

After 4 years, upgrades trump downgrades

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Credit quality of corporates has improved significantly and the trend will continue through this fiscal, says Roopa Kudva, managing director and CEO of Crisil Ltd, and region head, South Asia, Standard and Poor's. Positive outlooks have hit an all-time high, too, but the flip side is negative outlooks are three times more, underscoring the fragile nature of recovery, Kudva said. Excerpts from an interview:

What has been the trend in corporate ratings of late?

The biggest change is that after a gap of 4 years, upgrades exceed downgrades. If you take this fiscal, up to September 16, we have upgraded 205 companies and downgraded 99. The trend is expected to continue for the rest of the fiscal. Our modified credit ratio will be more than 1 for the first time after 2006. Bear in mind that this is on a portfolio of 5,000 companies of which 90% are mid-sized, between



Q&A

Roopa Kudva

Rs50 crore and Rs500 crore, and the rest larger. The clear indication is that the worse is over. Yet, there are some areas where the signals remain weak. For example, defaults have increased this fiscal — from 20 in September 2009 to March 2010 to 37 in this fiscal so far.

Why's that?

Most of the defaults have been due to liquidity issues. There is no particular trend in terms of sectors, it is more company-specific.

Was it an issue of working capital or longer credit?

It's both. In some cases it was working capital and in others, long-term money.

What about outlooks?

We have a positive outlook on 3% of our portfolio, which is an all-time high, but companies with a negative outlook are three times that. There are 425 companies with a negative outlook and 150 positive. So the crux is that yes, the credit cycle has turned, the worst is over and there are more upgrades than downgrades — but, the undertone is fragile.

What are the reasons for this?

First is that some companies, particularly exporters, have been hit by demand slowdown. Second is there is liquidity pressure because commodity prices have risen fast, forcing companies to seek more working capital. The third reason is delays in project implementation.

How long have these pressures existed?

Things are much better since September 2008, there is no systemic liquidity pressure now. I think it's more about individual companies.

Are we seeing early signs of a releveraging cycle?

If you look at what happened in 2009-10, leveraging declined because companies were forced to be more judicious and cost-conscious and deferred investments. They could thus manage their working capital needs more efficiently. But this will change going forward; leveraging will increase because of better economic prospects, consumer spending and capital expenditure. Also, as cited earlier, working capital needs will go up due to higher commodity prices.

Will that cost-cutting lead to efficiency gains? More bang for the buck, as it were?

Absolutely. If you look at the way Indian companies responded to the downturn, two-three things stood out compared with the downturn in the late 1990s. Turn to Page 10

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One is that companies moved very fast to curtail production and managed their working capital very efficiently. They preserved liquidity. They were more prudent, a lot more agile in cutting down. So they naturally have a lot more control on the cost of working capital now.

So no material stress on profit margins despite the input pressure?

Margins will be stressed because of commodity price reasons. I think were it not for the efficiency improvement, the impact would have been greater.

Do you think SME ratings will be the next game-changer in India, and for Crisil?

Yes, I think that has happened, is happening, very silently. Let me give you some examples. Of the 5,000 entities that Crisil rates today, about 90% have a turnover of less than Rs500 crore. In addition to that we have rated almost 20,000 SSI (small-scale) units. Our assessment is that they have saved Rs100 crores of interest cost alone by getting rated because 23 banks have announced interest rate concessions linked to SSI ratings. Ratings make it easier for them to access the markets for funds. We have seen a number of companies with good ratings float commercial papers. We have seen companies with BBB and A- (minus) ratings enter the market, we are seeing retail issuances of corporate bonds. SME ratings also engender transparency. Another gamechanger is that the companies find the feedback from the rating agency very useful as a self-improvement tool etc. In so many of these SSI units, the first time that they get rating they get a subsidy from the Government of India. But for renewal of a rating, there is no subsidy.

How much is the subsidy?

It varies with size etc, but anywhere between Rs10,000 to Rs30,000 per SSI. And guess what, SSIs are returning in droves to renew their ratings by paying higher fees - clearly they have felt the benefits of getting rated — transparency and accounting practices have improved.

Are you talking about first-generation entrepreneurs here?

A lot of the second-generation entrepreneurs are taking over smaller units and a lot of them see the value of running their organisation on a professional basis and getting views and opinions from an independent third-party.

On a thumb rule basis, how much interest-cost savings are there to be had for an average SSI?

It depends on the bank. Banks have announced interest rate concessions ranging from 0.25% to 1.25%, depending on the rating.

Will SME ratings essentially be a volume play for Crisil?

Today ratings is about 40% of the total Crisil group business. Within ratings, I think yes the smaller enterprises will be the big driver of growth going forward. The deepening of the rated population has been a significant development. If you look at it, on January 1, 2008, Crisil had ratings on less than 450 companies. Today, two-and-a-half years later, we have 5,000 companies and about 20,000 small



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enterprises. How do you keep a tab on the red flags on such a big canvas? Is there some sort of heat mapping system?

Our surveillance system is online and ongoing. It's not that we show you our face only once a year.

Even for SSIs?

For SSIs it's a one-time renewal after one year, but for 5,000 companies it is ongoing.

Isn't one year too big a gap when tracking SSIs?

For them, the rating is linked to the renewal cycle of the facility with their banks.

So the onus is on the banks to warn you?

It is on us and the rated entity.

You have offshore business in Argentina, Poland and soon, China. What do you do there?

We have three or four business lines of which one is ratings. The second part is high-end knowledge process outsourcing (KPO). We have 6 of the top 10 banks in the world as clients and several of large insurance companies and asset management firms. We have services for equity research, derivatives research and for credit research. We analyse companies outside India and feed the data into the banks. We have analysts in Argentina because it has same time zone as the US, so we can transfer work to Buenos Aires from Chennai and Mumbai.

A global delivery model?

Yes, a global delivery model. The second reason is that Argentinians speak Spanish so they can help through a lot with the European analyses. The

reason we set up a base in Poland is that a lot of our clients are increasingly demanding quantitative analysis and Poland has a vast talent pool as far as mathematics and physics are concerned.

Yes, they are formidable in maths...

Yes, they are. And why we are going to set up in China is because a lot of our customers now want research on Chinese companies in their language. So we are going to set up that and the company we are in talks to acquire — Pipal Research — is also engaged in research. Our UK unit Irevna's main customers are financial institutions, whereas Pipal's main customers are industrial companies. So that will help us increase our footprint from financial companies to corpo-rates as well.

How much do non-ratings contribute to Crisil's numbers?

Last year ratings was roughly 44%, research about 44%, which includes KPO and India research and the balance 10% to 12% comes from our policy advisory business with 22 countries where we are working in the area of privatisation of infrastructure. For example, in Mauritius, we are assessing the Highlands Project which involves creation of a new city over 1,000 hectares. This new city will house the capital of Mauritius. We have already received financial proposals from international developers and we expect to commence negotiations with them soon.

On one side you have the ratings business, on the other you have policy advisory and KPO. How big is the scalability challenge for you? Is asymmetry an issue?

Our business mix is extremely synergistic in two ways. One is that the skillset required is the same. We require the same type of analytical capabilities across businesses. Second is that whichever way we look at it, we are doing business analysis and financial analysis, be it ratings or KPO or advisory. Another common theme is that we give purely independent opinion. So everything beautifully synergises with each other.