Credit Quality: Apr – Dec FY18

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The movement in the credit ratings of entities rated by CARE Ratings in the first three quarters of FY18 (Apr – Dec) illustrates the overall improvement in credit quality of these entities. There have been 39% more upgrades than downgrades during this period.

Credit Rating and Modified Credit Ratio (MCR)

The changes in credit rating of the rated entities reflect improvement, stability or weakness in the financial health of these entities. These changes are captured in CARE Ratings' Modified Credit Ratio (MCR), and the movement of the MCR helps measure mobility in ratings. It is thus, reflective of the changes in credit quality in the system.

CARE Ratings' 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. An MCR closer to one indicates higher stability in the ratings, with a larger proportion of reaffirmations.

The changes in credit quality as measured by MCR since 2011-12 have been summarized below. 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.

Exhibit 1 captures the movement in MCR in the first three quarters of the fiscal years FY12-18. The MCR for Apr – Dec FY18 was 1.06 times, and indicates stability in credit quality. It excludes cases in the category of "Issuers not co-operating".

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Exhibit 1: Modified Credit Ratio (Apr - Dec)

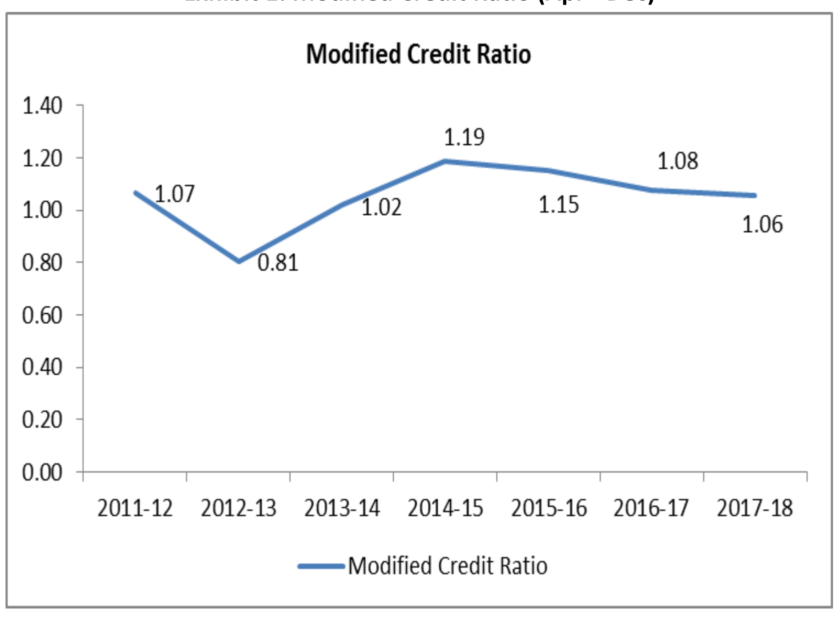
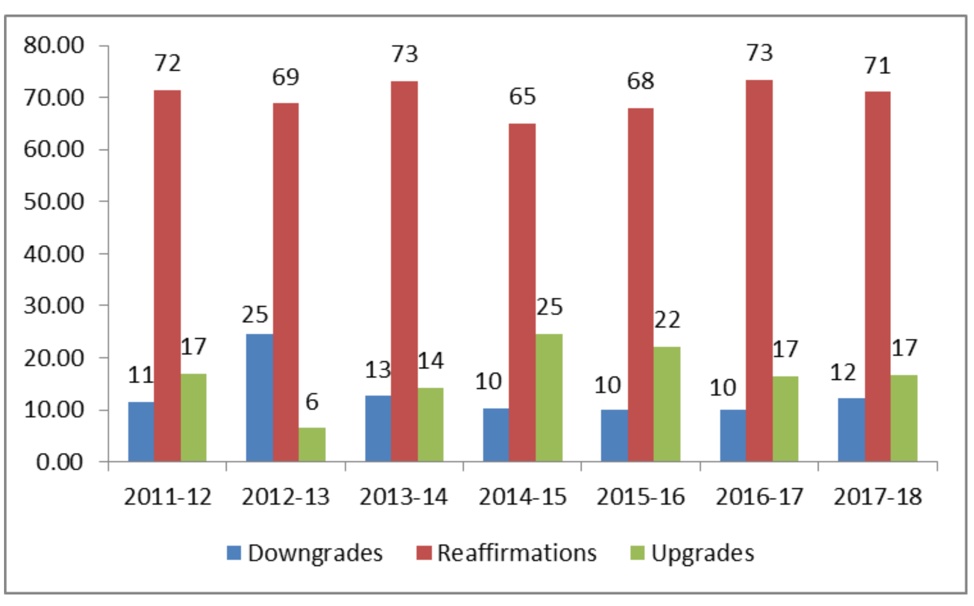


Exhibit 2 below showcases the rating actions undertaken by CARE Ratings in the first three quarters of the fiscal year in the last 7 years and the trend during the same.

- On an average, 70% of the rating actions undertaken by CARE Ratings have been reaffirmed. Reaffirmations as a percentage of total rating actions increased from 68% in 9MFY16 to 71% during the corresponding period in FY18.
- The share of reaffirmations fell from 73% to 71% from Apr-Dec 2016 to Apr-Dec 2017. In 9MFY18, downgrades accounted for 12% of rating actions (excluding Non-cooperation cases), whereas upgrades accounted for 17% of the same.
- The number of entities that have been downgraded in Apr - Dec of the current fiscal has increased by 46% over the corresponding period in the previous year, while upgrades have risen by 23%. Total re-affirmations have grown by 17% during the same period.
- During 9MFY18, the upgrades among entities rated were on account of improvement in financial and operational performance primarily reflected through an increase in scale of operations, rise in profitability, improvement in capital structures and debt protection metrics whereas the downgrades among entities rated were on account of weakening credit profiles reflected through delays in project execution, declining income and profitability, stressed liquidity position, leveraged capital structure and deteriorating asset quality (primarily in banking and financial institutions).

