India Inc earnings signal end of deleveraging cycle

Financial ratios worsen in H1FY23 amid poor profitability, higher borrowings

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The corporate balance sheet deleveraging cycle that started after the breakout of the Covid-19 pandemic came to a halt in the first half of 2022-23 (FY23) as companies stepped up borrowings, worsening their financial ratios.

The combined gross borrowings of the 760 companies excluding banking, finance, insurance and stock-broking firms were up 12.2 per cent year-on-year (YoY) during April-September 2022 (H1FY23), growing at the fastest pace in three years (or six half-yearly periods). In comparison, these companies' combined operating profit, or Ebitda (earnings before interest, taxes, depreciation, and amortisation), was down 0.4 per cent YoY; interest expenses were up 12.5 per cent; and their net profit was down 10 per cent in the period.

The combined net worth, which largely reflects their retained earnings, of these companies was up just 8.5 per cent YoY in H1FY23, growing at the slowest pace in two years.

The sample companies' gross total borrowings rose to ₹34.23 trillion at the end of H1FY23 from ₹31.4 trillion at the end of March this year and from ₹30.51 trillion a year ago.

A combination of poor profitability and incremental borrowing in the first half of FY23 resulted in deterioration of financial ratios for India Inc. The gross debt-to-equity ratio for these companies increased to 0.77x in H1FY23 from 0.72x in H2FY22 (the October 2021-March 2022 period), while the interest coverage ratio (ICR) declined to 6.1x from a high of 7.5x at the end of FY22.

A decline in companies' ICR means a decline in their ability to service debt.

Turn to Page 7

FINANCIAL CHECK-UP

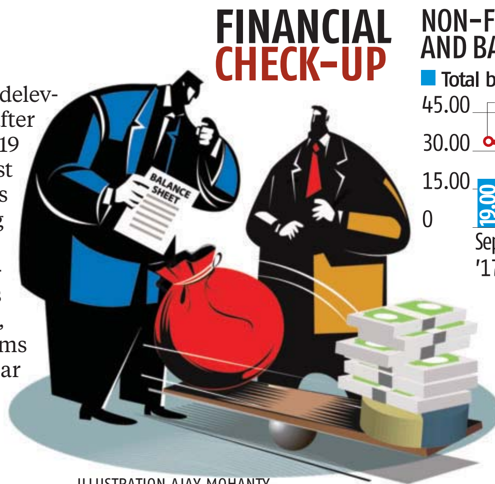
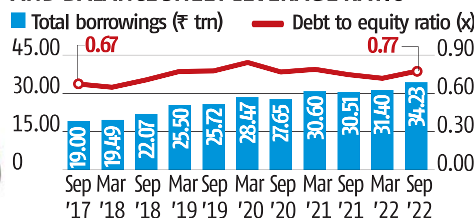
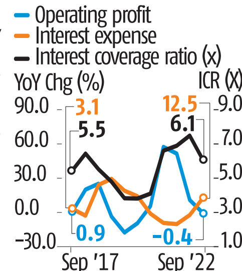


ILLUSTRATION AJAY MOHANTY

NON-FINANCIAL COMPANIES' BORROWINGS AND BALANCE SHEET LEVERAGE RATIO



OTHER KEY PARAMETERS OF SUCH FIRMS



Note: Based on half-yearly data of a common sample of 760 companies excluding banking, financial services and insurance firms; ICR: Interest coverage ratio
Source: Capitaline; Compiled by BS Research Bureau

FROM PAGE 1

India Inc...

The ICR indicates the number of times a company's operating profit is, in relation to its interest expenses.

Analysts say this signals the end of the cycle of corporate deleveraging seen after March 2020. "A boom in corporate profits in the post-pandemic period allowed companies to prepay debt and lighten their balance sheet. The cycle now seems to be over and operating metrics and financial ratios worsened due to a decline in profits and operating cash flows in the first half of FY23," said Dhananjay Sinha, director and chief strategist at Systematix Institutional Equity.

He expects the trend to persist in the second half of FY23, which could have a significant impact on the companies' growth trajectory.

"Poor finances may force many companies to put brakes on their growth plans and scale back operations. This could result in net sales growth decelerating to around 8 per cent in H2FY23 from nearly 30 per cent-plus in H1FY23," added Sinha.

Other experts attribute the rise in corporate indebtedness to higher working capital, which they said will self-correct in the forthcoming quarters. "Companies have been forced to sit on higher inventory in recent quarters due to volatility in commodity prices and disruptions in global supply chains, leading to higher working capital borrowings. In their management commentary for Q2FY23, most manufacturing companies projected a decline in inventory and working capital requirements in H2FY23 due to a fall in commodity prices and improvement in supply chain," says Shailendra Kumar, chief investment officer (CIO), Narnolia Securities.

The net current assets, or the total working capital for the companies, in the Business Standard sample were up 27.5 per cent YoY in H1FY23, while their combined inventory of finished products and raw materials was up 28 per cent. In comparison, the combined fixed assets were up 12.5 per cent YoY in this period.

On the brighter side, incremental borrowings by corporations translated into higher demand for bank credit and boosted banks' earnings in H1FY23.

"The credit outstanding of the industry segment registered a robust growth of 12.6 per cent YoY in September 2022 from 1.7 per cent growth in the year-ago period. It was due to robust growth in MSMEs, which were driven by inflation-induced working capital requirements, ease of doing business supported by increasing digitisation in the banking system for faster loan turnarounds, and demand for new capex," analysts at CARE Rating noted in their recent report on corporate credit.

A faster growth in corporate credit and a rise in interest rates have, however, resulted in a surge in companies' interest expenses, which grew by 12.5 per cent in H1FY23, the fastest in two-and-a-half years.

Exports...

India's import sources in October: Top 10

Country	Value ($ mn)	YoY chg (%)
China	7,851	-9.7
UAE	3,867	1.5
US	3,526	-4.7
Saudi Arabia	2,721	11.6
Russia	3,842	441.4
Iraq	2,628	44.1
Indonesia	2,260	46.9
Singapore	1,970	27.5
South Korea	1,607	1.7
Australia	1,300	-30.9
Top 10 total	31,572	13.9
% share of total imports		56
Total imports	56,693	5.7

Source: Department of Commerce