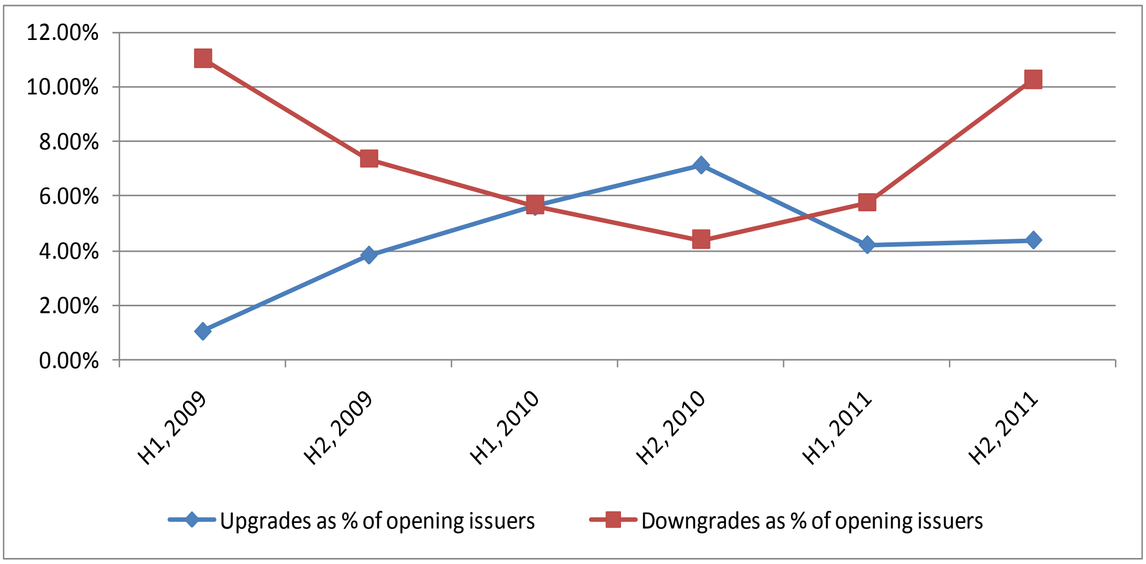
Performance of ICRA-Assigned Ratings
Update for 2011

Downgrades on the rise in H2, 2011: hotels, power, textile, metals & mining, sugar, engineering affected the most

This rating feature presents a study of the changes in ICRA-assigned ratings, in terms of upgrade and downgrade, in calendar year 2011. There has been a sharp increase in downgrades in the second half (H2) of 2011 (even from the elevated levels of H1, 2011), while rating upgrades as a percentage of opening issuers have declined. The key findings of the study are captured in the charts and the bullet list that follow.

Chart 1: Half-Yearly Trend in Rating Upgrades and Downgrades



- The trends in rating upgrades and downgrades have been in line with ICRA's anticipation, as highlighted in the earlier ICRA studies on rating performance[1]. Following adverse changes in the operating environment, the total number of rating downgrades as a percentage of opening issuers reported a sharp increase from 4.4% in H2, 2010 to 5.8% in H1, 2011, and further to 10.3%[◊] in H2, 2011.

- Over the same period, the total number of rating upgrades declined from 7.1% (H2, 2010) to 4.4% (H2, 2011).

- An analysis of the rating actions during the last four halves indicates that the inverse credit ratio[2], which after having declined from 1.01 in H1, 2010 to 0.62 in H2, 2010 rose to 1.36 in H1, 2011 and further to 2.34[∇] in H2, 2011, was driven primarily by a significant increase in rating downgrades.

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◊ However, the sharp increase in rating downgrades in H2, 2011 is also partly attributable to the change in rating definitions following the SEBI circular of June 2011. If we were to exclude such cases of rating downgrades, the percentage would be lower at 6.1% for H2, 2011.
2 The ratio between downgrades and upgrades
∇ 1.38 after excluding the downgrades on account of change in rating definition

- As much as 75% of the issuers downgraded in H2, 2011 had been rated in the Non-Investment grade at the beginning of H2, 2011, as against 69% in H1, 2011 (65% in H2, 2010), indicating that a significant proportion of the downgrades in H2, 2011 involved issuers with relatively weaker credit profiles.

