CareEdge RATINGS

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FORESIGHTS

# GROWTH SLOWS SHARPLY IN Q2 FY25 AMID A SLUMP IN INDUSTRIES

India Inc.'s performance in Q2 FY25 remained weak, with decelerating sales and contracting profitability. This slowdown mirrored broader economic trends, as economic growth moderated sharply in Q2 FY25. Meanwhile, high food inflation has kept headline inflation elevated. Amidst these challenging growth and inflation dynamics, the MPC adopted a 'wait and watch' approach and kept the policy rates unchanged. However, the RBI's CRR cut will inject liquidity into the banking system supporting credit growth and bolstering economic momentum.

# NOTE FROM
# SACHIN GUPTA
## Chief Rating Officer & Executive Director

**India's Economic Resilience Amid Global Uncertainties**

As 2024 concludes, India's economic outlook is cautiously optimistic. The Indian government is set to maintain fiscal consolidation amidst global uncertainties, with GDP growth expected at 6.5% for FY25 and 6.7% for FY26. In the first half of FY25, India's corporate sector demonstrated resilience despite global challenges. However, businesses are hesitant to make long-term investments leading to a delay in private capital expenditure. Expectations for improved private investment are positive for 2025, aided by anticipated monetary policy easing.

Growth momentum has been influenced by shrinking public capital expenditure, prolonged monsoon rains, and weakened urban demand. Yet, recovery in consumption and increased government capital expenditure, supported by strong agricultural production and a robust services sector, are projected to drive growth in the second half of FY25. CPI inflation is predicted to moderate thanks to a strong kharif harvest and favourable rabi conditions. Excluding vegetable inflation, CPI inflation has remained under 4%. Average CPI inflation is estimated at 4.8% for FY25 and 4.5% for FY26, while core inflation may hover around 3.5% in FY25 and 4.3% in FY26. WPI inflation is expected to average 2.5% in FY25 and 3% in FY26.

Net revenue collections should align with budget targets, as a drop in corporate tax collection could be balanced by strong income tax revenues. However, the Centre's capital expenditure might fall short by Rs 1.5 trillion. Nominal GDP growth is anticipated at 9.9%, below the targeted 10.5% for FY25, with a fiscal deficit expected at 4.8% of GDP, slightly better than the 4.9% budgeted.

Merchandise exports are projected to rise by 2.5%, with services exports expected to grow by 13% in FY25. Remittance trends are encouraging, keeping India's current account deficit (CAD) manageable at 0.9% of GDP in FY25. While a strong dollar and weak yuan may exert pressure, manageable CAD and foreign exchange reserves are likely to support the rupee, trading around Rs 84 by the end of FY25 and Rs 84-86 by the end of FY26.

The RBI is expected to cut policy interest rates by 50-75 basis points in 2025 as food inflation eases. The yield on 10-year government securities may range from 6.5% to 6.6% by the end of FY25 and between 6.1% to 6.3% by FY26. Credit growth in the banking sector has slowed due to mergers and higher risk weights imposed by the RBI. The net interest margins for banks are under pressure, leading them to lower deposit rates as growth aspirations temper. Credit costs are expected to increase for both banks and non-banking financial companies (NBFCs), especially in microfinance.

Residential demand is expected to remain strong in 2025, with inventory levels decreasing. The office leasing sector should maintain stability despite global pressures, with absorption and occupancy rates rising above 80%. The air travel sector anticipates passenger traffic growing at double GDP rates, with significant capital expenditure planned.

National Highway construction is set to decline by 10% in FY25, while toll projects are anticipated to rise. The data centre sector has a strong outlook due to substantial investment projections. In renewable energy, capacity addition and manufacturing should accelerate, while the pharmaceutical industry is on track for healthy growth, expected to reach around $65 billion, bolstered by a shift towards complex drugs and rising chronic disease treatment demands.

# NOTE FROM RAJANI SINHA

Chief Economist

**RBI Should Shift Focus on Growth**

With inflationary pressures continuing and growth losing momentum, the RBI Monetary Policy Committee (MPC) faced a challenging task. It chose a wait-and-watch approach to maintain focus on inflation, keeping the policy interest rates and stance unchanged. The Central Bank slashed the CRR by 50 bps to provide comfort on the liquidity front.

