RATINGS ROUNDUP

FH 2007-08

After five years, CRISIL's downgrades exceed upgrades

Global acquisition and large capital expenditure drive rating actions

N Muthuraman Director - Rating Criteria & Product Development Tel.: +91 (44) 4214 5029 Email: nmuthuraman@crisil.com

Subodh K Rai Senior Manager - Rating Criteria & Product Development Tel.: +91 (11) 4250 5125 Email: srai@crisil.com

After five years, CRISIL's downgrades exceed upgrades

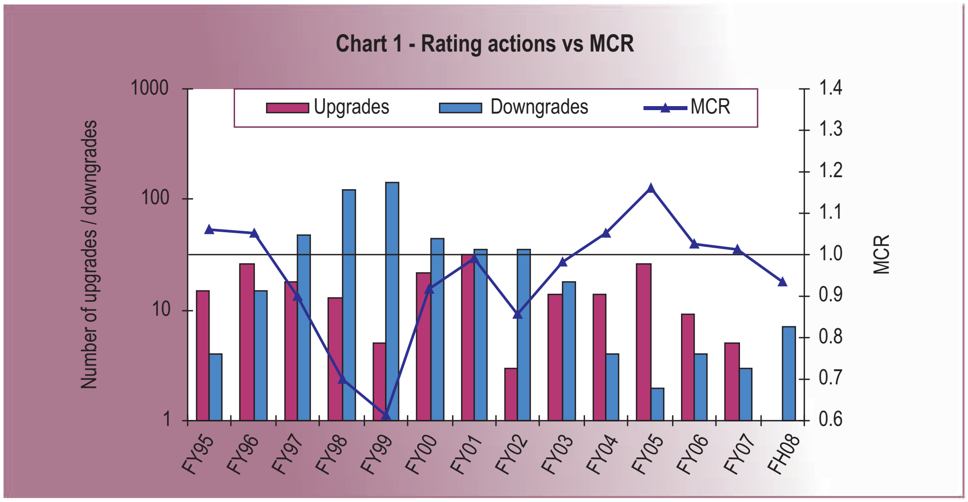
Global acquisition and large capital expenditure drive rating actions

CRISIL's modified credit ratio (MCR, the ratio of upgrades plus reaffirmations to downgrades plus reaffirmations) for the first half of 2007-08 (FH08) has dropped below 1 time - to 0.94 times - for the first time in five years. True to CRISIL's predictions in its Ratings Round-Up for 2006-07 (FY07), the downgrades during FH08 were driven largely by the increasing risk appetite of corporate managements. Six of the seven downgrades during FH08 were due to acquisitions, or large debt-funded capacity expansions, marking a sharp reversal in the hitherto improving trend of corporate India's credit quality.

CRISIL believes that changes in managements' attitude towards risk will continue to drive corporate India's credit quality. Strong financials can support increasing leverage and vaulting interest costs only to a certain extent; beyond this, aggressive acquisitions or capacity expansions will impact the creditworthiness. Successfully managing growth and integrating acquired entities, and the funding pattern for acquisitions and capacity expansions, are the other major factors that will drive credit quality over the remainder of the financial year. CRISIL expects that corporate India may also face profitability pressures going forward, on account of high input costs. This, coupled with high interest costs on account of a sharp increase in debt, may lead to pressure on companies' profitability margins, in turn affecting credit quality.

