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Heightened risk environment adds to corporate India's challenges: CRISIL *Funding to be impacted, demand may moderate*

As was expected, capital markets globally reacted negatively today in the aftermath of Friday's downturn followed by the downgrade of U.S. sovereign rating.

These developments have heightened risk perception and uncertainties in a global economy where the downside risks were already material. The manner in which financial markets and governments react over the next few weeks will determine how the prevailing fragilities in the global sovereign and financial sectors play out. This, in turn, will impact the trajectory of global growth. Should global growth weaken further, India will be impacted.

This environment adds to corporate India's challenges. ***"The primary impact will be on the availability and cost of funding, both domestic and international"***, says **Roopa Kudva, Managing Director & CEO, CRISIL**. Globally, an increase in risk aversion will reduce appetite for emerging market risk and could affect the ability of Indian companies to raise money externally. Access to equity markets too, is likely to be muted. ***"The second impact will be on demand: export growth is likely to slow down and domestic private consumption, which has been strong so far, could moderate as consumers become more cautious"***, adds **Ms. Kudva**. Volatility in exchange rates are also expected to increase.

Partly mitigating factors are the easing of pressures on global crude and commodity prices. Moreover, Indian corporates are likely to be cushioned by a primarily domestic-focused economy and strong balance sheets.

This increase in risks is consistent with CRISIL's expectations outlined in April 2011*. While we will continue to see upgrades, we can expect a higher number of downgrades and higher defaults. Rating actions so far already reflect this expectation. ***"In the first quarter of 2011-12, the number of downgrades was 105, as against 269 downgrades in the entire year 2010-11"***, says **Ramraj Pai, Director, CRISIL Ratings**. Number of defaults was 43, more than a third of number of defaults witnessed in 2010-11. Modified credit ratio (upgrade:downgrade ratio) for the first quarter was lower at 1.05 as compared to 1.10 for the year 2010-11. We expect these trends to continue.

Companies that will be more vulnerable include those with higher exposure to developed economies, significant un-hedged foreign exchange exposure, higher funding requirements and dependence on refinancing (companies whose foreign currency convertible bonds are due for redemption or that have higher dependence on short term debt).

Strong balance sheets and cautious approach of large Indian companies will help them better navigate this environment. ***"A CRISIL Research study across 20 sectors reveals that corporate India's debt equity ratio is currently at an acceptable level of 1"***, says **Mukesh Agarwal, Senior Director, CRISIL Research**. Further, the total cash and equivalents of top 50 CRISIL-rated Indian corporates stood at nearly Rs.3 trillion at the end of March 2011, representing 40 per cent of their aggregate debt.

*(refer our release titled "India Inc's credit quality peaking – Pressures on profitability to increase; Demand will be key monitorable", dated April 6, 2011).

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