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



Industry-wise Rating Movements

The MCR across key industries during April-December in FY16 – 18 is highlighted in Table 1 below.

Table 1: Industry-wise MCR

Industry	Apr – Dec FY16	Apr – Dec FY17	Apr – Dec FY18
Auto	1.11	1.09	1.12
Banks	0.84	0.95	0.89
Beverages	0.84	0.73	1.14
Cement and related products	0.92	1.42	1.43
Ceramics	2.19	1.24	1.29
Chemicals and chemical products	1.11	1.16	1.16
Construction	1.11	1.05	1.05
Education	1.25	1.02	1.13
Electrical Equipment	1.09	1.30	1.05
Electricity – Generation	1.14	1.06	1.28
Electricity - Transmission and distribution	1.13	1.00	1.29
Food and food products	1.41	1.07	1.07
Hospitality	0.93	1.35	1.18
Human health and social work activities	1.35	1.56	1.15
IT, ITES and Communication	1.13	1.20	1.02
Iron and Steel	1.06	0.97	1.02
NBFC, NBFI, Financial Institutions and Other Financial Companies	1.08	1.07	1.07
Other Machinery	1.08	1.02	1.16
Other Manufacturing	1.32	1.09	0.94
Pharmaceuticals	1.36	0.98	1.20
Real Estate activities	1.20	1.00	0.91
Rubber and plastics Products	1.45	1.44	0.96
Sugar	1.00	1.27	1.05

Industry	Apr – Dec FY16	Apr – Dec FY17	Apr – Dec FY18
Telecom	1.73	1.10	0.77
Textiles	1.18	1.17	1.13
Transportation and storage	1.31	1.82	0.95
Wholesale and retail trade	1.07	1.11	0.96

- Auto, Cement and related products, Ceramics, Iron and Steel, Pharmaceuticals, NBFC, NBFI and Other Financial Companies, Electricity (generation and transmission & distribution) and Textiles are some of the key sectors that witnessed an overall rise in credit quality in the nine months of current fiscal year (i.e. an MCR >1). These sectors registered a higher number of rating reaffirmations and upgrades.

- Banks, Financial Institutions, Real Estate, Rubber and Plastic Products, Telecom and Transportation and Storage are some of the sectors which witnessed an overall deterioration in credit quality (MCR <1).

- The number of upgrades outpaced the number of downgrades in the auto sector (including both auto ancillary and auto dealers) in 9MFY18 which was primarily triggered by overall optimism witnessed in this industry. The series of interest rates cuts along with push on infrastructure segment by the government have resulted in recovery of auto sector. Industry stands to benefit from this turnaround in Original Equipment Manufacturers (OEM) demand and stable replacement demand. Upgrades were also triggered by improvement in capital structure due to equity infusion in few players operating in this segment and reduced debt levels.

- The decline in MCR of banks in 9MFY18 is due to deterioration in asset quality, thus impacting profitability and capitalization levels. There was higher number of upgrades as compared to downgrades in NBFCs, NBFI and other financial institutions i.e. majorly in housing finance companies given increase in loan portfolio and comfortable asset quality with capital adequacy parameters. NBFCs were also benefited by relatively higher credit growth vis-à-vis banks given challenges faced by public sector banks.

- There were nil downgrades in companies operating in cement segment in nine months of current financial year. Although there was a short-lived decline in cement prices post demonetization, it witnessed growth on an annual basis in FY17 primarily on account of increased prices in northern markets. Government's increased focus on rural market along with higher infrastructure spends also triggered upgrades in the cement sector.

- MCR for Electricity Generation companies has also improved in 9MFY18, mainly in the Renewable energy sector, which is aided by boost provided to the sector by the Government attracting strong promoter groups and companies establishing strong debt protection mechanisms and liquidity cushions in the form of credit enhancement measures. Successful completion of projects, improvement in plant load factor and tie up of power purchase agreements led to the improvements in credit quality in this sector. The upgrades in the Electricity-Transmission and Distribution industry have been aided by improvements in debt coverage indicators, capital structure, growth in scale of operations and comfortable liquidity position.

- The deterioration of overall credit quality among real estate firms has been driven by tepid sales, delays in debt servicing and delayed implementation of projects and weakening liquidity positions. Downgrades in the sector increased in the first three quarters of FY18, with re-affirmations witnessing a marginal decline from 78% to 77%.

- The decline in credit quality in rubber and plastic industry in 9MFY18 primarily pertains to companies in sub investment category and is driven by leveraged capital structure and weakening of debt coverage indicators. Also,

price increase of raw material i.e. rubber mainly in H2FY17 and Q1FY18 had an impact on the profitability of this segment.

- MCR for steel sector improved in 9MFY18 on improving supply demand fundamental, increased domestic demand and rising exports and ramping up of capacity of newly commissioned facilities.
- MCR for telecom segment witnessed a decline in credit quality with intense competition prevailing in the segment resulting in dip in profitability and worsening of liquidity position for companies operating in this segment.

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