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Interest cost in the corporate sector

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There is constantly demand for lowering of interest rates by corporates as it affects the decision to invest in capital besides their financial performance. Just how important is this interest cost? Also do all companies pay the same rate of interest or is there variation across industries as both the requirement and risk factors are different? Further, has there been any tendency for companies to deleverage and lower their debt levels in FY17 since capital formation in the economy has slowed down in the last few years. These are some questions which are addressed in the foregoing study.

The study is based on results of a sample of 2386 companies for FY17. The sample companies have been classified under 38 sectors. Four variables have been analysed here.

1. **Interest to sales ratio.** This gives an idea of the importance of the interest component for companies. As requirement for funds vary across purpose and capital requirements for different industries, this ratio highlights the importance of cost of capital in overall matrix.

2. **Average interest rate for the sector.** This has been reckoned as the ratio of interest payments to the average of total debt outstanding for 2015-16 and 2016-17. As risk perceptions vary across sectors, this aspect is captured here. However, while the rates would vary across sectors, companies could be procuring funding at variable rates within the group based on their own credit rating. This aspect is not addressed here.

3. **Change in absolute debt levels.** The difference in outstanding debt between 2015-16 and 2016-17 has been calculated here. On account of lower investment levels, it was noticed that growth in bank credit had slowed down. Further, companies were retiring expensive debt from cash reserves besides switching to cheaper credit from institutions or the debt market where interest rates were more responsive to policy rate changes.

4. **Investments made by companies in fixed assets as depicted by growth in GFA.** This gives an indication of the sectors which were investing in capital in FY17. It shows hence the amount of capital formation taking place in different sectors.

Ratio of interest cost to sales

Table 1 below presents information on the ratio of interest to sales for various sectors. For industry as whole the ratio is quite low at 3.3% and varies from less than 0.5% to 12.9%. As may be expected, the capital intensive industries such as power, realty, telecom and iron and steel have the highest ratios followed by logistics, infrastructure, textiles and construction material.

- Some of these industries have also been found to have high stressed assets as per RBI's FSR which highlighted that the highest levels were in the industries metals, cement, textiles, automobiles and construction.
- Logistics, education and hospitality are some of the services which carry relatively higher interest costs.
- The highest ratio is for finance companies which use funds as basic raw material for onward lending. The ratio is 52.9%.
- 15 of the 38 industries have an interest cost to sales ratio above the average of the sample.

Table 1: Interest to sales ratio (%)

Sector	No	Ratio	Sector	No	Ratio
Power	25	12.89	Miscellaneous	54	2.53
Realty	80	12.60	Chemicals	154	2.53
Telecom	19	9.41	Retailing	10	2.52
Iron & Steel	90	8.86	Trading	131	2.47
Logistics	37	8.67	Capital Goods	154	2.34
Infrastructure	73	7.30	Gas Transmission	3	1.99
Textile	198	6.48	Consumer Durables	27	1.82
Construction Material	75	6.46	Alcohol	12	1.78
Hospitality	51	6.38	Diamond & Jewellery	17	1.51
Education	6	6.01	Ind. Gases & Fuel	10	1.39
Non - Ferrous Metals	23	5.84	Automobile & Ancillaries	141	1.02
Paper	32	5.47	FMCG	83	1.00
Agri	86	4.40	Crude Oil	19	0.72
Electricals	28	4.13	Ship Building	2	0.52
Media/ entertainment	64	3.80	IT	122	0.43
Ferro Manganese	5	3.17	Abrasives	3	0.34
Plastic Products	72	2.95	Mining	5	-
Aviation	2	2.92	**All**	**2055**	**3.25**
Diversified	20	2.92	***Finance***	***331***	***52.94***
Healthcare	122	2.78			

Average interest cost

Table 2 provides information on the average interest cost for various industries on their outstanding borrowing. The average was 8.2% for the sample which may be compared with the current MCLR of 7.75-8.10% and base rate of 9-9.55%. Companies have been replacing more expensive loans with cheaper ones and have hence on an average kept the rate down.

