Assessment of Credit Quality of Rated Entities in Q1 FY19

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The credit quality of the entities rated by CARE Ratings for the first quarter of the current fiscal (Q1 FY19) has been seen to be fairly stable. There has been a marginal improvement in credit quality of rated entities as measured by CARE Ratings '*modified credit ratio' (MCR)* in Q1 FY19 when compared with that in the corresponding period last year i.e. Q1 FY18.

Modified Credit Ratio (MCR)

CARE Ratings' Modified Credit Ratio (MCR) which is defined as the ratio of (upgrades and reaffirmations) to (downgrades and reaffirmations) was 1.02 in Q1 FY19, slightly higher than the ratio of 1.01 in Q1 FY18.

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.

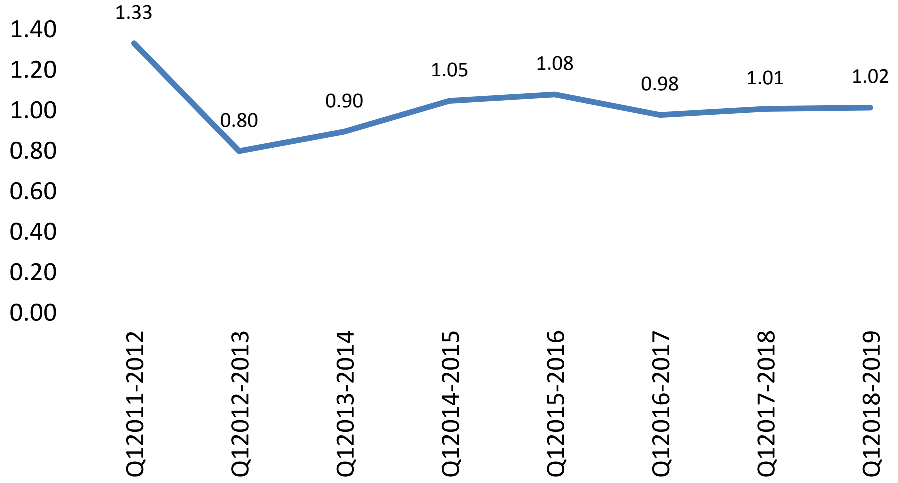
The movement of the MCR consequent to the periodic review of the credit rating of the rated entities (which point out the improvement, stability or weakness in the financial profile of these entities over time) not only helps measure mobility in ratings but is also seen as being reflective of the changes in credit quality in the system given the large quantum and diverse set of entities rated by CARE Ratings.

The large proportion of reaffirmations and the higher number of upgrades during the first quarter of the current fiscal (Q1 FY19) attests to the relative stability in the prevailing credit quality in the system. The MCR of entities rated by CARE Ratings has been over 1 since Q2 FY14, signifying the sustained overall stability in credit quality for the past 5 years.

Exhibit 1 captures the movement in MCR during the first quarter of the last 8 fiscal years[1] i.e. Q1 FY12 to Q1 FY19. The MCR excludes cases in the category of "Issuers Not Co-operating".

[1] **Fiscal year refers to the period between 1 April to 31 March.**

Exhibit 1: Modified Credit Ratio (MCR)



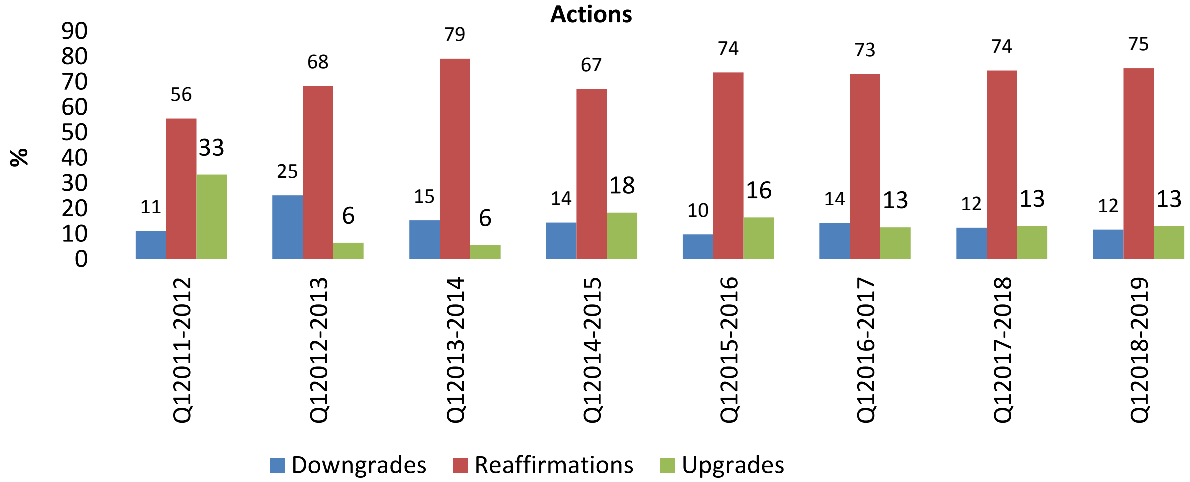
Source: CARE Ratings

Trend in MCR

Exhibit 2 below highlights the rating actions undertaken during the first quarter of the fiscal year in recent years. The findings have been summarized as below

