CARE Ratings
Professional Risk Opinion

Credit Quality in FY16

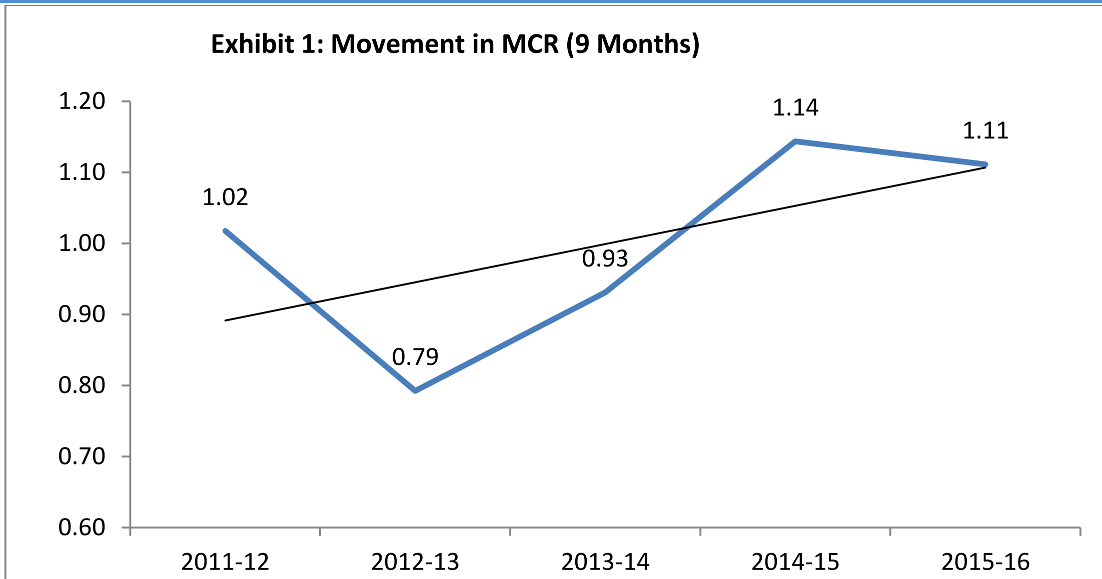
An assessment of the credit quality of the rated entities, gathered from the mobility or changes in the credit ratings assigned to the entities, indicates that quality of corporate credit has been on a steady path of improvement since the second quarter of 2013-14. Although a moderation in the overall credit quality of corporates has been witnessed in the ongoing fiscal i.e. for the 9 month period of FY16 compared with the corresponding period in FY15, the quality of corporate credit can nevertheless be viewed as predominantly exhibiting a fair degree of stability on a sustained basis.

Illustrated here are the findings of our analysis on the credit ratings changes of the entities in our portfolio from 2011-12 onwards. The changes or movement in credit ratings of the various entities reflect the improvements, stability and weakness in the financial health of the entities. Given the large quantum and diverse set of entities rated by CARE Ratings, the cumulative findings can be treated as being representative of the overall system.

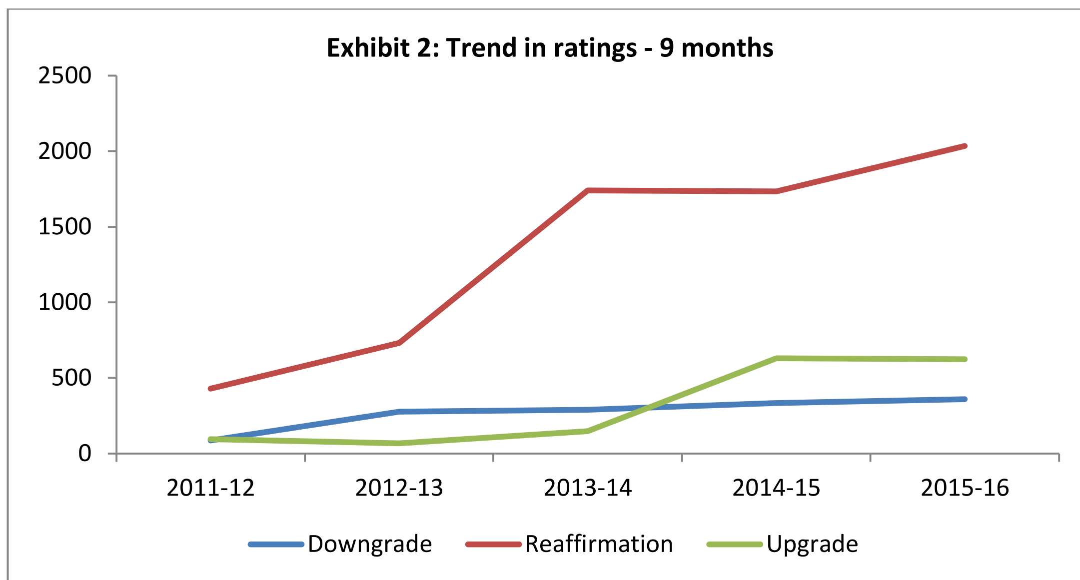
Modified Credit Ratio (MCR)

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 an improving credit quality of the rated entities. An MCR closer to one indicates higher stability in ratings, with larger proportion of reaffirmations.

