

## Financial Performance of Corporate Sector: Q3 FY11

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#### **Background:**

The Indian economy has been through challenging times in FY11, more so in the third quarter. The IIP numbers for Q3 have been quite disappointing, the cumulative growth in IIP for Q3 FY11 stood at 5.3% compared with 13.3% in Q3 FY10. Inflation has been a serious problem faced by the economy in Q3. Inflation growth rate for manufactured products was 4.8% in the third quarter as against 2.2% in FY10 for the same period also fuel & power prices increased by 10.8% and the primary articles by 16.4%.

In order to curb inflation, RBI has increased the policy rates; Repo and RRepo once in Q3 FY11. IMF data indicates that Q3 also saw an increase in global commodity prices, metal prices increased by 27.8% (-14.6%), energy by 12.8% (-43.1%) and petroleum prices saw a growth of 11.4% (-41%). The price increase was supported by relatively strong demand and supply constraints in emerging markets.

The third quarter saw a significant increase in the resources raised by the domestic market through public offers. Equity issue for Q3 FY11 amounted to Rs 29,433 crore in comparison with Rs 6,188 crore for Q3 FY10. Foreign trade showed some signs of improvement with exports increasing by 28.7% (15.2%). Imports for petroleum products fell drastically to -1.1% in Q3 FY11 from 18% in Q3 FY10 and the non petroleum products registered a growth of 12.1% (-7.1%).

The performance of corporate sector should be viewed against this background.

#### **Financial Performance**

The overall sample included in this study is a set of 2259 companies across 48 industries which accounted for two-third of the overall corporate sales in 2009.

**Table 1: Growth rates of Sample Companies**

(%)	2009	2010
Sales	14.4	20.6
Other income	-17.5	5.8
Total income	12.5	19.9
Stocks	126.7	29.9
Total expenses	12.6	19.9
Raw material	21.7	20.7
Salaries and wages	2.4	23.8
Interest	-4.6	16.6
Depreciation	33.9	5.3
Net profit	38.8	20.7

**Table 2: Important Ratios of Sample Companies**

(%)	2008	2009	2010
Net profit/Sales	9.3	11.3	11.3
Interest Coverage (times)	1.8	2.1	2.2
Raw materials/Total expense	45.8	49.4	49.7
Taxes/ (Net profit + Taxes)	29.6	27	27.6

*Profit ratios stable*

**Highlights of the aggregate performance:**

- Total sales for the sample companies grew by 20.6% in Q3 FY11 as compared with 14.4% in Q3 FY10. This shows a major recovery in top line growth unlike in FY10 when growth was subdued.
- Other income showed a growth 5.8% over the previous year growth of -17.5%
- Total income registered a growth rate of 19.9% (12.5%) in Q3 FY11
- Overall stocks increased to Rs 3,238 crore from Rs 2,493 crore. This indicates the buildup of inventory in specific sectors.
- Growth rate of Total Expenses for Q3 FY11 stood at 19.9% against 12.6% in the previous year. The higher growth in total expenses may be attributed to high growth in prices. This was reflected in the high ratio of raw materials to total expenses in both Q3-FY10 and Q3-FY11.
- Raw materials grew at 20.6% against 21.7% in Q3 FY10. Raw material prices were higher due to an increase in global prices of commodities such as metals, chemicals and food products.
- Interest payments increased by 16.6% in Q3 FY11 over - 4.6% in Q3 FY10. However, the share of interest payments in total expenses was 14.3% in Q3 FY11 and 14.7% in Q3 FY10. Interest payments increased by 16.6% in Q3 FY11 over -4.6% in Q3 FY10. However, the share of interest payments in total expenses was 14.3% in Q3 FY11 and 14.7% in Q3 FY10. Higher interest payments may be attributed to increasing interest rates during the year.
- Net profits for the sample grew by 20.7% on top of growth of 38.7% in the previous year.
- Profit margins, represented by Net profit to sales ratio remained unchanged at 11.3% in Q3 FY11
- Interest coverage ratio has shown a marginal increase at 2.2 in Q3 FY11 in comparison with 2.1 in Q3 FY10. This indicates that the interest coverage ratio has been maintained despite the rising interest rate regime.

