India Inc earnings feel the squeeze of interest costs

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Rising interest costs have become one of the biggest headwinds for corporate earnings. Interest expenses are now the fastest-growing cost head for India Inc and are weighing down corporate earnings despite a softening of raw material and energy costs in recent quarters.

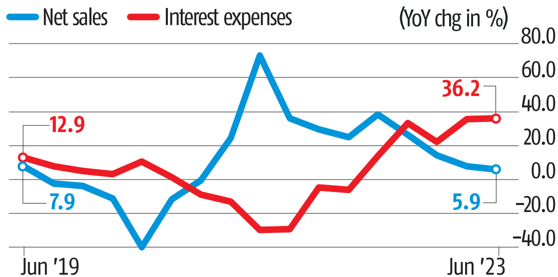
The combined interest expenses of the 271 listed companies, excluding banking, financial services and insurance (BFSI) and information technology (IT) services, were up 36.2 per cent year-on-year (YoY) in the 2023-24 (FY24) April-June quarter (first quarter, or Q1), growing at the fastest pace in three years. In contrast, manufacturers reported a sharp deceleration in raw material and energy costs in Q1 compared to the same period last year.

The companies' combined expenses on raw materials, power, and fuel, including inventory changes, were up just 2.3 per cent YoY, down sharply from 56.1 per cent YoY growth in Q1 of 2022-23 (FY23).

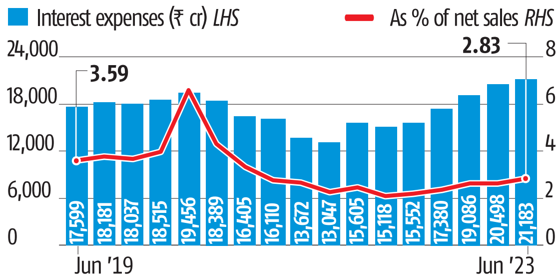
In comparison, these companies combined net sales were up 5.9 per cent YoY in Q1FY24, a sharp deceleration from 38.6 per cent YoY in Q1FY23 and 7.8 per cent YoY growth in the fourth quarter (Q4) of FY23. Turn to Page 6 ▸

CASTING A SHADOW

Opposite growth trajectories



Interest costs & their burden on revenues



Note: Based on an early-bird sample of 271 companies excluding BFSI & IT services firms; BFSI: Banking, Financial Services, and Insurance
Sources: Capitaline, Bloomberg
Compiled by BS Research Bureau

Ebitda margin of 22.1 per cent. It has the largest trade generics business among big pharma players in India, with an estimated 8-10 per cent share of this market. (Trade generics are medicines not pushed through doctors but directly through trade channels.)

Cipla is the second-largest player in the chronic branded-prescription business in India and has been increasing its focus on chronic therapies. It is the leader in respiratory therapies in the country. It is also among the top 10 players by prescription in the US market, where it is a late entrant. Now it draws 13 per cent of its revenue from international markets, and has 3 per cent contribution from active pharmaceutical ingredients.

India Inc...

The 271 companies in the Business Standard sample collectively spent ₹21,183 crore on interest expenses in Q1FY24, up from ₹15,552 crore a year ago and ₹20,498 crore in Q4FY23. The rise in interest burden in the past year has negated a large part of the gains to Corporate India from a decline in commodity and energy prices in the period. As a result, pre-tax and post-tax profits were down despite growth in operating profits, or earnings before interest, tax, depreciation, and amortisation (Ebitda), in Q1.

The combined operating profit, or Ebitda, of the companies in the Business Standard sample, was up 4.5 per cent YoY to ₹1.27 trillion in Q1FY24 from ₹1.22 trillion a year ago. However, their combined profit before tax was down 6.4 per cent YoY in Q1FY24 to ₹71,555 crore, while their combined net profit after tax was down 2.6 per cent YoY to ₹48,472 crore in Q1FY24.

For comparison, the combined interest expenses of all 385 companies that have declared their results for Q1FY24, including BFSI and IT companies, were up 42.5 per cent YoY in Q1FY24 against 12.7 per cent YoY growth in net sales (gross interest income in the case of lenders).

Banks and finance companies topped the charts with a 43.5 per cent YoY jump in interest expenses, but it was largely compensated by a 32.7 per cent YoY growth in their gross interest income.

In contrast, non-BFSI and manufacturing companies saw a record-high gap between the growth in their revenues and interest expenses. The combined net sales of the companies in the *Business Standard* sample in Q1FY24 grew at the lowest pace in 10 quarters due to the combined effect of a demand slowdown and price deflation for commodity producers. In contrast, companies' interest expenses continue to accelerate due to a rise in borrowings and higher interest rates.

This has raised the interest burden on corporate earnings.

Interest expenses accounted for 2.83 per cent of companies (excluding BFSI and IT) net sales in Q1FY24, up from 2.2 per cent a year ago, and the ratio is the highest in 10 quarters.

The interest burden on earnings is, however, still lower than that in the pre-pandemic period. Interest expenses-to-net sales ratio was 3.6 per cent on average during 2018-19 (FY19) and 2019-20 (FY20).

In contrast, this ratio had declined sharply in the post-pandemic period, hitting a low of 2.08 per cent in Q4 of 2021-22 due to a decline in interest rates and deleveraging by many companies. This has acted as a tailwind for corporate earnings. The cycle has now reversed, and interest costs have once again become a headwind for India Inc. This is similar to the situation in FY19 and FY20, when interest expenses were growing faster than net sales, resulting in muted earnings growth in the non-financial space.

FinMin...

The finance ministry in its review meeting held in March had told PSBs to manage the overall exposure to companies, inclusive of pledged shares, against the backdrop of a banking crisis in developed economies.

Canara Bank in its response to an email query said the top 10 corporate borrowers of the bank as on March 31, 2023 were either government-owned Maharatna or AAA/AA-rated companies where the credit risk premium was low. "It is the bank's endeavour to grow the credit book between RAM (retail, agriculture and MSME) and corporate credit in a ratio of 55:45 to diversify credit/concentration risk," it added.

A senior official of Punjab & Sind Bank said the bank's top 10 borrowers were either government-guaranteed or high-rated companies. "Earlier, the bank was little skewed towards corporate loans, but now the bank is focussing on the RAM portfolio, after which automatically the concentration will become less," the official said, requesting anonymity.

In an interview with