Tepid top line starts to show on India Inc's profit growth

Earnings upgrade at risk without a revenue revival, say analysts

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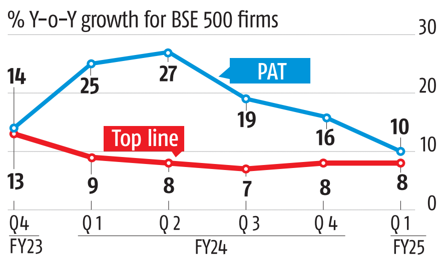
Benefits of favourable input and credit costs that helped margin expansion are waning



Note: OMCs and fertiliser companies excluded
Source: Nuvama Research

India Inc has managed to sustain net profit growth that has outstripped muted revenue expansion over the past several quarters, largely buoyed by favourable credit conditions and lower input costs. However, this divergence is now converging, with analysts stressing an urgent need for a resurgence in top-line growth to sustain bottom-line improvements.

The average year-on-year (Y-o-Y) net profit growth for BSE 500 companies (excluding oil marketing and fertiliser firms) over the five quarters (from the March 2023 quarter to March 2024 quarter) stood 20 per cent. This contrasts sharply with revenue growth, which averaged 9 per cent during the same period. Historically, profit margins and top-line growth have moved in tandem.

This sharp divergence in 2023-24 has been driven by margin expansion, supported by tailwinds such as lower input costs and improved operational efficiencies. However, these factors are now beginning to fade.

"We think margins would bump into more headwinds than tailwinds going ahead. This is because finance credit costs are now normalising as are input prices. Furthermore, corporations are already performing at high operating efficiency, leaving little room for margin expansion," said Prateek Parekh and Priyank Shah, equity strategist, Nuvama Institutional Equities in a note.

This shift became evident in the first quarter of 2024-25 when profit growth for BSE 500 companies slowed significantly to 10 per cent, dragged down by stagnant revenue growth of 8 per cent.

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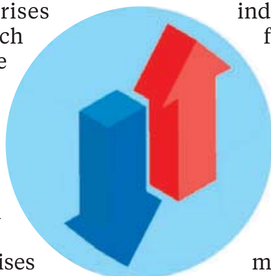
62% of BSE 500 firms log negative earnings in Q1

The profit boom seen after the Covid-19 pandemic has drawn parallels to the strong earnings growth seen after the dot-com bubble in 2000. However, unlike today, earnings growth in 2000 was also supported by robust top-line performance.

A recent note by Emkay Global Financial Services points to a sharp increase in negative earnings surprises. The proportion of companies in the BSE 500 universe delivering negative earnings surprises rose from 46 per cent in the March quarter to 62 per cent in the June quarter. "The Q1FY25 earnings season was weak, with negative PAT growth. Top-line momentum remained muted across the board, while energy dragged overall margins.



The share of negative surprises spiked," said Seshadri Sen, head of research and strategist at Emkay Global Financial Services. Analysts are now underscoring that profit margins have stabilised at elevated levels, leaving little room for further expansion in the face of weak demand conditions.

"Near-term signals are mixed," said Sen. "Weak commodities, a possible US rate cut in September, and a mass consumption recovery are significant tailwinds, but slowing consumption at the premium-end segment remains a worry," he added.

Following the muted first-quarter results, earnings revisions for FY25 by brokerages have been flat to marginally negative.

Nuvama cut its FY25 earnings growth estimate for Nifty 50 companies by 2 per cent, driven by cyclicals such as autos and industrials, while keeping forecasts for defensives like IT and FMCG largely unchanged.

Meanwhile, Citibank has left its headline Nifty growth estimates unchanged, forecasting stronger-than-average earnings growth from materials, industrials, and health care, while anticipating a moderation in earnings growth from auto companies.

JP Morgan has also revised its outlook, downgrading stocks in the automobile sector while upgrading those in consumer staples. The brokerage described the Q1FY25 earnings season as "lacklustre", weighed down by limited government spending, demand volatility, rising competition, and a relatively high base.