- 27 of the industry groups had an average interest cost of above 8.2%.
- The highest rates were for capital goods, followed by infrastructure and FMCG.
- Some of the services had very high cost of borrowing like education, retail, media, realty and aviation.

- The finance sector had averaged 8.5% and was just above the sample average.
- Crude oil, logistics and power had relatively lower cost of credit compared with the others. Accessing the bond market and ECBs were routes used by some of these companies to keep costs under check.

Table 2: Average interest cost

Sector	No	Rate	Sector	No	Rate
Abrasives	3	17.0	Non - Ferrous Metals	23	9.1
Capital Goods	154	14.2	Ferro Manganese	5	9.1
Infrastructure	73	13.0	IT	122	8.4
FMCG	83	12.9	Paper	32	8.4
Education	6	12.7	Ship Building	2	8.4
Electricals	28	12.7	Miscellaneous	54	8.4
Trading	131	11.2	Automobile & Ancillaries	141	8.3
Retailing	10	11.1	Chemicals	154	8.2
Construction Material	75	10.9	Diversified	20	8.1
Alcohol	12	10.5	Gas Transmission	3	7.7
Media & Entertainment	64	10.2	Plastic Products	72	7.7
Realty	80	10.1	Hospitality	51	7.3
Textile	198	9.9	Telecom	19	7.0
Agri	86	9.9	Healthcare	122	7.0
Diamond & Jewellery	17	9.8	Power	25	6.9
Consumer Durables	27	9.7	Logistics	37	6.3
Iron & Steel	90	9.5	Crude Oil	19	4.3
Aviation	2	9.1	**All**	**2055**	**8.2**
Inds. Gases & Fuels	10	9.1	Finance	331	8.5

Where has debt increased?

Aggregate debt of the sample companies excluding finance increased from Rs 17.73 lkh crore to Rs 18.65 lkh crore in FY17. For the finance companies the increase was from Rs 12.45 lkh crore to Rs 13.92 lkh crore.

- The industries with the highest share in o/s debt in FY17 were power (19.9%), iron and steel (14.1%), crude oil (12.4%) and telecom (10.4). As can be seen these 4 sectors accounted for around 57% of total debt in the system. The next three industries with high shares were lower at 4.5% for textiles, and 4.4% for both non-ferrous metals and infrastructure.
- The 4 leading sectors which increased their debt by over Rs 10,000 cr each in FY17 were telecom, power, non-ferrous metals and crude oil. With the exception of non-ferrous metals, the other three had low average interest cost of less than that of the sample companies. Some of these companies have accessed the ECB market to lower their borrowing costs, while others have also borrowed in the corporate debt market where transmission of policy rates has been swift.
- The other industries that witnessed an increase of more than Rs 2,000 crore each were logistics, iron and steel, auto, textiles and trading.
- Almost half the industries i.e. 19 had witnessed deleveraging with o/s debt level coming down in FY17. The highest amount of reduction in debt came from chemicals, construction material, industrial gases and aviation (not a representative sample as it consists of only 2 companies) besides the diversified group of companies.

Table 3: Change in outstanding debt (Rs cr)

Sector	No	Change	Sector	No	Change
Finance (not part of sample 2055 companies)	331	147,145	Electricals	28	-82
Telecom	19	37,740	Abrasives	3	-107
Power	25	29,937	Ferro Manganese	5	-131
Non - Ferrous Metals	23	16,547	Miscellaneous	54	-184
Crude Oil	19	10,708	IT	122	-234
Logistics	37	6,606	Alcohol	12	-406
Iron & Steel	90	6,315	Gas Transmission	3	-439
Automobile & Ancillaries	141	5,419	Consumer Durables	27	-588
Textile	198	3,771	Agri	86	-797
Trading	131	2,638	Infrastructure	73	-1,231
Realty	80	1,210	Mining	5	-1,507
Retailing	10	1,166	Capital Goods	154	-1,695
Media & Entertainment	64	1,065	Plastic Products	72	-1,697
Diamond & Jewellery	17	335	Healthcare	122	-2,209
FMCG	83	190	Aviation	2	-2,364
Hospitality	51	104	Diversified	20	-2,990
Education	6	95	Inds. Gases & Fuels	10	-3,175
Paper	32	39	Construction Materials	75	-4,370
Ship Building	2	0	Chemicals	154	-7,924
			All (excluding finance)	**2055**	**91,754**

Where was investment taking place?

