

Study: Industry Confidence Index

To gauge the confidence level in industry an index has been calculated which looks at 6 different parameters of which 5 are objective in nature while the last is based on CARE's subjective view of the sector outlook

The Confidence Index aims to quantify change in fundamental and financial performance across key sectors in the economy. The score/index is arrived at by giving objective scores based on the following factors:

- Revenue growth,
- Operating margins,
- Pricing power,
- CARE's Modified Credit Ratio,
- Interest coverage,
- Outlook.

This is done on a quarterly basis where comparisons are made over the same quarter of the previous year (revenue growth, pricing power, profit margin and interest cover ratio). In case of pricing power, the WPI or CPI is used to gauge whether there are any gains on pricing. This is important because in an era where producer prices keep coming down, there are disadvantages for companies which have to then cut down on costs. In case of the MCR the cumulative ratios is looked at for Q1, H1 (for second quarter), 9M for (third quarter) and full year (fourth quarter). The outlook factor is subjective and based on CARE's view of the same.

While there could be Multicollinearity between these variables, it is assumed that each one represents a separate facet of the industry's confidence level.

The Confidence index is based on views on 46 industries which include key sectors across consumer goods, services, industrial & manufacturing, construction & infrastructure, and commodities and is scalable across time and number of sectors.

Methodology

The 'net response method' is used here where the internal Survey is with analysts tracking 46 industries provide answers. The analysts post their views on how their sector looks like on the chosen parameters. The response is 'improved', 'worsened' or 'remained same' based on predefined criteria. The shares of responses under each parameter are then tabled for the three confidence levels. The Index is then calculated as follows:

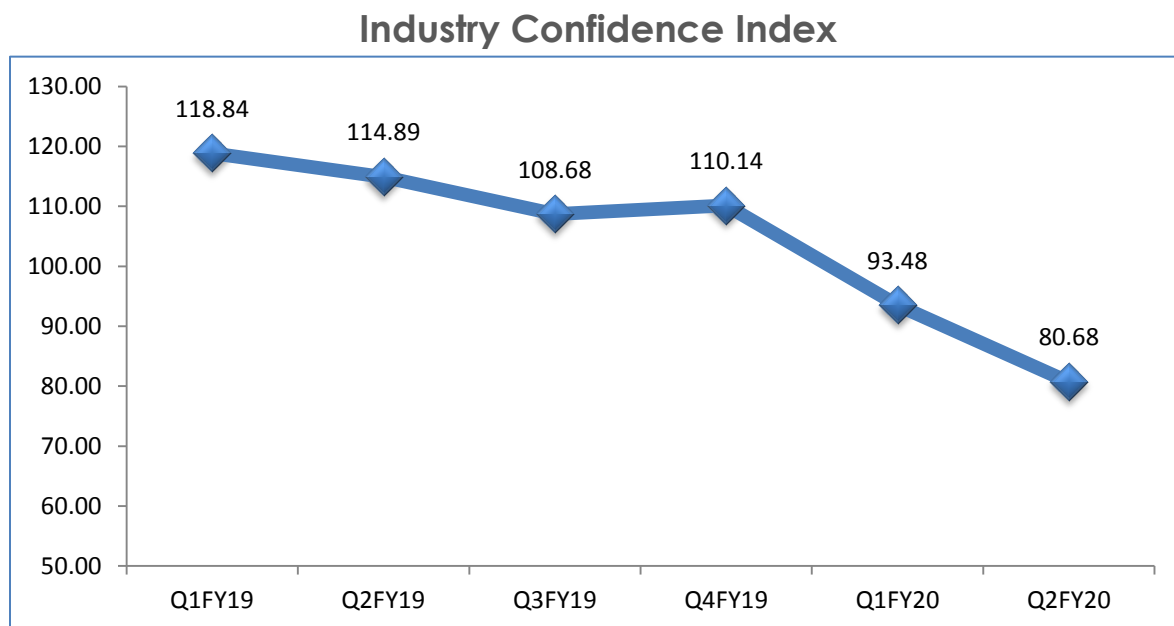
Step 1: Net Responses for each parameter = Share of 'improved' – Share of 'worsened'

Step 2: Confidence Index = 100 + Average of Net responses

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Therefore, in this Survey where 6 variables are examined and a net response is calculated for each one of these variables and the Confidence Index would be 100+ (average net responses for the six variables). Theoretically it can range from 0 (all variables are worsening) to 200 (all variables are improving)

Index Movement



Compiled on the basis of scores in the Model, "This score has been arrived at and is the view of CARE Ratings' analysts and not that of industry participants."