Exhibit 1 below captures the movement in MCR for 9 months period for the financial year over the years (5 years period). It is seen that the weakness in the MCR ratio (of ratio below 1) that prevailed in 2012-13 and 2013-14, reversed and significantly improved in the subsequent 2 years. The ratio has been steady at over unity or 1 in the last 2 years and has been reflecting an upward trend, indicative of the overall improvement and stability in credit quality at the system level.



Trends in Rating Movement



The extent of rating changes as well as the trend in the same is shown in exhibit 2 above. An analysis of the trend in the rating movement of the entities rated by CARE shows that:

- For the last 10 quarters (since Q2 FY14), upgrades have been outnumbering downgrades, indicating the improvement in the credit quality.
- The higher number of reaffirmations reflects the stability in the credit markets.
- Downgrades have seen a favourable decline from the highs of Q4 FY13.

Industry wise ratings changes

The industry-wise credit quality for the 9 months period of FY16 is highlighted in Table 1 below

Table 1: Industry-wise rating action- 9M FY16

Industry	Downgrade	No Change	Upgrade	MCR
Auto	10	54	16	1.09
Banks	7	30	1	0.84
Cement and related products	11	17	7	0.86
Chemicals and chemical products	14	73	22	1.09
Construction	55	207	67	1.05
Education	9	44	13	1.08
Electrical Equipment	9	57	12	1.05
Electricity - Generation	27	72	34	1.07
Food and food products	13	69	39	1.32
Hospitality	10	40	5	0.90
Iron and Steel	31	106	30	0.99
Manufacture of apparel	2	14	5	1.19
NBFI	4	111	13	1.08
Nonferrous Metals	6	14	2	0.80
Other manufacturing	27	115	62	1.25
Paper and paper products	5	28	10	1.15
Pharmaceuticals	6	40	17	1.24
Real Estate activities	14	92	31	1.16
Rubber and plastics Products	1	36	18	1.46
Sugar	4	17	4	1.00
Textiles	20	172	44	1.13
Transportation and storage	4	58	19	1.24
Wholesale and retail trade	10	150	18	1.05
Others	59	419	135	1.75

The factors that have aided upgrades across sectors can be broadly classified as being on account of improvements in operations, income and profit margins, debt service indicators and favourable changes in capital structure. **The segments and sectors that witnessed a notable improvement in credit quality given the high quantum of reaffirmations and upgrades are** –

(i) **Auto** – Credit quality aided by the growth in income, improved profit margins and improvements in scale of operations and capital structure

(ii) **Chemicals** – The improvements in the scale of operations, operating performance, export incomes are some of the reasons that have contributed to the rating upgrades and reaffirmations of entities in the sector.

(iii) **Pharmaceuticals**- The upgrades in the sector were on account of the stable and higher growth in revenues with increase in sales volumes and product expansion, improvements in liquidity position and profit margins.

(iv) **Wholesale trade –** The financial health of the entities of the sector was driven by improvements in the scale of operations, profitability and cash accruals. Further there have been improvements in overall liquidity position.

(v) **Real estate activities –** Comfortable to healthy booking advances and progress in projects, increases in rental incomes, improvements in debt coverage indicators and capital structure all helped in the upgrades for the segment

(vi) **Electricity generation –** Improved operational performance, timely completion of projects, improvements in profit margins, favourable liquidity position and improvements in debt servicing have helped in the credit quality of the entities of the sector

(vii) **Rubber and plastics –** The upgrades in the sector were on account of continuous increase in scale of operations and increase in income, profit margins and debt coverage indicators.

(viii) **Food products –** Scaling up of operations**, g**rowth in total income, stabilization of operations and improvements in capital structure primarily helped in strengthening the financial health of the entities in the sector.

(ix) **Textiles -** The increase and stabilization in overall operations, improvements in capital structure and debt coverage indicators, comfortable levels of profit margins are some of the reasons that helped in the credit quality of the companies in the sector .

The downgrades were the highest for the construction, iron & steel and manufacturing sectors. Delay in debt servicing were the primary drivers for the downgrades. In addition, changes in credit profile, deterioration of profitability margin and liquidity profile, decline in operating incomes and overall poor financial performance were some of the other reasons prompting downgrades. Factor such as project delays, changes in scale of operations and cost overruns were some of the reasons specific to the construction sector downgrades. In case of Iron & Steel, the slowdown in the industry and plant closures added to the strain.

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