CPI inflation moderated to 5.5% in November but remained above the RBI's 4% target. Food inflation remains elevated at 8.8% (three-month average), while core inflation is benign at ~3.5%. Within food inflation, the main culprit is vegetable price inflation, which averaged 26% in the current fiscal. CPI inflation excluding vegetables has been benign, averaging 3.5% in the current fiscal.

Another concerning aspect is the acceleration in edible oil inflation to 13.3% in November, driven by spiking global prices and increasing domestic import duty. While food inflation is due to supply-side factors, the RBI has previously highlighted its concern about inflationary pressures becoming broad-based. Furthermore, geo-political conflicts, threats of a trade war, and financial market volatility continue to pose risks. Given this background, the RBI revised its FY25 average inflation projection upwards to 4.8%, in line with our expectations. With the arrival of fresh harvest, food inflation is expected to moderate to ~6.5% by Q4 FY25.

With Q2 GDP growth sharply lower than expected, the RBI lowered its FY25 growth estimate to 6.6% from the earlier 7.2%. The growth slowdown was due to weak industrial sector performance, while the agriculture and services sectors saw healthy growth. Interestingly, the RBI highlighted that the manufacturing slowdown is not broad-based and is confined to a few sectors like iron and steel, cement, and petroleum products.

Going ahead, the anticipated pick-up in public and private capex should support growth. Furthermore, the expected moderation in food inflation could positively impact consumption. Overall, economic growth is expected to improve in H2. However, our FY25 growth projection at 6.5% is marginally lower than RBI's projection.

The systemic liquidity had tightened with persistent capital outflows and the 50bps CRR rate cut will help improve the situation. This will help release liquidity of ~Rs 1.2 lakh crore in the system, easing short-term rates and preparing the ground for a policy rate cut in the coming quarter.

India's projected GDP at 6.5-6.6% in FY25 is not alarming but warrants attention as it moderates from 7-8% growth recorded in the last two years. CPI moderation in Q4 FY25 could allow RBI to start a shallow rate-cutting cycle. We expect RBI to cut the policy rate by 50-75 bps in 2025. As the RBI Governor takes charge, he is required to navigate the fine balance between managing inflation and sustaining growth. Furthermore, challenges on the currency front also persist, given the weakening pressure on the rupee amid a strong US dollar.

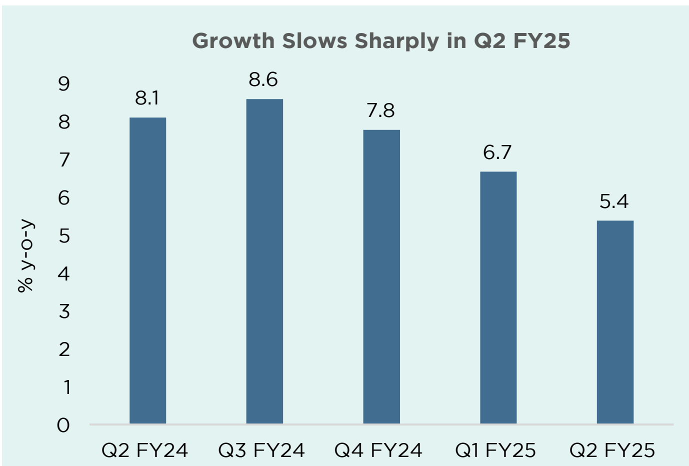
This is an edited version of the article published in The Indian Express on December 02, 2024.