The Industry Confidence Index shows a decline during Q2 and Q3 of FY19, and a slight improvement during Q4 FY19. Subsequently it has declined in the next two quarters to a low of 80.7 in Q2FY20 vs 114.9 in Q2FY19.

The index witnessed sharp decline, mainly on the back of high negative net response across 4 of the 6 parameters: *Revenue, Pricing Power, Rating Changes and Interest Coverage*. The net response for revenue parameter was 57% during Q2FY19 which indicated higher proportion of industries reporting positive growth in revenue in that quarter. But the same for Q2FY20 is -54%, which indicates decline by 103 percentage points over the last one year and decline of 41 percentage points post Q1FY20. Monsoons and economic slowdown have impacted the topline of companies across major sectors which has led to more industries reporting de-growth in revenues or revenues remaining unchanged during the current financial year.

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Table: Movement of Net Responses across parameters

	Revenue (Standalone)	Operating Margin	Pricing Power	CARE MCR	Interest Coverage	Outlook
Q1FY19	43%	33%	11%	-10.9%	7%	30%
Q2FY19	57%	-4%	6%	-9%	6%	32%
Q3FY19	40%	-4%	13%	-33%	6%	31%
Q4FY19	26%	28%	4%	-43%	22%	24%
Q1FY20	-13%	20%	4%	-22%	-24%	-4%
Q2FY20	-54%	7%	-9%	-33%	-24%	-2%

The other parameters which contributed to negative movement in the index are interest coverage (-24% vs 6% in Q2FY19) and CARE's Modified Credit Ratio (-33% vs -9% in Q2FY19). The numbers are not indicative of change in actual interest coverage, but only difference between number of industries reporting improvement in interest coverage and number of industries reporting decline in interest coverage.

Similarly, pricing power also recorded a decline across sectors/products as a result of low demand and resultant under-utilization of installed capacity.

On the other hand, Operating Margins continued to be the only parameter which recorded positive net responses during Q2FY20 (7% vs -4% in Q2FY19).

Net responses on outlook remained stable but has declined by 34 percentage point compared with Q2FY19 but has recorded a 2 percentage point improvement from Q1FY20.

Outcome & Summary

The index for Q2FY20 substantiates the current economic downturn and its impact on various parameters on industries. Revenues, operational performance, pricing power and improvement/deterioration in ability to meet their financial costs and obligations- among the six parameters have continued to show visible signs of strain.

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Appendix: Methodology Used

Why have these parameters been chosen?

Three broad categories have been considered here for measuring the industry confidence level. A factor that has been kept in mind is that objective data should as far as possible be available on each parameters so as to remove bias. However, a 'subjective' factor can still be added and call taken and there is nothing sacrosanct about all factors being objective.

A. Financial performance

- Revenue growth tells us about how the industry has fared in in terms of improved, declined or remained stable
- Operating margin is reflective of how the companies have performed at the operational level and other factors like improvement in terms of efficiency and cost control.
- Pricing power is important especially during business cycles and hence adds to the confidence level. **For this parameter, Wholesale Price Index, Consumer Price Index or relevant industry pricing benchmarks have been used.**

B. Creditworthiness

- MCR tells us upfront whether the industry has done well in terms of the rating changes. Here the CARE MCRs are used to gauge the extent to which the confidence levels are better or worse.
- Interest coverage ratio is taken to be reflective of debt serviceability and improvement or decline in finance costs for the industry.

C. Outlook

- Outlook for the sector takes into consideration global and domestic factors which have a bearing on the industry over the coming quarters as well as the quarter for which the industry index has been derived. The factors taken to arrive at an outlook includes but is not limited to: impact of currency movements, commodity prices, policy both local as well as global, capacity addition and utilization etc. The analyst has to identify key factors which impact their sector and then provide an objective reasoning on what impact it would have on the sector in the subsequent year/quarter. ***Outlook is the only subjective element among all parameters used in calculation of this index.***

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