

Assessment of Credit Quality of Rated Entities in Q1 2019-20

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There has been a deterioration in the credit quality of entities rated by CARE Ratings in the first quarter of the ongoing financial year which attests to the prevailing slowdown in the domestic economy. The credit quality as measured by CARE Ratings 'modified credit ratio' (MCR), for Q1 2019-20 declined to a 6 year low of 0.8. The ratio in the corresponding period of 2018-19 was 1.02.

While the moderation in credit quality which is indicative of the higher number of credit rating downgrades has been across categories and sectors, it has been more pronounced in the case of small enterprises (total revenues less than Rs.100 crs) as well as for entities who carried 'below investment grade' ratings (credit rating below CARE BBB-). The stability in credit quality of the large and medium enterprises (LME) and the entities that have 'investment grade' rating have been sustaining and limiting the moderation in credit quality at the aggregate level. The SME segment accounted for 45% of the ratings reviewed by CARE Ratings in Q1 2019-20

The credit rating downgrades of entities in Q1 2019-20 has been largely on account of liquidity pressure leading to, at times, delays in debt servicing, high debt levels, weakening profit margins, decline in scale of operations, deterioration in capital structure and debt coverage indicators. At the same time, the reaffirmation and upgrade of ratings of entities has been influenced by the entities with favourable financial position/ profitability, increase in scale of operations, comfortable debt servicing parameters, liquidity position and capital structure. Company and industry specific factors too have influenced the rating changes.

Modified Credit Ratio: Concept and Trend

The Modified Credit Ratio (MCR) is defined as the ratio of (upgrades and reaffirmations) to (downgrades and reaffirmations).

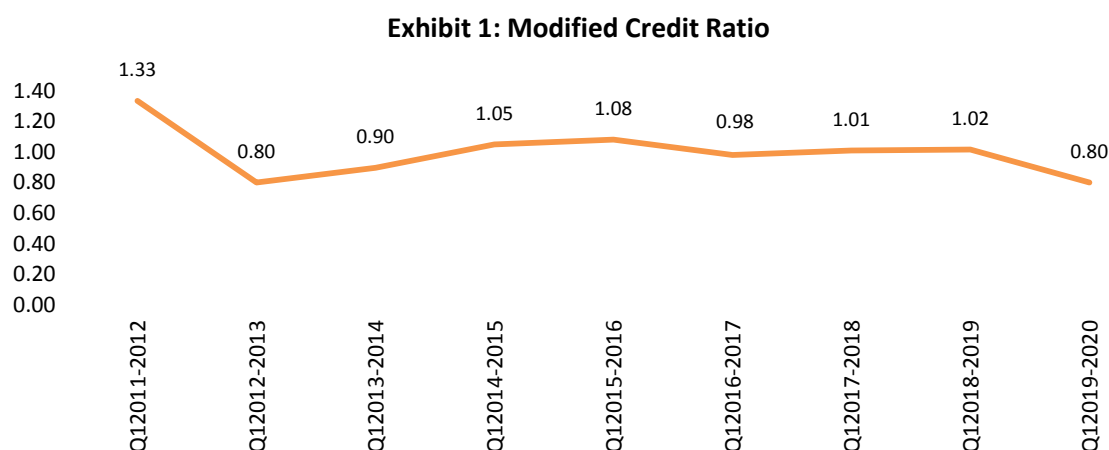
An increase in MCR denotes an increase in upgrades vis-à-vis downgrades, whereas a decrease in MCR shows the reverse. In other words, an increase in the MCR implies an improving credit quality of the rated entities while a decline in the same signals a deterioration in credit quality of the rated entities. An MCR closer to one indicates higher stability in the ratings, with a larger proportion of reaffirmations.

The movement of the MCR consequent to the periodic review of the credit rating of the rated entities (which point out the improvement, stability or weakness in the financial profile of these entities over time) not only helps measure mobility in ratings but is also seen as being

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reflective of the changes in credit quality in the system given the large quantum and diverse set of entities rated by CARE Ratings.

Exhibit 1 captures the movement in MCR in the first quarter since 2011-12 and Table 1 and Table 2 captures the category wise MCR. The MCR excludes cases in the category of “Issuers Not Co-operating”.



The MCR in Q1 2019-20 has been the lowest when compared with the corresponding quarters of the last 6 years and is at the same level as of Q1 2012-13 when the domestic economy was faced with a slowdown.

