PLAIN FACTS

Can debt-light Indian cos draw investments?

BY NITI KIRAN

When the pandemic-led challenges emerged early on, India Inc. switched to repair its balance sheet, pouncing on low interest rates and surplus liquidity. The debt-retiring spree helped shrink the combined gross debt by 12% in 2020-21, shows a *Mint* analysis of a sample of top listed firms. However, borrowings have now risen 31% in the year ended 31 March, latest data shows. Analysts attributed the increase in leverage to the improving business environment, as India's manufacturing sector rebounded after the second covid-19 wave. The analysis covers 184 non-banking and non-financial NSE 500 companies whose financial results for 2021-22 are available.

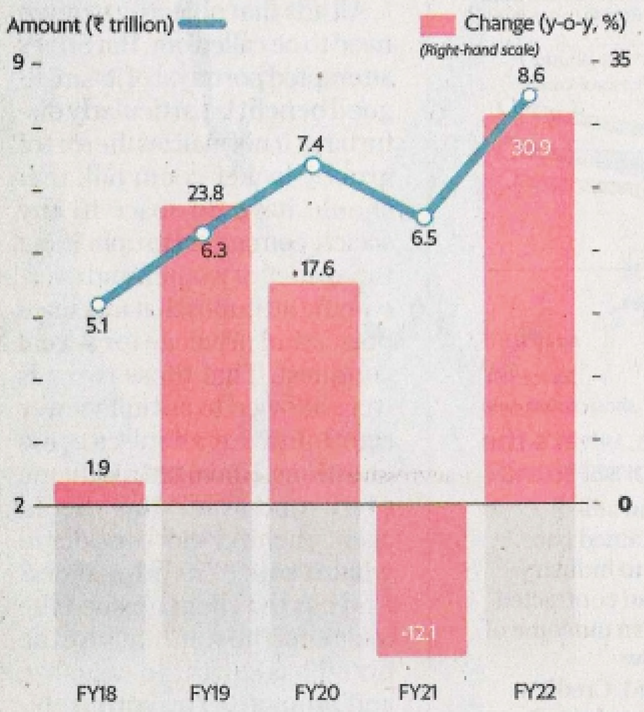
"Some segments are starting to see a strong rebound in capital expenditure," said Sharad Verma, managing director and senior partner, BCG. "In a low-interest rate regime, this capex rebound could partly be the reason for these companies to increase debt levels to finance some of the capex."

Higher commodity inflation is also likely to have led to a jump in companies' working capital requirements.

Debt-to-equity (D-E) ratio, another proxy for leverage, also rose in FY22 in sectors such as power, metals and mining, automobile and pharma. The power sector saw the sharpest rise in D-E ratio from 0.89 to 1.11 times. The auto sector's D-E ratio rose from 0.19 to 0.21. The reason could, however, vary: for instance, the power sector saw increased investment, while auto faced higher working capital requirements, said Rajani Sinha, chief economist, CareEdge.

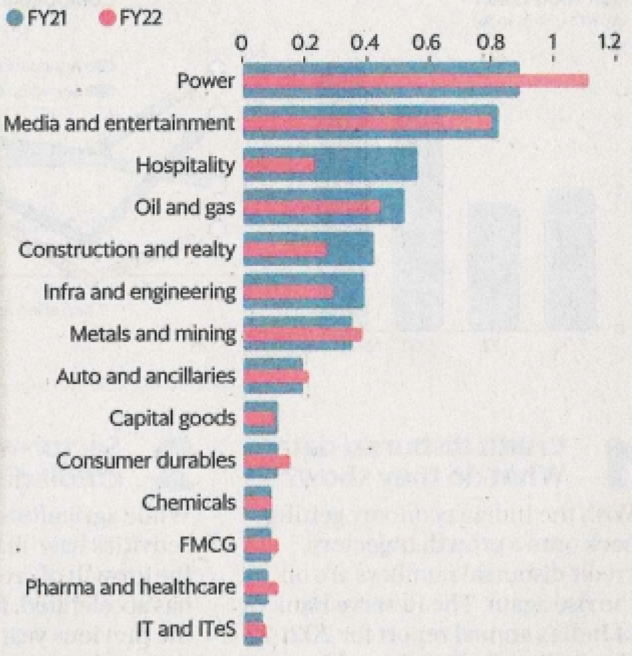
In FY22, companies tapped on low interest rates to fund capex and working capital needs

Total debt of companies in the sample



The debt-to-equity ratio of some sectors raced past their FY21 levels

Sectors with highest debt-to-equity ratio in FY22



Analysis based on standalone data for 184 NSE 500 companies (excluding BFSI) whose FY22 results are available so far.