The declining MCR, and what it indicates

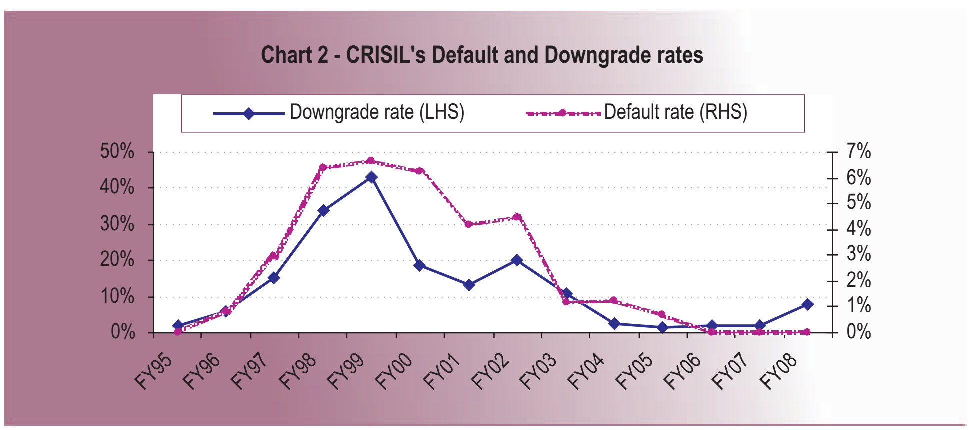
CRISIL's MCR is a strong indicator of systemic credit quality, and therefore of underlying business fundamentals (refer Box 1 for a correlation between CRISIL's MCR and key economic indicators). In FH08, CRISIL's MCR for long-term ratings reduced to less than 1 time (to 0.94 times) for the first time in five years, from a level of 1.16 times in FY05. The MCR for FH08 reflects one upgrade and seven downgrades in CRISIL's long-term ratings (refer Appendix 1 for CRISIL's upgrades and downgrades of long-term ratings in FH08). The last time downgrades outnumbered upgrades was in FY03, when an MCR of 0.98 was recorded.



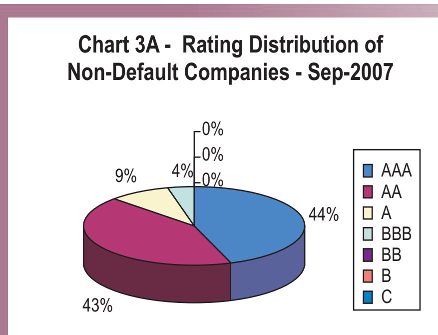
The decline in CRISIL's MCR marks a reversal in corporate India's trend of improving credit quality. The decline is in line with the view that CRISIL expressed in its Ratings Round-Up FY2006-07, that management attitude towards risk would continue to drive credit quality, with large capacity expansions affecting companies' credit profiles.

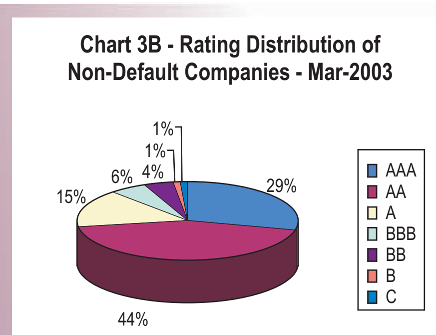
The increasing downgrade rate, and what it means

CRISIL's downgrade rate (defined as the ratio of downgrades in long-term ratings to outstanding long-term ratings) increased significantly to 8 per cent in FH08 from 1.7 per cent in FY07 (refer Chart 2).



The downgrades are typically one to two notches, and are unlikely to result in defaults immediately, since most CRISIL-rated companies remain in the high investment grade. The distribution of CRISIL ratings (refer Chart 3) shows that the number of companies in the 'AAA' rating category increased significantly to 44 per cent in FH08 from 29 per cent in FY03. No CRISIL-rated instrument has defaulted during the past 33 months; this is the longest period without defaults in more than a decade.





Rating Watch

CRISIL places a rating on watch when an event has occurred that has potential to impact the rating, but the impact of the event cannot be accurately assessed at the time. As on September 30, 2007, CRISIL had five ratings on watch (refer Appendix 1). Four of these were placed on watch as a result of acquisitions, or the undertaking of projects that were larger than the entities' current size of operations.