# GROWTH SLOWS SHARPLY IN Q2 FY25 AMID A SLUMP IN INDUSTRIES

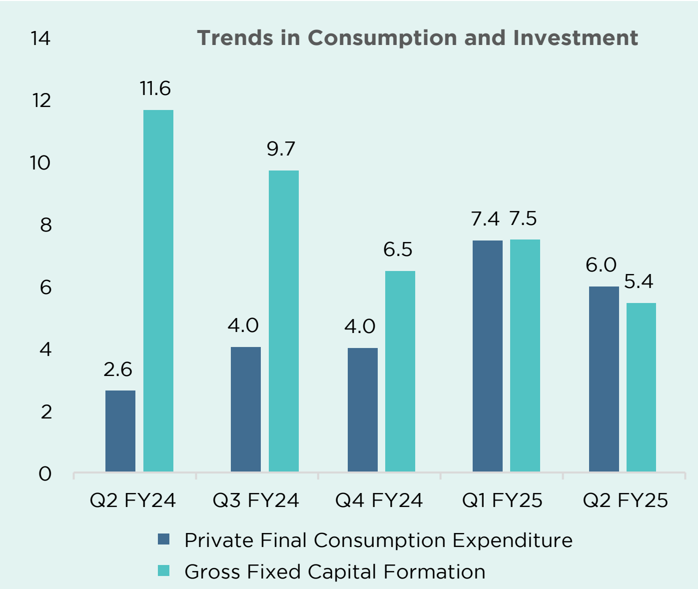
The GDP growth in Q2FY25 moderated sharply to a seven-quarter low of 5.4%, down from 6.7% in the last quarter and much below the market expectations. The GVA growth came in at 5.6% in Q2 FY25. While the GDP growth was expected to moderate as being indicated by some of the high frequency macroeconomic indicators and weaker corporate performance, the quantum of deceleration is much sharper than expected.

In terms of the sectors, agriculture growth continued to recover, growing at 3.5% YoY in Q2, higher than the 2% growth witnessed last quarter. The services sector, too, maintained its broad momentum, growing at 7.1% YoY in Q2, marginally slower than Q1 growth. However, the industrial sector performed poorly, with all major subheads witnessing a slowdown. A prolonged monsoon this year impacted the mining sector in Q2 FY25. Additionally, the contraction in public capex further slowed construction activities. The manufacturing growth witnessed a steep slowdown in growth, growing at 2.2% YoY in Q2, much lower than the 7% YoY growth in the previous quarter. The slowdown in the manufacturing sector was on the expected line, reflecting the moderation seen in IIP data and corporate profitability. However, the quantum of slowdown was higher than expected.

Within the services sector, trade, hotels, transport, communication and broadcasting services saw an improvement in growth compared to the previous quarter. However, the growth moderated in the financial, real estate and professional services to 6.7% compared to the previous quarter's growth of 7.1%. Growth in public




Source: MOSPI




Source: MOSPI

administration services also slowed marginally to 9.2% in Q2 down from 9.5% in the previous quarter. A slower government spending could have impacted this sector.

On the expenditure side, the private final consumption expenditure moderated to 6% in Q2 FY25 from 7.4% in the previous quarter. However, it remained largely healthy. While there are signs of an ongoing recovery in the rural demand, urban demand continues to slow which is concerning. High food inflation and muted real wage growth continues to impact private consumption demand.

There has also been a sharp moderation in investments as measured by Gross Fixed Capital Formation. The government's capex, which had been supporting growth so far, saw a moderation, with the Centre and consolidated State capex falling by 15% and 11%, respectively, in H1. Exports of goods and services grew by 2.8% YoY in Q2, slowing from 8.7% YoY growth witnessed last quarter. However, it was accompanied by a contraction in imports as well, which fell by 2.9% YoY in Q2. On the brighter side, the government's final consumption expenditure rebounded in Q2 as reflected by higher revenue spending.