Source: Capitaline, Mint analysis

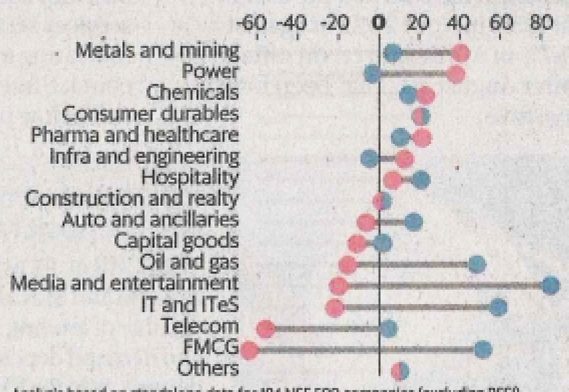
Restrictive Expansion

ACUTE BUSINESS uncertainty and weak demand domestically and externally had kept India Inc. low on animal spirits even before the pandemic. For long after the 2008 financial crisis, investments remained muted globally, and companies made assiduous efforts to enhance capacity. But of late, many sectors have seen some revival due to low interest costs and a commodity boom. Net fixed assets, a proxy for investments, grew 39% in FY22 for metal companies after contracting in the previous year. Chemicals and consumer durables saw 22% and 20% growth, respectively. The impact will spread across sectors gradually as capex will take time to come on board.

But will interest rate hikes deter the recovery? "[Even] as interest rates rise, they will still remain low (relative to earlier levels) for some time," Sinha said. "Moreover, investment decisions won't depend just on interest rates, but also on factors such as demand, supply and capacity utilization."

overall capex impact was still muted

Sectors with best year-on-year growth (%) in net fixed assets in FY22

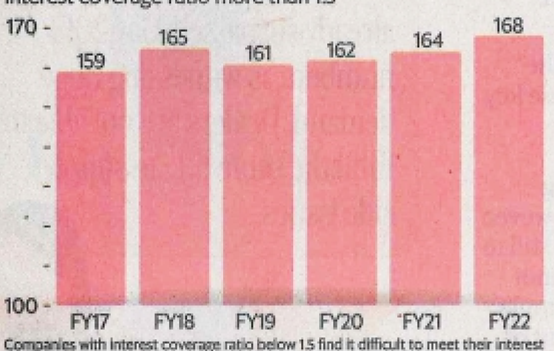


Analysis based on standalone data for 184 NSE 500 companies (excluding BFSI) whose FY22 results are available so far.

Source: Capitaline, Mint analysis

Effort to repair balance sheets has also improved debt servicing ability

Number of companies (out of 184) with interest coverage ratio more than 1.5



Companies with interest coverage ratio below 1.5 find it difficult to meet their interest expenses. Analysis based on standalone data for 184 NSE 500 companies (excluding BFSI) whose FY22 results are available so far.

Source: Capitaline, Mint analysis

Better Credit Profiles

IN THEIR effort to deleverage the balance sheets, companies have improved their ability to service debt on the back of healthy operating profits. The combined interest coverage ratio (ICR) of the sample rose from 6.4 in FY21 and 5.8 in FY20 to 9.2. The combined operating profit was up nearly 31%, while the average borrowing cost fell 318 basis points. This boosted companies' credit profiles sharply, with 91% firms reporting ICR above 1.5, up from 89%. Below a ratio of 1.5, companies' ability to meet interest expenses becomes questionable.

Experts are keeping faith in India Inc.'s ability to service debt and expect it to remain at similar levels, going forward. But some headwinds are arising from commodity inflation as the burden has been passed on only partially to end consumers, affecting margins. Even if margins don't improve over time, operating profits of companies can cover interest expenses, experts argued.

Healthy Reserves

ALL THIS while firms have also been building a war chest for future shocks. Amid the pandemic, companies' cash hoarding jumped 32% in FY21 and 19% in FY22. "Balance sheets for most companies are much stronger than five years ago, and many are sitting on pretty sizable surplus reserves," Verma said. Quite a few have high cash-to-market capitalization ratios, and the uncertainties are only expected to make them cling on to the cash for some more time.

"Companies will continue to be conservative on this and how they allocate this capital is the key decision they are looking at," Verma said. Moving further, he expects some impact from interest rates, but still finds a lot of macroeconomic indicators very conducive.

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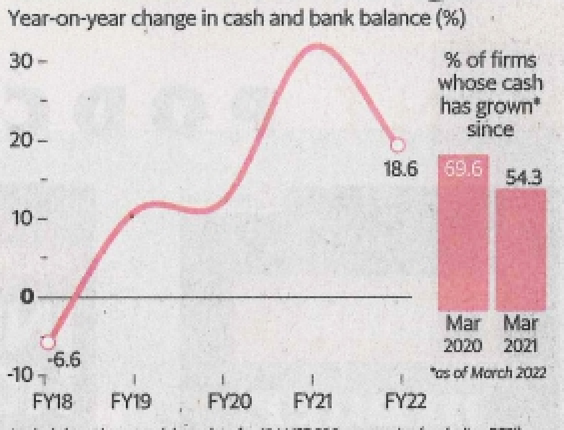
(This is the concluding part of a three-part series about corporate India's recovery from the pandemic and the path ahead. The first part covered companies' stock market performance, and the second part covered earnings data.)

Companies are going to hang on to cash as uncertainties mount again

Year-on-year change in cash and bank balance (%)



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Source: Capitaline, Mint analysis

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