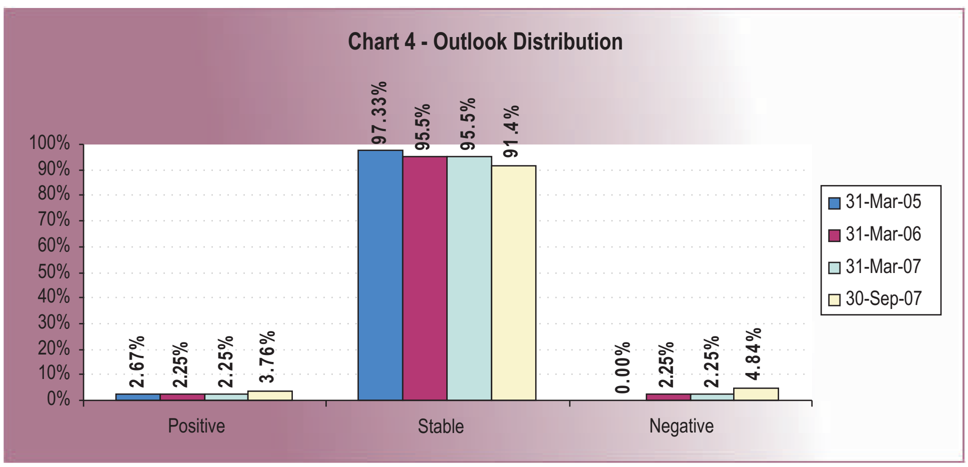
Table 1 Distribution of CRISIL's ratings on watch

	March 31, 2007	September 30, 2007
Rating watch with positive implications	0	1
Rating watch with developing implications	3	4
Rating watch with negative implications	3	0

Outlook Distribution

Rating outlooks, assigned by CRISIL since September 2003, have proven to be reliable lead indicators of the likely direction of rating movement. The proportion of positive and negative outlooks also indicates the potential direction of credit quality.

As on September 30, 2007, more than 91 per cent of CRISIL-rated entities had stable outlooks, reflecting CRISIL's view that no major changes were likely in the credit profiles of the vast majority of rated entities over the short to medium term (refer Chart 4). However, the share of stable outlooks has steadily declined to 91 per cent in September 2007 from 97 per cent in March 2005; the proportion of negative outlooks has correspondingly increased during this period.



Ratings with negative outlooks outnumber ratings with positive outlooks (9 to 7). Though the numbers of positive and negative outlooks remain small, the fact that negative outlooks outnumber positive outlooks indicates the increasing likelihood of rating actions resulting in downgrades.

Of the total ratings outstanding as on March 31, 2007, 7.7 per cent were either downgraded in FH08, or are on rating watch with negative implications, or carry negative outlooks, compared to a corresponding figure of 1.0 per cent for the whole of FY05.

A Sectoral View

All sectors of the Indian economy are represented among entities in CRISIL's rating portfolio. The following paragraphs indicate CRISIL's opinion on the prospects of the manufacturing, infrastructure[1], and financial sectors with regard to credit quality. The opinion factors in the increased risk appetite of Indian corporates, and its likely impact on credit quality; it also takes into account the corporates' strong financials, which will absorb some increase in business and financial risk.

The manufacturing sector accounted for most of the rating actions in FH08, with one upgrade and five downgrades. Among infrastructure companies, there were two downgrades in FH08, resulting in an MCR of 0.89 times. The downgrades were the result of large capacity expansions. There were no upgrades or downgrades among companies in the financial sector; this resulted in a sectoral MCR of 1 time for the sector in FH08 (refer Chart 5 for trends in sectoral MCRs).

