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Interview | Ravishankar, founder director, Brickwork Ratings

Turnaround story for large firms yet to start

THE banking sector may be feeling the heat from strain in corporate balancesheets, but it is not a lasting or devastating problem. With right policy and regulatory intervention the challenge can be dealt with, says ***D Ravishankar****, founder director, Brickwork Ratings in an interview with* ***Ashwin J Punnen****. Excerpts:*

■ Currently, there is considerable stress on corporate balancesheet from high borrowings. How long it will take to see a turnaround?

We need to understand the difference between liquidity stresses on corporate balancesheet versus stressed loans of banks. Because of a slowdown in the economy, the incidence of stress in the corporate sector is showing an increasing trend. Several internal and external factors have put considerable pressure on the performance of the companies. As a result a number of them is unable to meet the debt obligations on time.

Stressed loans have seen an upward trend. Overall stress in the banking sector — gross NPAs and restructured advances — increased from 9.2 per cent in March 2013 to 11.1 per cent of the total in two years, according to RBI data. Gross NPAs grew to 4.6 per cent of gross advances as on March 2015, as compared to 3.4 per cent at end-March 2013.

Over the four years from FY11 to FY14, the overall debt-equity ratio of the corporate sector has come down from 1.40 to 1.22 level. There is a steep fall in the debt-equity ratio of small companies. From this, we can infer that the corporate leverage has not gone up. However, the bank stressed loan portfolio, on the other hand, has gone up. The corporate sector is facing temporary liquidity stress.

■ How should banks and firms tackle this issue?

The problems faced by some of the firms may be temporary in nature and therefore require short-term relief to bring them back on track. Companies that suffer from temporary liquidity constraints should approach the lenders for rescheduling principal installments within the original repayment period by reducing/postponing the immediate future instalments and suitably increasing the later installments, without extending the terminal date based on the revised cash flows.

A large portion of this is in the infrastructure space. Other sectors like iron and steel, textiles have similar loans. All of them will have to be tackled at different levels. Early identification of distressed projects is necessary, which gives an opportunity to set them right. It is hoped that the proposed bankruptcy code, operationalising of NCLTs will be fast tracked to tackle the distress in these assets. So, a turnaround may be in the offing, considering all these measures.

> **Firms that suffer from liquidity dearth should approach lenders for rescheduling principal installments**

■ Is the credit rating of domestic firms seeing any change? Are there more upgrades happening?

Currently, based on our rated universe, we found that the credit ratio is over one, which means that the ratios of upgrades are higher than the downgrades. Rating itself being forward looking, a credit ratio of over one only indicates that the economic scenario is likely to be better in the future. But if you categorise as per sizes — small, medium and large — we find that large companies' credit ratio is below one, medium and small companies' credit ratio is greater than one. This would imply that the turnaround story for large companies is yet to start. Credit ratio is looking only at the number of companies, and it looks healthy.

■ How is the corporate bond market emerging? Is there going to be product innovations going forward?

Recent reports are encouraging. The issuances in corporate bond markets have increased. Since, banks have a large amount locked in NPAs and stressed assets, the corporates have turned towards the bond markets. Generally, the corporate sector heavily looks at the banking sector for funds.

Till FY14, the ratio of sourcing from bank loans versus corporate bonds were in the ratio of 80:20. However, during FY15, the ratio of sourcing has changed significantly to 50:50. The entry of FPIs in the corporate sector might have contributed to the change. The institutional investors like insurance companies, mutual funds, provident funds invest mainly in bonds rated A and above and whereas FPIs invest even in non-investment grade companies. It is finally a trade-off between risk and return. What is required is more players to participate in the corporate bond market.

■ There is lot of competition in the rating business, is the quality of rating getting compromised? What are the checks and balances for conflict of interest?

If you look at the default statistics, even today, there is not a single AAA company that has defaulted in India. Past performance has no relevance for the future but Indian CRAs have a good track record. Another yardstick is that, at the highest ratings you will find that stability rates are higher and this behaviour will continue — whether you take a year or two or even long-term average. The trend of stability rates being higher at higher ratings is continuing to exhibit the same trend, which is very positive. Until basel-II was introduced in late 2007 in India, all rating agencies put together would have rated around 1,000 companies from the beginning. Post introduction, the number would be around 30,000 companies by all rating agencies. Certainly, basel has provided a big boost for all rating agencies. When we entered in 2008, one of the criteria considered by Sebi while giving us permission was that the four existing rating agencies were not sufficient to handle these huge volumes.

The market balances the right rating. For instance, the issuers always look for a higher rating to reduce the cost and the investors always look for a higher yield. Similarly, the competition balances the right rating. The conflict of interest may arise if the rating agency carries out both advisory &and rating business. There is a need for keeping an arm's length between these businesses.

■ What are the various products offered by Brickwork Ratings under rating and grading space?

Some of the products include NCD/bond rating, bank loan rating – short-term exposures, term loans, MSME rating, commercial paper rating, securitisation rating, mutual fund rating, EWRM and financial health rating for insurance companies, micro finance institutions, banks and NBFCs, distressed assets (security receipts), etc.

■ How can the rating agencies help in corporate bond market development?

Rating provides visibility and lends credibility to an enterprise wishing to access corporate finance. It also helps bridge the information gap and asymmetry to the stakeholders. Rating agencies through working together with regulators and other market players have already created a vibrant market. Credit rating is the only common language between investors and issuers for carrying out transactions; whether it is for understanding the quality of the issue or pricing of issue. Hence, through rating transparency and disclosures will go a long way in developing the Indian corporate debt market.

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