While the moderation in credit quality is witnessed in both the SME and LME segment, the deterioration in credit quality has been sharper for the smaller enterprises (Table 1).. Similarly, the credit quality of the ‘below investment grade’ entities witnessed a greater decline (Table 2). The ‘below investment grade’ entities are mainly small enterprises (85% share). Thus the deterioration in overall credit quality can largely be ascribed to the SME segment. The SME segment accounted for 45% of the ratings reviewed by CARE Ratings in Q1 2019-20. The decline in the credit quality of the SME segment can largely be attributed to the liquidity crunch and decline in operating profits which has led to deterioration in their credit risk profile.

The MCR for the entities with ‘investment grade’ credit rating was close to unity in Q1 2019-20 (0.93), despite the moderation from 1.06 in Q1 2018-19, reflective of the stability in their credit profile.

Table 1 : MCR- LME and SME¹

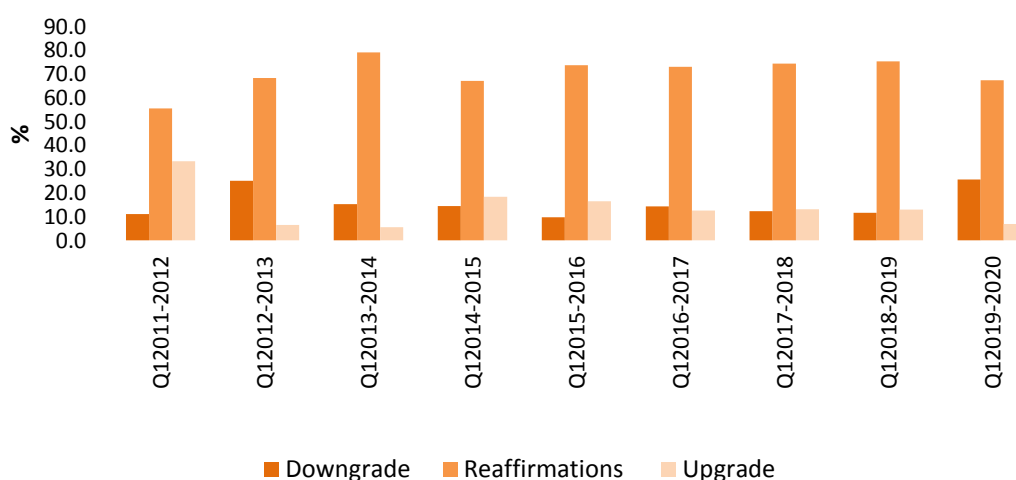
Period	LME	SME
Q1 2012-2013	0.77	0.95
Q1 2013-2014	0.91	0.86
Q1 2014-2015	1.06	1.02
Q1 2015-2016	1.06	1.12
Q1 2016-2017	0.98	0.98
Q1 2017-2018	1.02	0.98
Q1 2018-2019	0.99	1.10
Q1 2019-2020	0.88	0.71

Table 2 : MCR- Invest Grade and Below Investment Grade Companies

Period	Invest Grade Companies	Below Investment Grade Companies
Q1 2012-2013	0.89	0.62
Q1 2013-2014	0.97	0.82
Q1 2014-2015	1.22	0.90
Q1 2015-2016	1.22	0.96
Q1 2016-2017	1.11	0.84
Q1 2017-2018	1.08	0.94
Q1 2018-2019	1.06	0.95
Q1 2019-2020	0.93	0.73

In Q1 2019-20, 67% of the ratings reviewed were reaffirmed, indicative of the stability in credit quality for the majority of entities that were rated during the period. Although a higher quantum of ratings were reaffirmed in the first quarter of the current fiscal year, it was nevertheless lower than the 75% of reaffirmations of ratings reviewed in the corresponding quarters of the preceding 4 years (Q1 2015-16 to Q1 2018-19). The share of downgrades in total rating actions more than doubled from 12% a year ago to 26% in Q1 2019-20, while share of upgrades declined from 13% to 7%.

Exhibit 2: Percentage of Upgrades, Downgrades and Reaffirmations



Industry-wise Rating Movements

Of the 28 key sectors, the credit quality as measured by the MCR was above unity (1) for entities belonging to 4 sectors viz. information technology, cement, electricity generation, electricity transmission and distribution and healthcare (Exhibit 1). It was close to unity for sectors such as hospitality (0.95), auto (0.93), beverages (0.92), NBFC (0.91). MCR of 1 and close to unity highlights the stability in credit quality of the entities of these sectors in Q1 2019-20.