Chart 5A - Sectoral MCR - Manufacturing

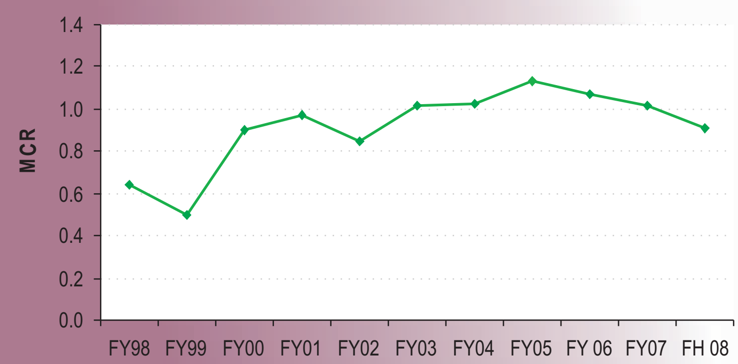
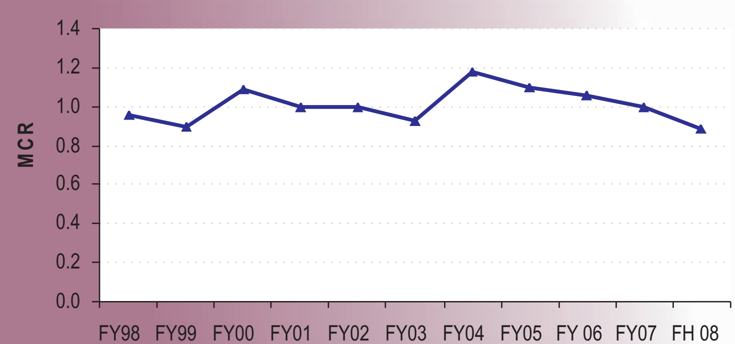
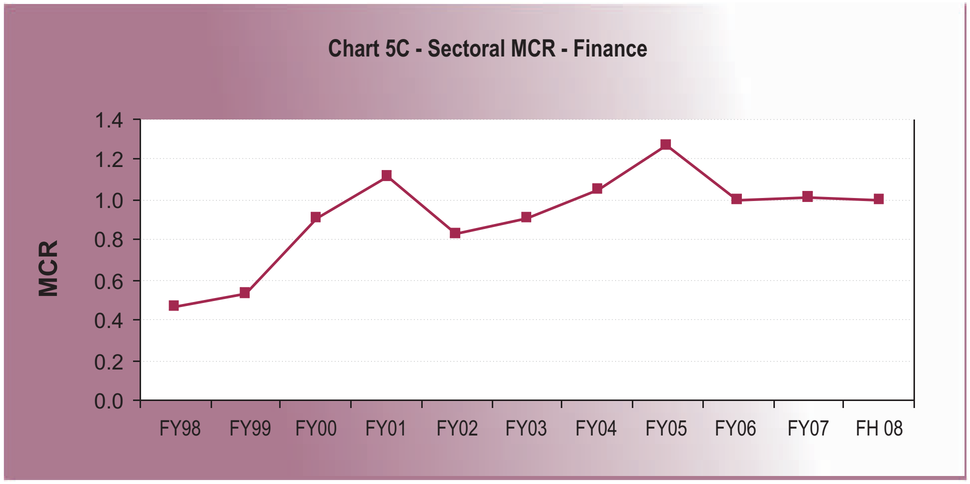
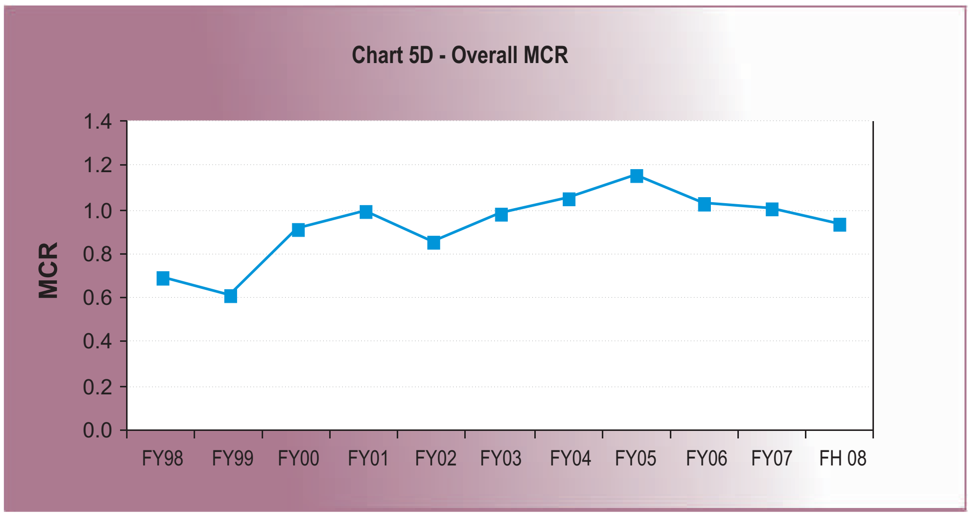


Chart 5B - Sectoral MCR - Infrastructure



[1] Infrastructure sector includes companies in power, oil and gas, mining, telephony services, road projects, utilities, urban local bodies and state governments.