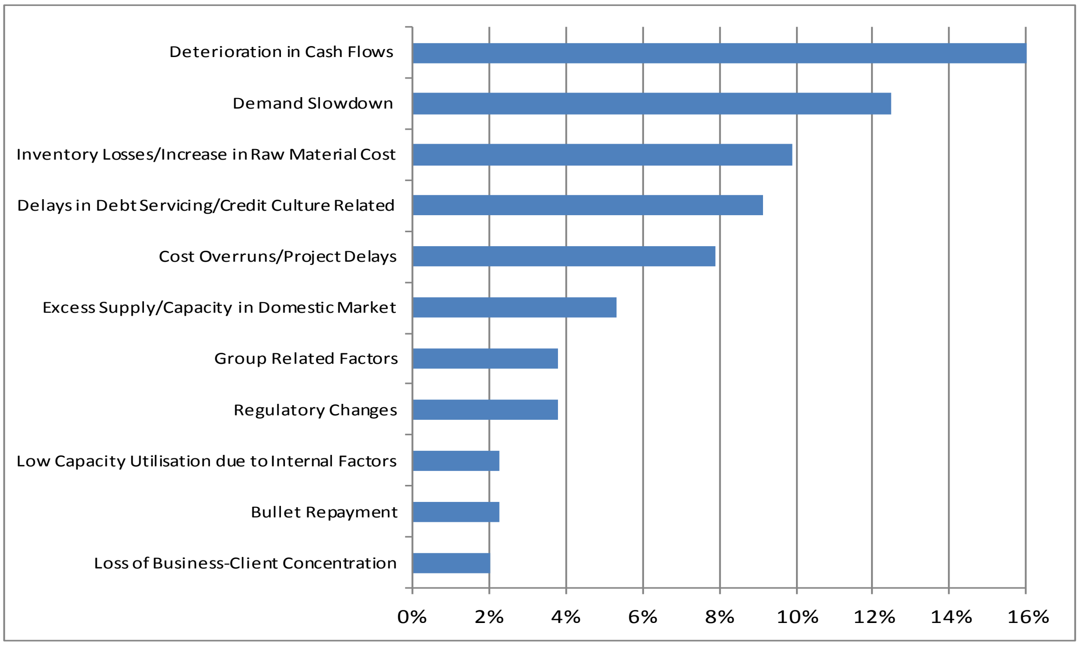
- In terms of sectors, the ones in which most of the rating downgrades were effected during H2, 2011 included, among others: textiles; metals & mining; real estate & construction; food & food products; and power/power related infrastructure companies. These sectors accounted for about 48% of the downgrades in H2, 2011. As for upgrades, the main sectors in which the upgrades happened during H2, 2011, included, among others: real estate & construction; auto ancillaries; textiles; gems & jewellery; and food & food products. These sectors accounted for about 39% of the total upgrades during the period under review.

- Sectors that witnessed large downgrades and had a high inverse credit ratio in H2, 2011 were hotels (inverse credit ratio of 15 times), and power (12.5). Apart from these, textiles, metals & mining, sugar, food & food products, and engineering reported higher inverse credit ratios (2.6 to 5.6) than the average for the overall rating changes (2.34) effected during H2, 2011.

Cash flow deterioration, demand slowdown, pressure on profitability key reasons for downgrades in Q4, 2011

The distribution of rating downgrades (effected in the fourth quarter, or Q4, of 2011) across key causative factors[3] is depicted in *Chart 2.*

Chart 2: Key Reasons for Rating Downgrades in Corporate Sector in Q4, 2011



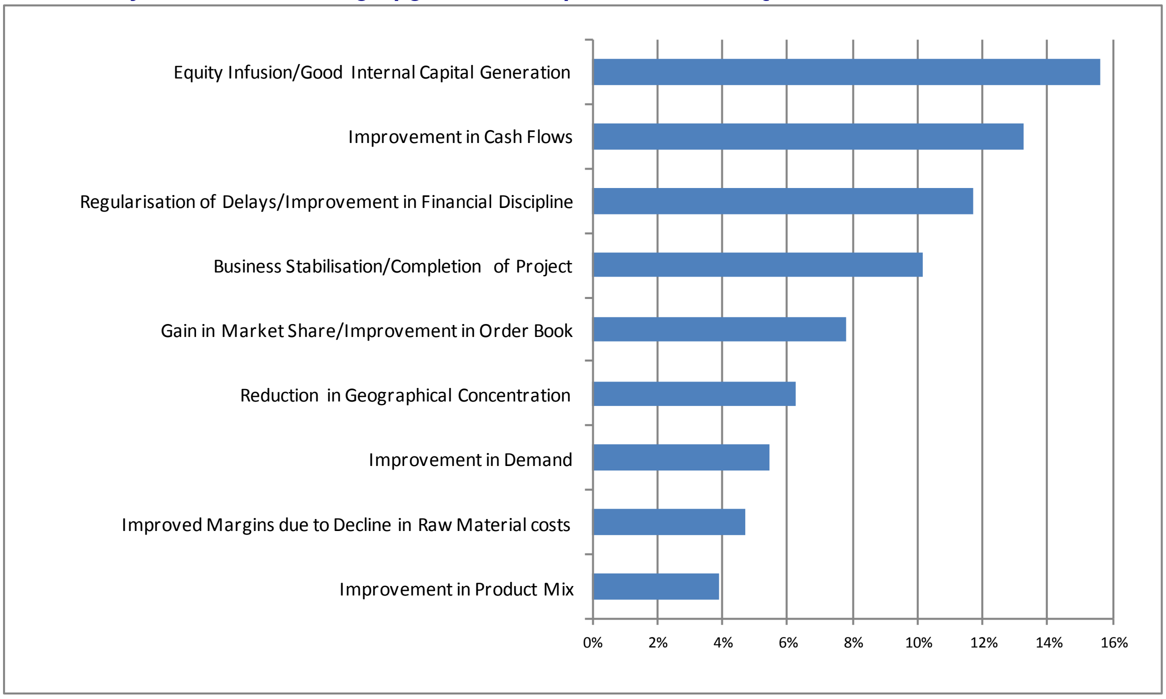
As *Chart 2* shows, deterioration in cash flows, demand slowdown, inventory losses/increase in raw material cost and delays in debt servicing have been the key reasons for the rating downgrades in Q4, 2011. Also, most issuers downgraded because of delays in debt servicing, were already in the Non-Investment grade at the time of downgrade.