*Resurgence in growth in sales*

*Interest costs, a concern*

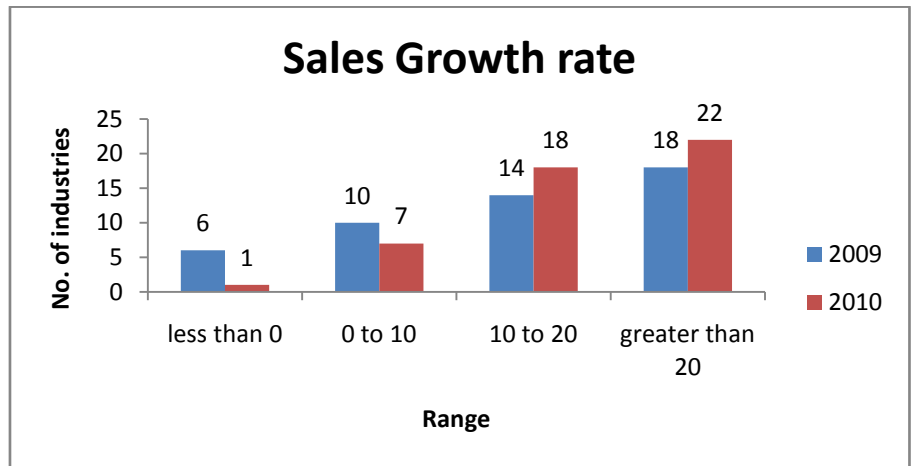
*Interest cover maintained*

*Buoyancy in sales growth quite pervasive across industries*

**Growth in net sales:**

Sales of the sample companies increased by 20.6% in Q3 FY11 compared with 14.4% increase in the same period last year. The industries which had higher growth of net sales in Q3 FY11 relative to the aggregate sample were tyres and tubes (37.7%), ceramic products (35.7%), cotton textiles (34.3%), two wheelers (33.6%), paints (33.1%), gems & jewelry (31.9%), dyestuffs (30.6%), passenger vehicles (29.6%), paper (29%), commercial vehicles (28%), asset financing services (28%), banking services (23.7%) and drugs & pharmaceuticals (23%).

As the chart below shows, there was an increase in the number of industries that had sales growth of over 20% from 18 to 22 and between 10 and 20% from 14 to 18. Only one industry (readymade textiles) had a negative growth rate – absolute fall in sales as against 6 in Q3-FY10. In general, there was an improvement in growth in sales.



**Some of the factors affecting the sales growth were;**

- Tyres demand continued to grow, particularly for radial tyres , both for trucks/buses and passenger car which was reflected in the sales growth for Q3 FY11.
- Sales of ceramic products grew on account of healthy demand from the real estate, retail, hospitality and health infrastructure.
- Growth in cotton textiles was driven by strong demand for denim and shirting fabrics.
- Sales of two wheelers, passenger vehicles and CVs grew on account of strong demand characterized by improved industrial activity, freight demand and availability of finance.
- Sales growth in banking sector was supported by growing demand for credit.
- The paper industry benefited from better capacity utilization as well as realizations.
- The festival season helped to prop up the sales of the paints and gems & jewelry industries.

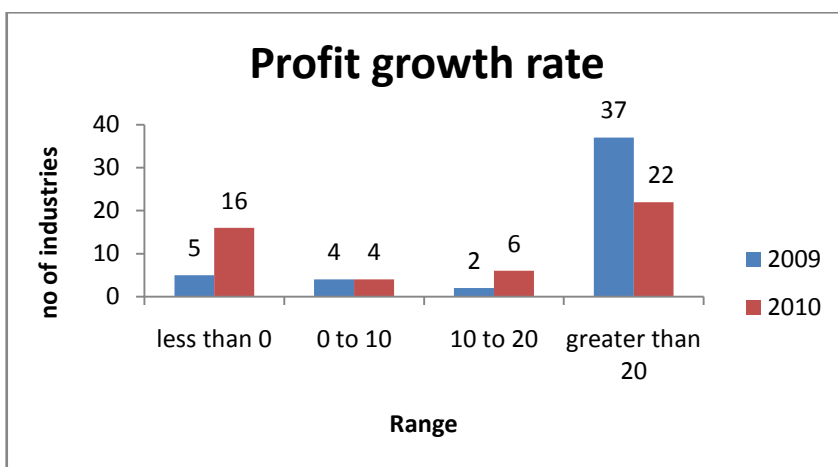
*Demand factors provide boost to several industries, and festival season helps*

Growth in sales was low in case of tea (4.6%), real estate (4.1%), sponge iron (2.6%) and aluminium (0.8%). The only industry which saw negative growth was readymade garment (-19.2%).

**Growth in net profits:**

Net profit for the sample registered a growth of 20.7% in Q3 FY11 on top of growth of 38.7% in Q3-FY10. Cotton textiles (206.6%), paper (72.8%), aluminium (63.1%), fertilizers (58.4%), manmade textile (54.4%), gems & jewelry (52.8%), asset financing (36.4%), glass (32.4%), petroleum (30.5%), edible oil (28.2%), banking (23.6%), passenger cars (22.2%), non-electrical machinery (21.6%), real estate (16.3%) and IT(16.2).