- On an average, 70% of the ratings reviewed by CARE Ratings have been reaffirmed. Reaffirmations as a percentage of total ratings reviewed improved marginally from 75% in Q1 FY18 to 76% in Q1 FY19.
- In Q1 FY19, the share of upgrades as well as downgrades was relatively was stable at 13% and 12% when compared with that in the previous year (Q1 F18).
- Higher profitability margins, significant improvement in the liquidity parameters & debt servicing indicators, comfortable capital structure and strength derived from promoters & management team prompted the rating upgrades.
- Declining profitability, adverse capital structure, deterioration in debt servicing parameters (delays/default in debt servicing) and worsening liquidity positions were the primary factors that led to rating downgrades.

Exhibit 2: Percentage of Downgrades, Reaffirmations and Upgrades to Total Rating Actions



Source: CARE Ratings

Industry-wise Rating Movements

The MCR across key industries in the first quarter of the fiscal year for the 4 year period of Q1 FY16 to Q1 FY19 is highlighted in Table 1 below.

Table 1: Industry-Wise MCR

Industry	Q1	Q1	Q1	Q1
Auto	0.97	1.00	1.12	1.11
Banks	1.50	1.00	0.60	0.60
Beverages	0.60	0.50	1.12	1.29
Cement and related products	0.63	1.00	1.18	1.25
Ceramics	1.75	1.00	1.00	1.00
Chemicals and chemical products	1.18	0.90	1.05	1.00
Construction	1.00	0.91	1.01	1.03
Education	1.19	1.11	1.11	0.97
Electrical Equipment	1.00	1.13	0.88	1.38
Electricity - Generation	0.91	1.00	1.29	1.10
Electricity - Transmission and distribution	1.20	1.00	1.25	0.85
Fabricated metal products	1.00	1.22	0.92	0.89
Food and food products	1.42	1.11	1.05	1.14
Hospitality	0.95	1.07	1.07	0.82
Hospitals	1.30	1.20	1.10	0.58
Information Technology & ITES (IT Enabled Services)	1.17	1.33	1.00	0.83
Iron and Steel	1.02	0.78	0.89	1.03
NBFC	1.13	1.00	1.27	1.00
Paper and paper products	1.19	1.00	1.17	1.09
Pharmaceuticals	1.07	0.89	0.92	0.93
Real Estate activities	1.00	0.97	0.84	0.92
Rubber and plastics Products	1.31	1.22	1.19	0.94
Sugar	1.00	1.07	1.00	0.91
Telecom	1.20	2.00	0.88	0.90
Textiles	1.20	1.07	1.02	1.05
Transportation and storage	1.26	0.56	0.92	1.05
Wholesale and retail trade	1.04	0.94	0.96	0.98

- The overall industry- wise analysis shows that 14 key industries had an MCR greater than or equal to 1, while 13 industries had an MCR less than 1.
- Auto, beverages, cement, construction, electrical equipment, electricity -generation, food & food products, iron & steel, paper & paper products, textiles and transportation & storage are the key industries that have seen an favorable credit quality in Q1-FY19 (i.e. an MCR >1).
- The sectors, which witnessed overall deterioration in the credit quality in Q1- FY19 i.e. MCR <1, included banks, education, electricity – transmission & distribution, fabricated metal products, hospitality, information technology & ITES hospitals, pharmaceuticals, real estate activities, rubber & plastic products, sugar, telecom, wholesale and retail trade .
- Ceramics, chemicals & chemical products and NBFCs were the sector registered stable credit quality in Q1-FY19 (MCR = 1)
- The downgrades of banks was mainly on account of the high levels of NPAs, higher net losses reported due to higher provisioning, deterioration in capital adequacy parameters and asset quality .Restrictions imposed on banks under the prompt corrective action (PCA) framework of the RBI also weighed on the credit quality of certain banks.
- The higher number of upgrades in the electricity equipment segment can be ascribed to improved capital structure, growth in total operating income, healthy profitability margins & order book and comfortable liquidity and debt servicing indicators.
- The improved credit quality of cement and related products can be ascribed to comfortable liquidity parameters, improved profitability, timely debt servicing, improvement in financial performance and favourable capital structure.
- The deterioration in credit quality of real estate firms has been driven by decline in total operating income owing to slowdown in the sector, significant delays in implementation of projects with time and cost over-run, cancellation of projects, delays in debt servicing, adverse capital structure and weakening liquidity positions.
- MCR for telecom segment continues to remain below unity with intense competition and evolving technology in the segment resulting in a dip in profitability, delays in debt servicing and worsening liquidity position.
- The decline in the MCR of Electricity – Transmission and Distribution can be ascribed to lower profitability and higher exposure to group companies and delays in debt servicing.
- The credit quality of beverages sector improved in Q1-FY19 primarily on account of improvements in operating profit margins, better debt service management indicated through better interest coverage ratios, pre-payment of term liabilities and comfortable capital structure.

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