

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 one 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 factors like:

- Revenue growth,
- Operating margins,
- Pricing power,
- CARE's Modified Credit Ratio (MCR),
- 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 50 industries which include key sectors across consumer goods, services, industrial & manufacturing, construction & infrastructure, BFSI, and commodities and is scalable across time and number of sectors.

Methodology

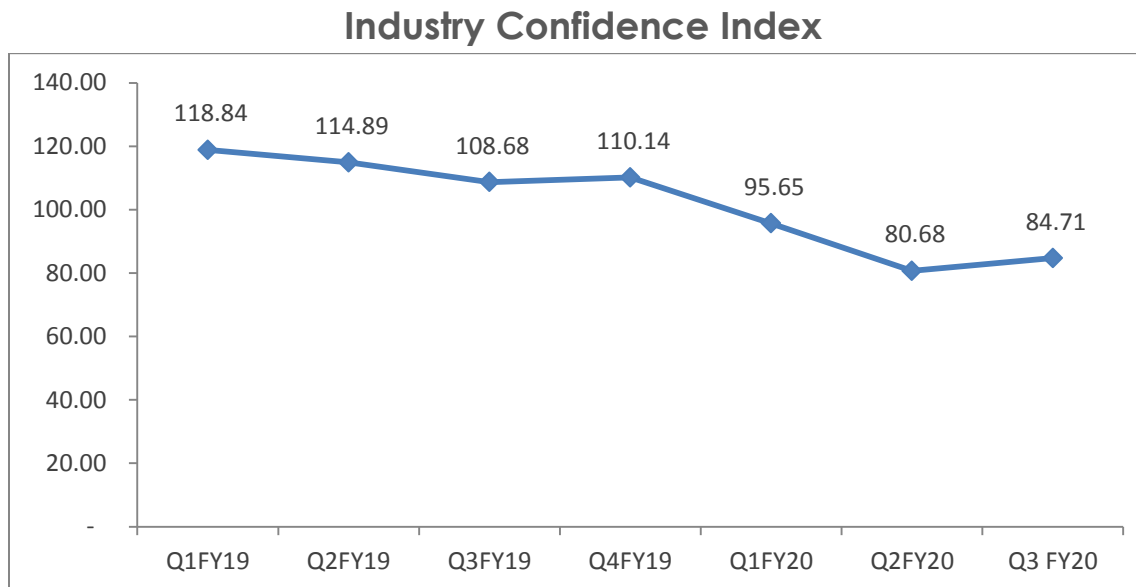
The 'net response method' is used here where the internal Survey is with analysts tracking these 50 industries provide answers. The analysts post their views on how their sector looks like on the chosen parameters. The response is 'improved', 'worsened' 'remained same' based on predefined criteria. The 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

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 in Q2 and Q3 of FY19, and a slight improvement in Q4 FY19. Subsequently it has declined in the next two quarters to a low of 80.7 in Q2 FY20 vis-à-vis 114.9 in Q2 FY19. **In Q3 FY20, the Index witnessed a marginal improvement on a q-o-q basis to 84.7 vis-à-vis Q2 FY20, however, on a y-o-y basis, the index continues to show a decline.**

The index witnessed sharp decline, mainly on the back of high negative net response across 4 of the 6 parameters: *Revenue, Rating Changes, interest Coverage and the Outlook for the industry* during the quarter. The net response for revenue parameter during Q3 FY19 was 40% which indicated higher proportion of industries reporting positive growth in revenue in that quarter while net response for Q3 FY20 is -48%, indicating lower revenues on a y-o-y basis for most of the industries covered in the study. Sustained economic slowdown in the country has impacted the topline of companies across major sectors during FY20 which has led to more industries reporting de-growth in revenues or revenues remaining unchanged during the current financial year.

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%
Q3 FY20	-48%	8%	10%	-26%	-22%	-14%

Note: BFSI has been excluded for evaluating movement of net responses for Interest coverage

The other parameters which contributed to negative movement in the index are interest coverage (-22% vis-à-vis 6% in Q3 FY19) and the outlook for various industries which is negative or muted going forward (-14% vis-à-vis 31% in Q3 FY19). The numbers are not indicative of change in actual industry outlooks, but only difference between number of industries expected to witness improvement/weakness going forward. CARE's Modified Credit Ratio (MCR) continued to remain negative, however, it did not deteriorate further and registered 26% decline in Q3 FY20, vis-à-vis a decline of 33% in Q3 FY19 as well as Q2 FY20 each.

Similarly, pricing power also recorded a marginal 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 Q3 FY20 (8% vis-à-vis -4% in Q3 FY19).

Outcome & Summary

The index for Q3 FY20 substantiates the current economic downturn and its impact on various parameters on industries. Revenues, operational performance and margins, product pricing and 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.

Methodology Used

Which are the parameters included here?

The six parameters considered here are:

Parameters	% of Improvement	% of worsening	% No change	% improvement minus % worsening (Net Responses)
Revenue growth				▲ R
Profits (operating profit margin)				▲ OPM
Pricing Power				▲ PP
Rating Changes (CARE MCR)				▲ R
Interest cover				▲ IC
Outlook				▲ O
Average of the Above (Σ)	XX	XX	XX	=(Average of All ▲)
Index Final				100+ Σ

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 Industry Confidence Index is being 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.***

Some guidelines kept in mind when evaluating the confidence level in any industry

Basis for responses						
	Revenue	OPM	Pricing Power*	Rating (MCR)	Interest Coverage	Outlook
Improvement	Increase over 0.5%	Improvement in margin	Increase	Sectoral MCR over 1	An increase in coverage ratio	A favorable movement in factors taken into consideration.
Unchanged	Growth or de-growth of 0.5%	Steady or upto 10bps	Steady or upto 10 bps	MCR at 1	Steady coverage ratio with excl. upto 10bps change either direction	No change in the factors considered.
Worsening	De-growth of over 0.5%	Decline over 10 bps	Decline of over 10bps	MCR less than 1	Decline in coverage ratio.	Any deviation in the factors considered as well as decline due to unfavorable business sentiments.

**Based on WPI, CPI or other industry-wide or global benchmarks*

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