



## ICRA RATING FEATURE

*Update for 2002*

## ICRA RATINGS -A TRANSITION STUDY

ICRA has been monitoring the performance of its ratings assigned since inception both to assess whether these adequately reflect the impact of macro-economic shifts, and to ascertain the degree of co-relation between the level of rating and the default probability. At the beginning of each year a cohort is formed consisting of all ratings outstanding as in January that year. The yearly shifts (including re-affirmations, revisions and withdrawals) in the ratings of each such cohort formed since January 1992 are tracked<sup>1</sup>. While the average one-year transition matrix gives an indication of the behaviour of the ratings over a one-year horizon from 1992 till 2002, the one-year transition matrix of each year's cohort demonstrates the pattern of the rating transition in each individual year. The transition matrices of the individual years thus provide an insight into the co-relation between events of the past period and the rating movements then.

ICRA ratings and their movements have been able to reflect/capture the overall economic situation during the past year, as this note explains.

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<sup>1</sup> Please refer to the ICRA Rating Transition Study – May 2002 , for detailed methodology on cohort analysis available on the ICRA website: [www.icraindia.com](http://www.icraindia.com)

### **Decline in downward migration of ICRA ratings in 2002**

The following tables trace the transition of ICRA long-term ratings outstanding as in January 2002 vis-à-vis those outstanding as in January 2001, over a 12-month period.

**Table 1: ONE-YEAR TRANSITION MATRIX—2002**

	LAAA	LAA	LA	LBBB	NI
LAAA	100.00%	0.00%	0.00%	0.00%	0.00%
LAA	3.03%	93.9%	3.03%	0.00%	0.00%
LA	0.00%	3.85%	80.8%	3.85%	11.5%
LBBB	0.00%	0.00%	0.00%	85.7%	14.3%

**Table 2: ONE-YEAR TRANSITION MATRIX—2001**

	LAAA	LAA	LA	LBBB	NI
LAAA	87.1	12.9%	0.0%	0.0%	0.0%
LAA	0.0%	80.0%	14.3%	2.9%	2.9%
LA	0.0%	0.0%	69.4%	16.7%	13.9%
LBBB	0.0%	0.0%	0.0%	90.9%	9.1%

**NI: Non-investment grade; ratings below BBB- (i.e. LBB+ till LD)**

**The categories of LAA, LA and LBBB include ratings with the suffix “+” or “-” within the respective categories. Thus, for instance, the category LAA includes three ratings: LAA+, LAA, and LAA-.**

Some of the important characteristics of the one-year 2002 ICRA long-term rating transition matrix are discussed here.

- ◆ Ratings in all categories show a distinct improvement in their stability compared with their performance in 2001 (the exception being the lowest investment grade of “LBBB”);
- ◆ All 28 LAAA ratings as of beginning 2002 maintained their rating during the following 12 months.
- ◆ During 2002, LAA and LA (the relatively higher investment grade ratings) rated issues witnessed a movement to the higher rating category, a phenomenon that was totally absent in the previous year.
- ◆ Around 97% of the LAA ratings were maintained or upgraded (one entity was upgraded to the LAAA category). For the remaining 3% of the LAA ratings (one entity) downgraded, the revision was restricted to a single category.
- ◆ Compared with 2001, the LA category ratings also exhibited a significant increase in their stability in 2002 (percentage of LA ratings re-affirmed or upgraded was 84.65% in 2002 vis-à-vis 69.4% in the previous year).
- ◆ The movement into the NI category declined in 2002 for both the LAA and LA categories (no LAA rating moved into the NI category). However, the number of LBBB ratings moving into the NI category increased in 2002 over the previous year.

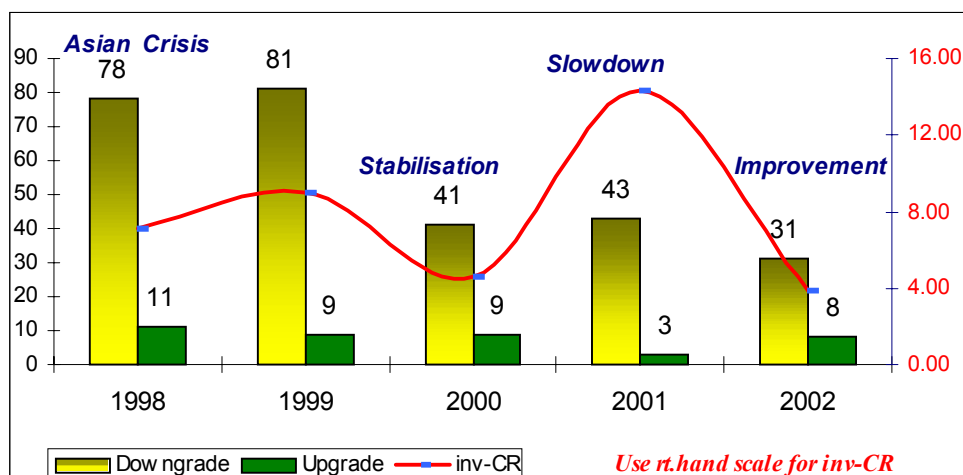
The transition for ICRA’s long-term ratings does reflect the impact of some improvement in the business environment and its outlook in 2002 vis-à-vis 2001. The decline in the percentage of downgrades for LAA and LA categories in 2002 resulted from more ratings being re-affirmed than upgraded. This indicates that the relative recovery and the expectation that some improvement was in evidence in 2002 led to most entities being able to maintain their credit quality rather than improve it to the extent of warranting a rating upgrade. This probably further reiterates the fact that the year 2002 was able to arrest the deterioration witnessed in 2001, but not provide for a strong recovery.