For the sample of 2055 companies, the increase in GFA was 11.5% from Rs 28.91 lkh crore to Rs 32.23 lkh crore. The stock of GFA was again concentrated in the 4 industries with highest outstanding debt and accounted for around 57-58% of the total.

- In terms of capital formation (change in GFA), the leading sectors were media, retailing, healthcare, telecom and FMCG. The first two however had a share of less than 1% each in overall GFA for the sample.
- In case of healthcare, while GFA growth was high, the absolute level of debt came down which could be attributed to the use of internal funds for investment purposes.
- In terms of incremental GFA during FY17, 4 sectors accounted for around 70% of the total: crude oil (23.5%), telecom (18.4%), power (15%) and iron and steel (13.4%).

Table 4: Change in GFA

Sector	No	Growth	Sector	No	Growth
Media & Entertainment	64	20.1	Inds. Gases & Fuels	10	9.0
Retailing	10	19.6	Realty	80	8.4
Abrasives	3	18.8	Trading	131	8.3
Telecom	19	18.3	Non - Ferrous Metals	23	8.3
FMCG	83	15.1	Diamond & Jewel	17	8.1
Healthcare	122	14.8	Construction Mat	75	6.4
IT	122	14.8	Diversified	20	6.1
Crude Oil	19	13.4	Chemicals	154	5.5
Electricals	28	13.3	Textile	198	4.9
Mining	5	13.2	Ship Building	2	4.8
Education	6	12.9	Con Durables	27	4.6
Power	25	12.8	Infrastructure	73	3.5
Iron & Steel	90	12.0	Hospitality	51	3.0
Miscellaneous	54	11.8	Agri	86	1.7
Paper	32	11.8	Ferro Manganese	5	-1.8
Gas Transmission	3	10.8	Plastic Products	72	-2.4
Alcohol	12	9.8	Aviation	2	-20.2
Capital Goods	154	9.7	**All**	**2055**	**11.5**
Automobile & Ancillaries	141	9.5	***Finance***	***331***	***12.3***
Logistics	37	9.2			

To Summarize:

The above may be summarized by the following matrices.

Matrix 1: Debt change, Interest to sales and interest cost

Industry with incremental debt of above Rs 1000 cr in FY17	Interest to sales ratio <=3.2: Low 3.2-6.5: Medium Above 6.5: High	Interest cost <= 8.2%: Low 8.2-10: Medium Above 10: High
Telecom	High	Low
Power	High	Low
Non ferrous	Moderate	Moderate
Crude oil	Low	Low
Logistics	High	Low
Iron and steel	High	Moderate
Auto	Low	Low
Textiles	High	High
Trading	Low	High
Realty	High	High
Retail	Low	High
Media	Moderate	High

Industries in bold italics have higher than sample growth in GFA.

Matrix 2: Sectors with high interest cost and debt change

Industry with high interest cost >10%	Debt status Low: <Rs 1000 cr Moderate : Rs 1000-2500 cr
Capital goods	Deleveraging
Infrastructure	Deleveraging
FMCG	Low
Education	Low
Electricals	Deleveraging
Trading	Moderate
Retail	Moderate
Construction material	Deleveraging
Alcohol	Deleveraging
Media & entertain	Moderate
Realty	Moderate
Interest cost 9.5-9.9%	
Textiles	High
Agri	Deleveraging
Diamonds & jewelry	Low
Consumer durables	Deleveraging
Iron and steel	High

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