### Growth by Expenditure (% y-o-y)

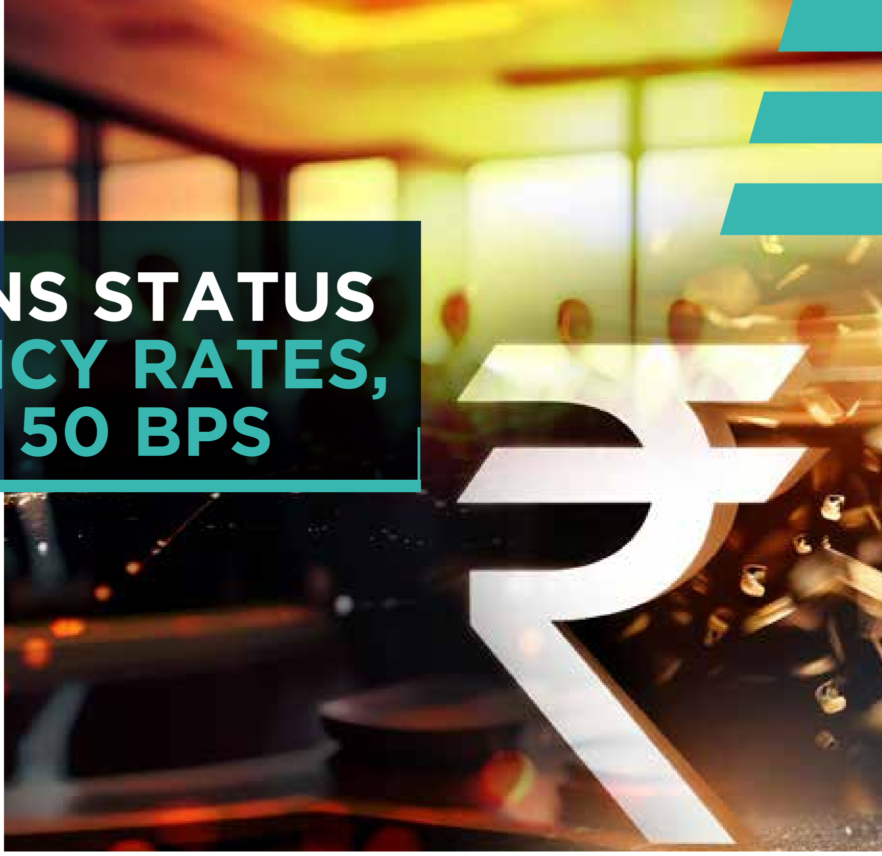
| Particulars | Q3 FY24 | Q4 FY24 | Q1 FY25 | Q2 FY25 |
|---|---|---|---|---|
| Government Final Consumption Expenditure (GFCE) | -3.2 | 0.9 | -0.2 | 4.4 |
| Private Final Consumption Expenditure (PFCE) | 4.0 | 4.0 | 7.4 | 6.0 |
| Gross Fixed Capital Formation (GFCF) | 9.7 | 6.5 | 7.5 | 5.4 |
| GDP (at constant prices) | 8.6 | 7.8 | 6.7 | 5.4 |

Source: MOSPI

## Way Forward

We expect GDP growth to pick up in the second half of the year as the government pushes up its capex spending. Agricultural production is estimated to be healthy and that should help further bolster rural consumption. Food inflation is also expected to moderate by the fourth quarter and that would be supportive of pick up in consumption. Beyond that urban consumption would be dependent on improvement in the employment scenario and real wage growth. Sustained momentum in consumption growth would be critical for private investment to pick up. The order book of capital goods companies and road development companies are showing a significant pick up in first half of the year and that bodes well for overall pick up in capex. However, weak growth in China and consequent flooding of markets like India would remain a deterrent for pick up in private investment. On the external front, while merchandise exports growth is likely to remain muted in midst of global uncertainties, we expect the momentum in services exports to continue. Overall, we expect GDP growth of around 6.8% in H2, taking our projection for FY25 to around 6.5%.