Manufacturing and Infrastructure sectors

Aggressive acquisitions and large capacity expansions to affect credit profiles

The increasing risk appetite of Indian corporates in the manufacturing and infrastructure sectors is evident in the growing number and size of acquisitions. Of acquisitions of about USD50 billion (approximately Rs.2,000 billion) in FH08, overseas deals accounted for about USD25 billion (approximately Rs.1,000 billion)[2].

The total investments by Indian corporates in capacity expansion across sectors are expected to increase significantly. The total estimated investments for seven major industries (aluminum, automobiles, cement, oil and gas, petrochemical, steel and textiles) during the period between FY07 and FY11 is expected to be Rs.6,295 billion, which is more than thrice the investments in these industries during the period between FY02 and FY06.

The aggressiveness of Indian corporates' growth plans is also illustrated by a study of about 70 CRISIL-rated companies[3] with a total turnover of Rs.2.6 trillion. The study reveals that the total planned capital expenditure between FY08 and FY10 is expected to be nearly 1.4 times the aggregate net worth of the companies as on March 31, 2007. This is in comparison to a figure of 0.6 times for the period FY05 to FY07 (refer Table 2).

[2] Source: CRISIL estimates, Newspaper reports

[3] CRISIL ratings cover more than two thirds of manufacturing companies forming part of BSE Sensex. This study covers more than 50% of these rated manufacturing companies.

Table 2 **(Rs. Billion)**

	Networth	Capital Expenditure during the next 3 years	Capital Expenditure / Networth
March 31, 2004	861.5	517.4 (FY05-07)	0.60
March 31, 2007	1,458.6	2,049.7 (FY08-10)	1.41

Source: CRISIL Estimates

CRISIL expects the capacity expansions and acquisitions to be largely debt-funded. Thus the median gearing of these companies is expected to reach 0.97 times in FY08 from 0.61 times in FY06. The median interest coverage of these companies during FY08 is expected to reduce to 6.21 times, from 7.48 times in FY06. The median net cash accruals to total debt ratio is also expected to decline to 32 per cent in FY08 from 37.6 per cent in FY06. The decline in the debt protection measures in some cases can be much higher than the medians, depending on the extent of risk that the company managements take. This trend reflects changes in managements' attitude to risk.

On the whole, CRISIL-rated companies are better placed today to withstand stress on their financial profiles than they were four years ago. Rating changes that do take place over the short term will mainly be the result of large debt-funded acquisitions and capacity expansions, and the decline in credit profiles may not be steep, given companies' strong financial positions. In the medium term, Indian companies may also face pressure on profitability on account of high input costs and increase in interest costs arising from a sharp increase in debt; this may impact their credit quality. CRISIL expects manufacturing industries to report stable performance over the medium term, with the exception of the sugar, automobile, and auto-ancillary industries, whose performance is likely to remain weak.

In the infrastructure sector, CRISIL expects large debt-funded capacity expansions and government policy directions to drive any rating changes over the medium term. The infrastructure sector has not witnessed large acquisitions, but the scale and size of capacity expansions has increased significantly; this can have an impact on credit quality.

The Financial sector

Profitability of banks will remain under pressure

CRISIL believes that a slowdown in credit growth, coupled with growing high-cost deposits, may impact the profitability of financial sector entities. The high interest rates will continue to result in higher delinquencies, especially in the retail portfolio. However, the credit profiles of financial sector entities are likely to remain stable, backed by adequate capitalisation, and continued support from government (in case of PSU banks or FIs) or parent entities.