*Growth in net profits impressive as it comes over high growth last year*



The chart above indicates that there were 16 industries which witnessed a decline in profits which may be attributed mainly to higher growth in expenses on account of increasing prices of commodities which could not be fully passed on to the consumers.

*But, number of industries with lower profit growth levels increases*

**Following factors had an impact on net profits:**

- Higher sales contributed to the high growth in profits for the cotton textiles
- The growth in aluminium profits were driven by strong demand, higher capacity utilization and better control over costs.
- Man made textiles were influenced by healthy growth in demand for apparel from domestic and export market which in turn boosted demand for synthetic fibres.
- The growth in gems and jewel was due to an increase in disposable income in the hands of consumers and a shift towards branded jewellery. This sector also experienced slower growth in salaries, advertising and other operating expenses.
- Petroleum growth was attributed to increased refinery and a recovery in global oil demand. This sector had an impact of lack

*Higher sales growth and better realizations helps improve profits across sectors*

of government subsidy, lower crude processing and higher staff costs and taxes.

- The growth in edible oil was a contribution of higher capacity utilization of soya crushing and edible oil refining capacities. Strong growth in sales and greater focus on value addition also contributed to better performance.

- Banking sector's growth was a result of healthy growth in net interest and fee income.

- The profits of real estate had a strong impact of higher spending on land, plots and constructed properties which led to sharp growth in total expenses.

- IT sector generated profits owing to strong demand for outsourcing services and stable fees.

Industries which registered negative growth rate in profits in Q3 FY11 were; commercial vehicle (-7.9%), electricity (-15.6%), steel (-17.1%), cement (-19.4%), pesticides (-23.1%), electronics (-32%), tyres & tubes (-38.8%) and sugar (-94.6%). The cement sector was affected because of the difficult operating environment in the sector, rising cost structure, weak realizations on a per tonne basis and also the fall in the selling price. The absence of fresh government-funded infrastructure projects, coupled with uneven recovery in the sectors such as real estate curtailed the demand for cement. Steel sector reported a negative growth rate owing to high raw material costs and seasonal factors. The profits of the commercial vehicle and electronics sectors were also affected by rising input prices.

#### **Net profit margin**

While net profit margin remained unchanged for the entire sample, it had declined in case of: sugar, inorganic chemicals, pesticides, paints, cosmetics, tyres and tubes, cement, refractory, steel, sponge iron, electrical machinery, electronics, two-wheelers, electricity and telecom.

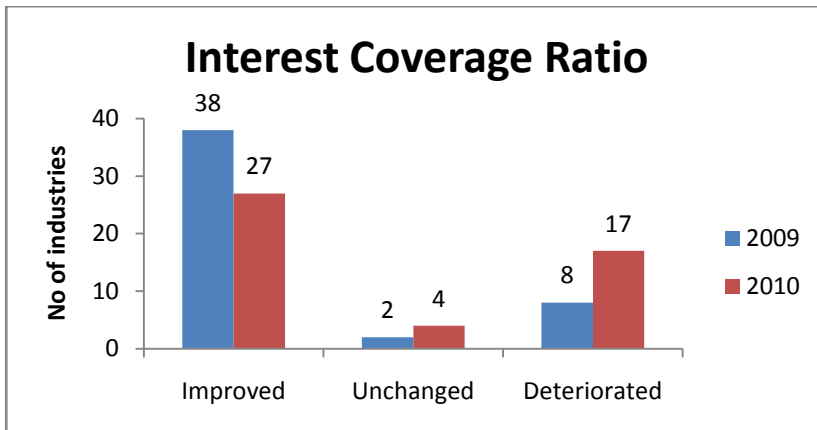
#### **Interest Coverage Ratio:**

Interest coverage ratio (defined as profit before interest and taxes to interest payments) for the sample industries improved marginal at 2.2 in Q3 FY11 from 2.1 in Q3 FY10. Non-electrical machinery (11.8), tea (11.5), fertilizers (8.2), petroleum products (7.4), manmade textiles (5.5) and transport services (3.6) were among those industries which showed improvement in both the years (Q3-FY10 and Q3-FY11). The improvement was a result of increase in profits for the above industries. Electronics(8), steel (6.6), edible oil (3.7), real estate(3.4) tyres & tubes (2.8) and sugar (1.2) are among the sectors whose performance deteriorated in Q3 FY11 owing to slower or negative growth of net profits witnessed by these sectors. Cement and

*Higher cost of raw materials impacts growth in profit*

*Interest cover maintained at aggregate level*

infrastructure were among those sectors whose ratio deteriorated for both the years.



The chart above shows that interest cover improved for 27 industries compared with 38 in Q3-FY10. The number of industries in which it declined increased from 8 to 17. This does show that interest payments have exerted pressure on companies in specific industries.

*Interest payments however, impacts cover for certain industries*

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