¹ SME- Small Enterprise (total revenue less than Rs.100 crs)

Exhibit 3: Sector with MCR > 1 in Q1 2019-20

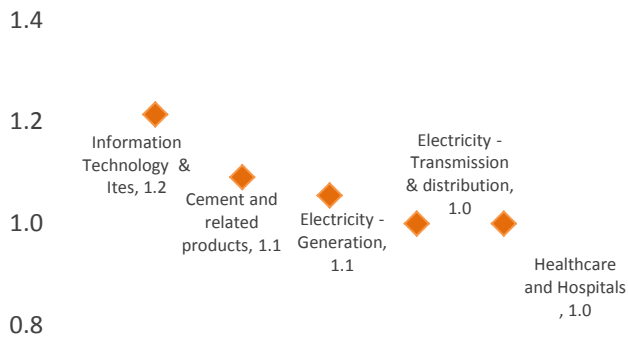
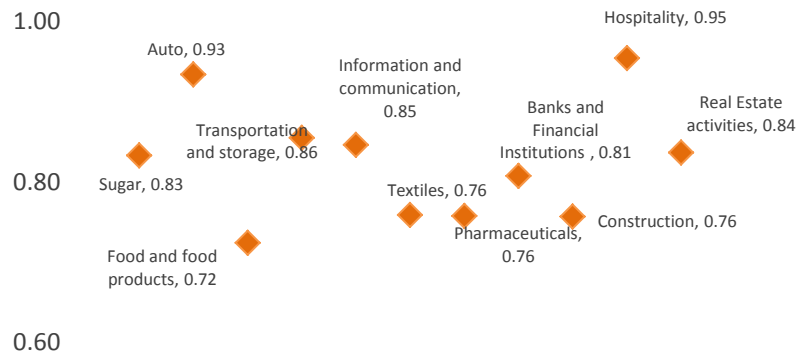


Exhibit 4: Sectors with MCR < 1 in Q1 2019-20



The MCR across key industries during the first quarter of the financial year for the 5 year period Q1 2015-16 to Q1 2019-20 is highlighted in Table 3 below.

Table 3: Industry-wise MCR

Industry	Q1 2015-2016	Q1 2016-2017	Q1 2017-2018	Q1 2018-2019	Q1 2019-20
Agriculture, forestry and fishing	1.00	0.58	1.18	1.08	0.75
Auto	0.97	1.00	1.12	1.11	0.93
Banks and Financial Institutions	1.25	1.00	0.87	0.90	0.81
Beverages	0.60	0.50	1.12	1.29	0.92
Cement and related products	0.63	1.00	1.18	1.25	1.09
Ceramics	1.75	1.00	1.00	1.00	0.79
Chemicals and chemical products	1.18	0.90	1.05	1.00	0.75
Construction	1.00	0.91	1.01	1.03	0.76
Cotton	1.50	0.75	0.90	1.25	0.85
Education	1.19	1.11	1.11	0.97	0.72
Electrical Equipment	1.00	1.13	0.88	1.38	0.67
Electricity - Generation	0.91	1.00	1.29	1.10	1.06
Electricity - Transmission and distribution	1.20	1.00	1.25	0.85	1.00
Food and food products	1.42	1.11	1.05	1.14	0.72
Hospitality	0.95	1.07	1.07	0.82	0.95
Human health and social work activities	1.30	1.20	1.10	0.58	1.00
Information and communication	1.44	1.30	0.91	1.00	0.85
Information Technology & ITes (IT Enabled Services)	1.17	1.33	1.00	0.83	1.21
Iron and Steel	1.02	0.78	0.89	1.03	0.77
NBFC and NBFI	1.07	1.01	1.07	1.05	0.91
Other manufacturing	1.14	0.99	0.90	1.06	0.74
Pharmaceuticals	1.07	0.89	0.92	0.93	0.76
Real Estate activities	1.00	0.97	0.84	0.92	0.84
Rubber and plastics Products	1.31	1.22	1.19	0.94	0.80
Sugar	1.00	1.07	1.00	0.91	0.83
Textiles	1.20	1.07	1.02	1.06	0.76
Transportation and storage	1.26	0.56	0.92	1.05	0.86
Wholesale and retail trade	1.04	0.94	0.96	0.98	0.77

- 8 sectors witnessed an MCR closer to one which indicates a larger proportion of reaffirmations. For 19 sectors, the average MCR was 0.78.

