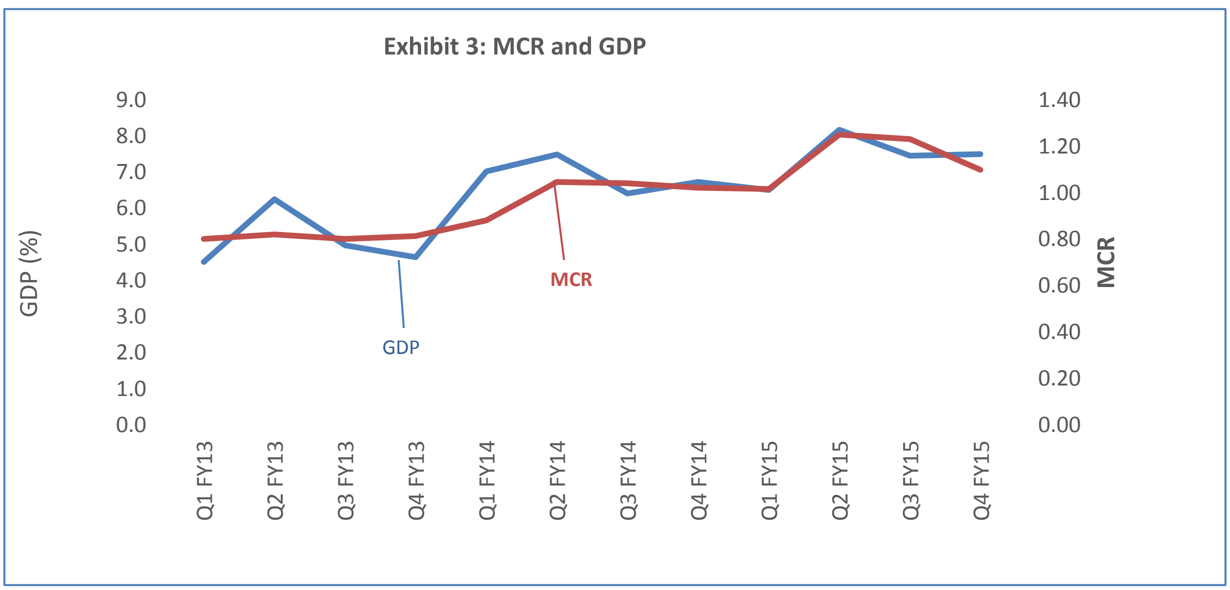


Exhibit 3 highlights the strong correlation, of 0.84, between the MCR and GDP (based on 2011-12 base year) during Q1FY13 to Q3FY15. The improvements in the MCR are reflective of the improving domestic economic environment and fundamentals. The weakness in the MCR in FY13 can thus be largely attributed to the weakness in the country's economy.

Industry wise Rating Action

A comparison of the MCR across 33 major sectors for the various years has been given in table 1

- There has been a notable improvement in the credit quality across sectors in FY15. Among the major sectors barring sectors such as sugar, non-ferrous metals, hospitality and some financial companies, all the sectors have seen their MCR improve (above 1) compared to FY14.
- The sectors that have recorded noteworthy improvement in credit quality (MCR of above 1.2) in FY15 from that in the previous year include – paper, textiles, ceramics, electricity (T&D), pharmaceuticals, computer hardware & electronic products, agriculture, information & communication, NBFC and auto.
- Rubber & plastic products, food products, fabricated metal products, education, transport, construction electrical equipment, telecom, iron & steel, real estate activities, wholesale and retail trade and cement are the other sector that have seen stable to improved credit quality.

Table 1: Industry-wise Movement in MCR

Industry	2011-2012	2012-2013	2013-2014	2014-2015
Agriculture, forestry and fishing	1.00	0.91	1.18	1.22
Auto	1.38	0.92	0.97	1.20
Banks	1.16	0.87	0.80	0.97
Cement and related products	1.00	0.82	1.03	1.03
Ceramics	0.94	0.69	0.93	1.32
Chemicals and chemical products	1.11	0.94	1.04	1.26
Computer hardware, electronic and optical products	0.83	0.46	1.07	1.27
Construction	0.93	0.75	0.90	1.13
Education	0.97	0.79	1.00	1.15
Electrical Equipment	0.87	0.69	0.93	1.11
Electricity - Generation	0.98	0.79	0.85	1.22
Electricity - T & D	0.63	0.80	1.00	1.30
Fabricated metal products	1.27	0.86	1.08	1.15
Financial Institution	1.00	0.86	0.92	1.00
Food and food products	1.07	0.86	1.08	1.15
Hospitality	0.79	0.78	0.96	0.85
Information and communication	0.92	0.80	1.03	1.22
Iron and Steel	0.90	0.79	0.99	1.07
NBFC	1.00	1.00	1.14	1.20
NBFI	1.23	1.00	1.09	1.15
Non ferrous Metals	0.93	0.73	0.97	0.91
Other Financial companies	1.00	1.08	1.00	0.94
Other Machinery	0.94	0.73	1.00	1.05
Other Manufacturing	1.11	0.85	1.04	1.07
Paper and paper products	1.13	0.80	1.00	1.41
Pharmaceuticals	0.98	0.75	1.00	1.29
Real Estate activities	0.79	0.89	0.96	1.05
Rubber and plastics products	1.05	0.76	1.15	1.17
Sugar	0.56	0.82	1.13	0.96
Telecom	1.50	0.39	0.87	1.09
Textiles	0.97	0.85	1.25	1.34
Transportation and storage	0.86	0.71	0.94	1.15
Wholesale and retail trade	1.05	0.87	1.00	1.04

Contact:

Arun Kumar	***Kavita Chacko***
Chief General Manager - Ratings	***Economist***
arun.kumar@careratings.com	*kavita.chacko@careratings.com*
	91-022-61443593