[3] Multiple reasons could have led to a rating change

Rating upgrades prompted mainly by company-specific factors

The distribution of rating upgrades (effected in Q4, 2011) across key causative factors is depicted in *Chart 3*.

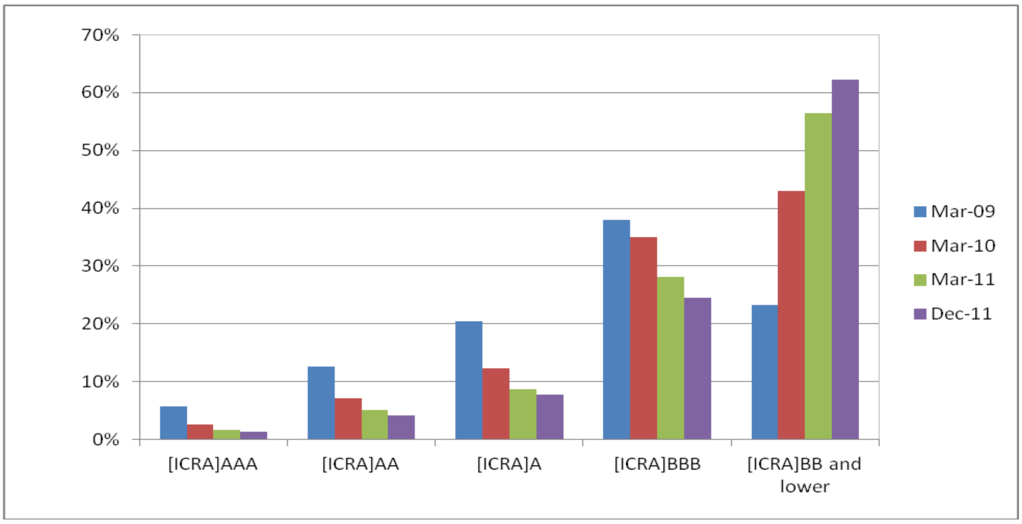
Chart 3: Key Reasons for Rating Upgrades in Corporate Sector in Q4, 2011



As *Chart 3* shows, the rating upgrades during Q4, 2011 were prompted mainly by company-specific factors. Improvement in capital structure, reduction in working capital intensity following decrease in inventories/receivables, improved financial discipline, and business stabilisation were the top reasons for the rating upgrades. Further, most issuers that were upgraded because of reasons related to credit culture/regularisation of delays continued to be rated in the Non-Investment grade.

Composition of ICRA-rated universe continues to shift towards lower investment grade categories

Chart 4: Distribution of ICRA-Assigned Long-Term Ratings Outstanding by Category



As *Chart 4* shows, the proportion of lower rated issuers has increased significantly over the last two years. The percentage of entities rated in the LBBB or lower rating categories increased from 28% as on March 31, 2008 to 85% as on March 31, 2011, and further to 87% as on December 31, 2011. This shift is attributable to the large “inflow” of bank loans in the rating universe, besides to a significant increase both in the number of ratings assigned and in the acceptance of lower category ratings.

Outlook

Going forward, ICRA expects the operating environment to remain challenging and rating volatility to remain high, given that the rated universe now has more of lower rated issuers, for whom rating stability is typically lower. However, while the inverse credit ratio is likely to remain adverse (that is, downgrades are likely to exceed upgrades), the sharp downward revision seen recently may be expected to moderate on the strength of the following factors:

- Likely shift in monetary stance and improvement in liquidity conditions
- Moderation in cost of funds, as interest rates are likely to have peaked
- Decline in concerns over excessive incremental leveraging as a large number of companies adjust to the difficult operating environment and have placed large investments on hold
- Reduction in competitive intensity for new projects
- Greater stability in the exchange rate of the Indian rupee, especially in the context of the sharp depreciation seen over the last two quarters

However, sectors especially those with linkages to the global markets remain exposed to stress in the international markets. Additionally, the following factors would continue to exert a downward pressure on ratings:

- Sluggish business outlook
- Intense competitive pressures
- Policy related uncertainties
- High leveraging concerns for entities in the midst of significant investments
- Limited access to equity markets
- Refinancing risks
- Project implementation delays

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