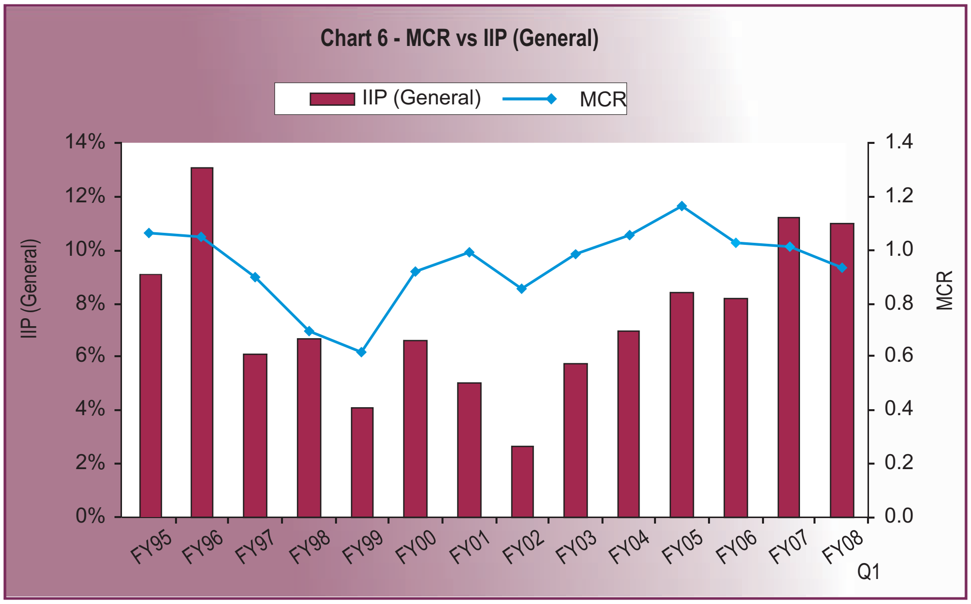
Conclusion

CRISIL believes that large debt-funded acquisitions and capacity expansions, driven by corporate India's increasing risk appetite, will continue to constrain credit quality over the near term. The ability of companies to manage acquisitions and expansions, and capital structure, will be a key driver of their ratings over the medium term. CRISIL believes that the profitability margins of Indian corporates might also be under pressure in the medium term due to high input costs and increase in interest cost, which may impact credit quality.

Box 1: CRISIL MCR has strong correlation with IIP and real interest rates

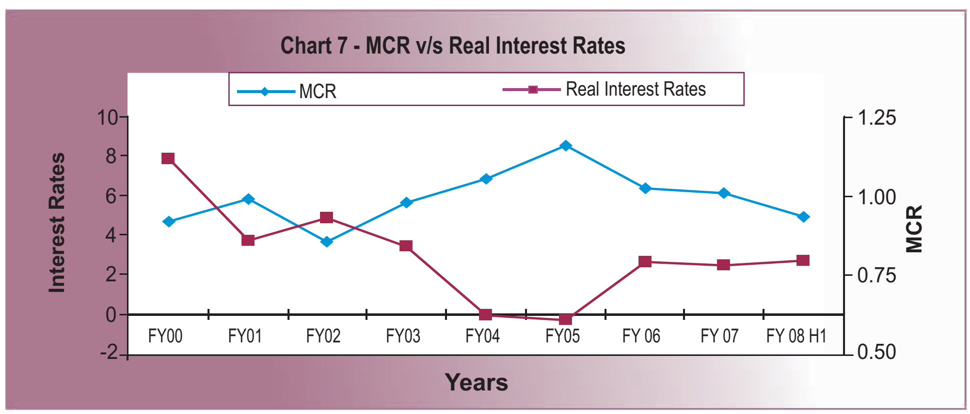
Correlation with IIP:

CRISIL's MCR is a sensitive measure of industrial performance and the prospects of the Indian economy, as it covers a wide range of sectors and key players in each sector. This is reflected in the consistently high degree of correlation between CRISIL's MCR and India's Index of Industrial Production (IIP) as Chart 6 indicates.



Correlation with real interest rates

Real interest rates and CRISIL's MCR have historically demonstrated a strong inverse correlation: MCR declines when real interest rates rise, and vice-versa, as Chart 7 indicates. Real interest rates have increased in the past 30 months, mirrored by a declining MCR. The high real interest rates are unlikely to decline over the near term, and may add to credit quality pressures.



