Finance cost weighs on India Inc's earnings in Q3

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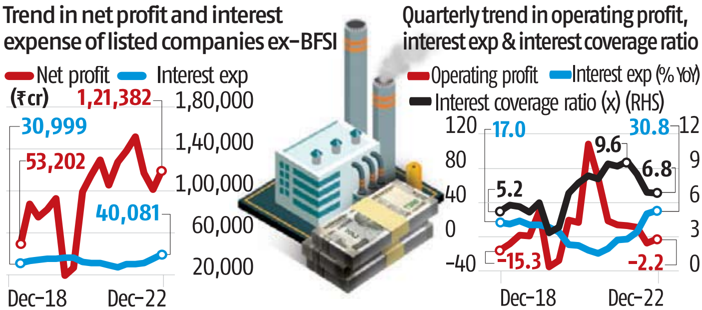
After supporting India Inc's profits for two-and-a-half years since the outbreak of Covid-19 at the end of the fourth quarter of financial year 2019-20 (FY20), interest rates and finance costs have become a drag on corporate earnings.

The increase in such costs comes on the back of interest rate hikes by central banks around the world in an attempt to cool inflation, which shot up in 2022 because of supply disruptions caused by the pandemic and the Russian invasion of Ukraine. The monetary policy committee of the Reserve Bank of India is expected to increase the repo rate by a further 25 basis points (bps) on Wednesday.

OPERATING PROFIT DIPS, INTEREST COSTS RISE



Note: Based on quarterly results of a common sample of 888 listed companies excluding banks, finance, stock broking and insurance (BFSI). x denotes multiple; exp: expenses; Compiled by BS Research Bureau; Source: Capitaline

The combined interest expenses of 888 listed companies — excluding firms in the banking, financial services, and insurance (BFSI) space — rose 30.8 per cent year-on-year (YoY) in the December quarter (Q3) of FY23, growing at the fastest pace in at least 17 quarters.

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Source: MGNREGA

core of the vehicle and without which the vehicle cannot run. *Business Standard* has reviewed the complaint letter to MHI. "If scheme conditions are flouted, requisite action will be taken," Union Minister for Heavy Industries Mehendra Nath Pandey had cautioned the industry in November 2022. Of the 64 OEMs registered under FAME II so far, at least 17 have been debarred from seeking subsidies, according to data available on the MHI website.

India Inc's...

In comparison, these companies' combined operating profit or PBIDT (profit before interest, depreciation and tax) declined 2.2 per cent YoY, and net sales rose 18.2 per cent YoY in Q3FY23. This was the first time in the last nine quarters when interest expenses grew faster than both top line (i.e. net sales) and operating profit.

As a result, the combined net profit of these 888 companies declined 12.7 per cent YoY to ₹1.21 trillion from ₹1.39 trillion a year ago, though earnings rose 17.3 per cent sequentially from ₹1.03 trillion in Q2.

The combined interest expenses of the non-BFSI companies in the Business Standard sample shot up to ₹40,081 crore in Q3FY23 — the highest in at least 21 quarters — from ₹30,637 crore a year ago. In contrast, these companies' quarterly interest expenses had declined by 24.6 per cent from a high of ₹36,892 crore in Q4FY20 to a low of ₹27,819 crore in Q2FY22. In comparison, the companies combined PBIDT declined to ₹2.74 trillion in Q3FY23 from ₹2.8 trillion a year ago. A disproportionate rise in interest expenses amidst a contraction in operating profit has also led to a decline in the companies' debt servicing ability as measured by the interest coverage ratio (ICR). The ICR of these non-BFSI companies declined to a nine-quarter low of 6.84 times (x) in Q3FY23 from 9.15x a year ago and 6.90x in Q2. ICR is calculated by dividing a company's operating profit or Ebitda (earnings before interest, taxes, depreciation, and amortisation) by its interest expenses. A higher ratio indicates better ability to service a firm's debt with its earnings and internal accruals.

Analysts attribute the faster growth in company's interest expenses and a decline in their interest coverage ratio to both a rise in interest rate in the last one-year and incremental borrowings by many companies.

"The reversal in the interest rate cycle has increased the companies' borrowing cost in the last few quarters and it shows in their interest expenses. Many companies have also resorted to incremental borrowings in the last two quarters to fund working capital requirements in the face of a decline in earnings and cash flows from their highs in FY22," said Dhananjay Sinha, director and head research and strategy at Systematix Institutional Equity. He expects this trend to continue in the forthcoming quarters as well, as the interest rate cycle is yet to peak and commodity and energy prices remain elevated, pushing up the need for working capital.

Big firms such as Reliance Industries, JSW Steel and Vedanta reported a further rise in their borrowings in Q3FY23 over the same period last year. This, the analysts say, hints at the end of the balance sheet deleveraging cycle that had occurred in FY21 and the first half of FY22.

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