- During 2002, five ICRA long-term ratings were downgraded to the NI category from an investment grade compared to seven such downgrades in 2001. Two entities each belong to the fertiliser and the Banks/Financial institution segments. One entity is from the construction sector.

### Significant decline in the inv-CR in 2002

ICRA considers both medium- and long-term rating revisions to calculate the inverse credit ratio (inv-CR), which is the ratio between downgrades and upgrades.

Figure 1: RATING REVISIONS (LONG & MEDIUM TERM) SINCE 1998

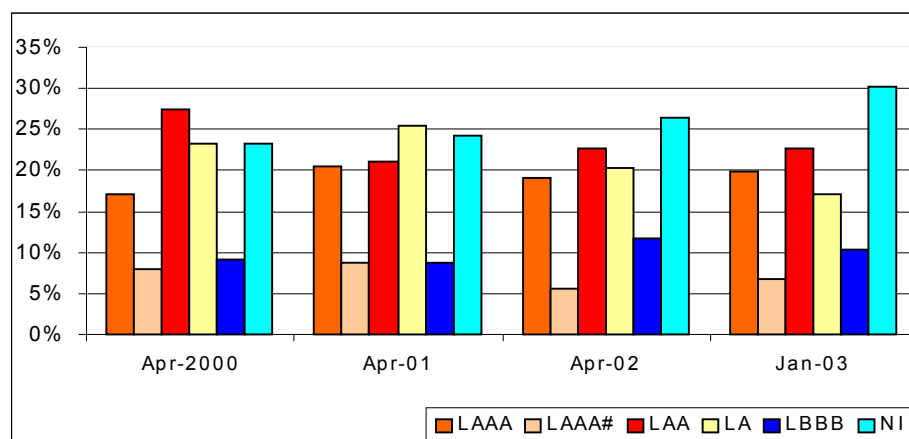


During 2002, there was both a decrease in downgrades and an increase in upgrades, which led to a sharp decline in the inv-CR during the year. The inv-CR in 2002 was the lowest for the five years till then. While the number of downgrades has been decreasing since 1998 (except in 2001 when they were almost at the same level as in 2000), it was in 2002 that for the first time the same was accompanied by an increase in the number of upgrades.

Out of the 8 entities upgraded, 3 were from the housing finance sector, and the rest were from the cement, pharmaceuticals, chemicals, abrasive and construction sectors.

Out of 31 entities whose long/medium term debt ratings were downgraded; 4 each were from the NBFC, Bank/Financing Institution and real estate/construction/building material related sectors; 3 belonged to the fertiliser sector, while 2 each were from the sugar, hotel and pharmaceutical industries. The remaining belonged to the steel, textile related, engineering and other diverse industries.

The pattern of rating revisions bears evidence to ICRA's cautious rating approach. Thus, during periods of economic deterioration, the number of downgrades was not higher, but the number of upgrades was lower. Therefore, although the number of downgrades decreased when the economic situation improved, the same had not increased during the downturn phase.

**Shift in ratings towards lower category continues**

LAAA# indicates the percentage of outstanding LAAA ratings of entities other than Banks and Public Sector Undertakings (PSUs)

- ◆ There was an increase in the percentage of long-term ratings outstanding in the NI category as in January 2003, to almost 30% as against 26.4% as in April 2002. The percentage of LA and LBBB category ratings outstanding fell to 17.6% and 10% as in January 2003 compared with 20% and 11.7% respectively, in April 2002. As in January 2003, the LAAA and LAA category ratings outstanding maintained their share in the long term ratings outstanding at almost the same level as in April 2002.
- ◆ As in January 2003, the LAAA ratings outstanding accounted for 20% of the total long-term ratings outstanding, which was almost at the same level as in April 2002 (19%). Banks and strong Public Sector Undertakings (PSUs) continued to be the major constituents of this category, although their presence in this category decreased to 63.8% as in January 2003 from 71% as in April 2002. LAAA rated companies, other than banks and PSUs, accounted for a higher 7.4% of the total long-term ratings outstanding as in January 2003 (the additions being Associates India Financial Services Pvt. Ltd., and BASF Ltd.; the latter witnessed an upgrade), up from 5.5% as in April 2002, but lower than the 8.7% as in April 2001.



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