Appendix 1

CRISIL's Long-Term Rating Upgrades in the First Half 2007-08

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	Soma Textiles and Industries Ltd	Textile	BB+	Stable	BBB-	Stable

CRISIL's Long-Term Rating Downgrades in the First Half 2007-08

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	India Glycols Ltd	Organic Chemicals	A+	Negative	A	Negative
2	Indian Farmers Fertiliser Cooperative Ltd	Fertilisers	AA	Stable	AA-	Stable
3	Tata Steel Ltd	Steel	AAA▼	-	AA+	Stable
4	Hindalco Industries Ltd	Aluminum	AAA▼	-	AA	Stable
5	Essel Mining and Industries Ltd	Mining	AA▼	-	AA-	Negative
6	The Tata Power Company Ltd	Power	AAA■	-	AA	Stable
7	Electrosteel Casting Ltd	Steel and Steel Products	AA	Stable	AA-	Stable

▼- Rating watch with negative implications
■- Rating watch with developing implications

CRISIL's Fixed Deposit Rating Upgrades in the First Half 2007-08

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	The Jammu and Kashmir Bank Ltd	Banking	FAA	Stable	FAA+	Stable
2	Jindal Saw Limited	Steel	FA+	Stable	FAA-	Stable

CRISIL's Fixed Deposit Rating Downgrades in the First Half 2007-08

Sr. No	Company	Industry	Rating From	Outlook From	Rating To	Outlook To
1	India Glycols Ltd	Organic Chemicals	FAA-	Negative	FA+	Negative

CRISIL's Long-Term Ratings on Watch as on September 30, 2007

Sr. No	Company	Industry	Rating	Watch
1	Carborundum Universal Ltd	Abrasives	AA+	Rating watch with developing implications
2	Coromandel Fertilisers Ltd	Fertilisers	AA	Rating watch with developing implications
3.	Godavari Fertilisers and Chemicals Ltd	Fertilisers	A+	Rating watch with positive implications
4	Global Trade Finance Limited	Non Banking Financial Company	AA	Rating watch with developing implications
5	Torrent Power Limited (Formerly Torrent Power AEC Limited)	Power	AA-	Rating watch with developing implications

CRISIL Offices

Head Office
CRISIL House
121 / 122 Andheri-Kurla Road
Andheri (East)
Mumbai 400 093, India.
TEL +91 (22) 6691 3001 - 09
FAX +91 (22) 6691 3000

Regional Offices in India

Ahmedabad
303, Paritosh, Usmanpura
Ahmedabad 380 013, India.
TEL +91 (79) 2755 0317 / 1533
FAX +91 (79) 2755 9863

Bangalore
W-101, Sunrise Chambers
22, Ulsoor Road
Bangalore 560 042, India.
TEL +91 (80) 2558 0899, 2559 4802
FAX +91 (80) 2559 4801

Chennai
Thapar House
43 / 44, Montieth Road
Egmore
Chennai 600 008, India.
TEL +91 (44) 2854 6205 / 06, 2854 6093
FAX +91 (44) 2854 7531

Hyderabad
3rd Floor, Uma Chambers
Plot no. 9 & 10, Nagarjuna Hills
(Near Punjagutta X Road)
Hyderabad 500 082, India.
TEL +91 (40) 2335 8103 / 8105
FAX +91 (40) 2335 7507

Kolkata
Horizon, 4th floor
57, Chowringhee Road
Kolkata 700 071, India.
TEL +91 (33) 2289 1949 / 1950
FAX +91 (33) 2283 0597

New Delhi
The Mira
G-1, 1st Floor
Plot No. 1 & 2
Ishwar Nagar
Near Okhla Crossing
New Delhi 110065
TEL +91 (11) 42505100, 26930117 / 21
FAX +91 (11) 26842212

Pune
1187 / 17 Ghole Road
Shivajinagar
Pune 411 005, India.
TEL +91 (20) 2553 9064 / 67
FAX +91 (20) 2553 9068

CRISIL Limited

Website: www.crisil.com

About the CRISIL Ratings RoundUp

The CRISIL Ratings RoundUp is a semi-annual publication that analyses CRISIL's rating actions during a particular period and the linkages between these actions and underlying economic trends. Since credit rating is an opinion on likelihood of timely future debt repayments, an analysis of rating actions in a large and diverse portfolio of rated companies, can be useful indicator of economic prospects. This edition analyses CRISIL's rating actions in H1/FY 2007-08.