# RBI MAINTAINS STATUS QUO ON POLICY RATES, CUTS CRR BY 50 BPS



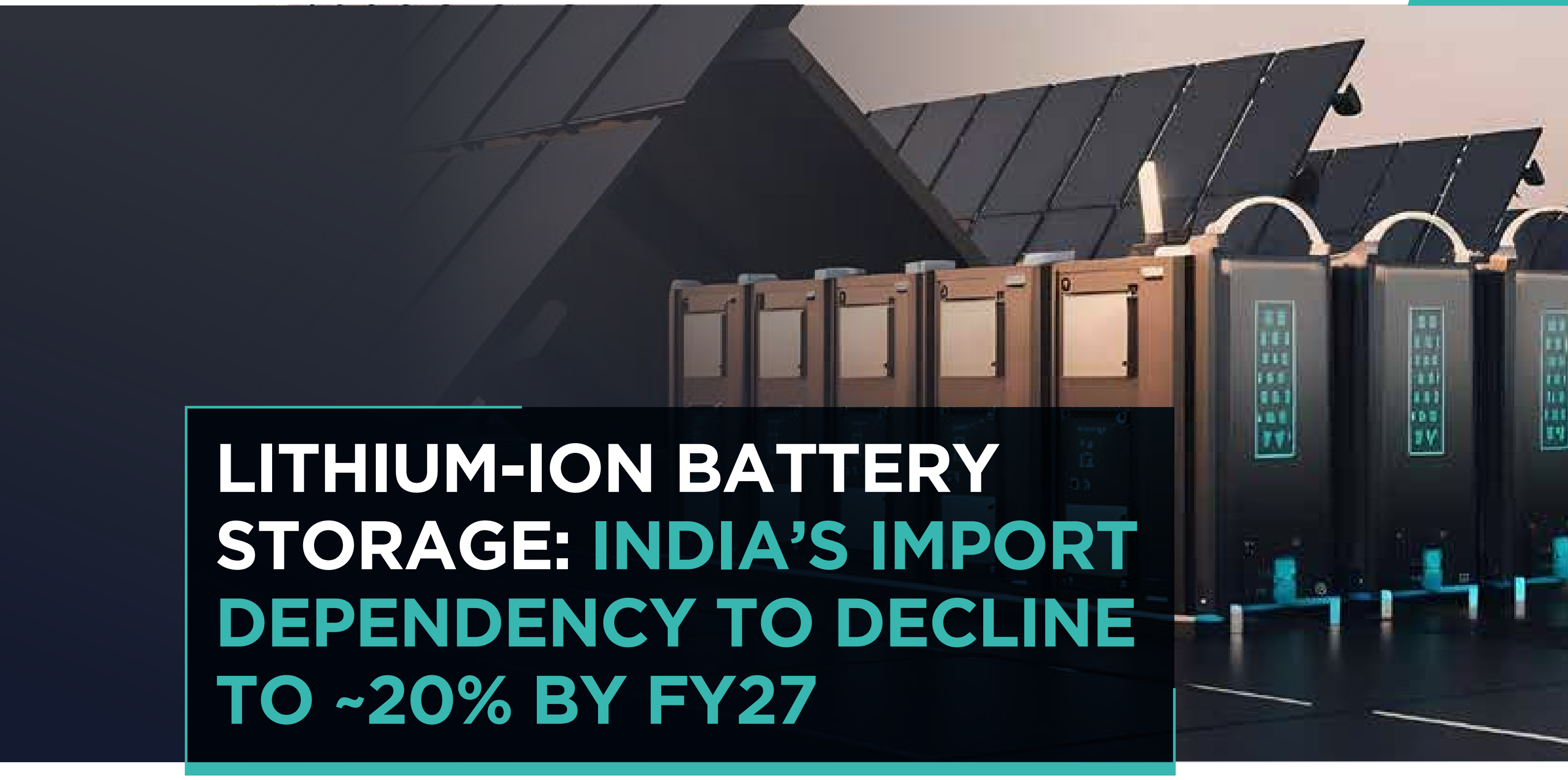
In its December 2024 meeting, the MPC of the RBI maintained the policy repo rate and stance with a 4:2 majority. Notably, the majority in favour of maintaining the status quo fell to 4:2, from the previous 5:1 vote. However, the RBI has decided to reduce the cash reserve ratio (CRR) by 50 bps, aligning it with pre-pandemic levels, and thereby supporting systemic liquidity and money market rates. Adverse recent growth and inflation prints have led the RBI to adopt a "wait and watch" approach. The RBI has reduced the FY25 growth projections downwards by 60 bps to 6.6%, closer to our expectation of 6.5%. CPI inflation projection was increased by 30 bps to 4.8%, in line with our projection.

Strong FII outflows to the tune of ~ USD 13 billion over the past couple of months have intensified pressure on the Indian rupee. Markets anticipate fewer Fed rate cuts now, as the new administration's proposed policies, such as tax cuts and higher tariffs, are likely to be inflationary. The US Federal Reserve is now expected to reduce policy rates by a further 25 bps in 2024 and by ~50-75 bps in 2025, lower than previous estimates. FII outflows and consequent RBI's intervention in the forex market have resulted in a USD 45 billion fall in forex reserves to USD 657 billion. However, India's external situation remains comfortable with sufficient forex reserve and a manageable current account deficit. While volatility in the equity market may continue, FII inflows would be supported by passive inflows into the debt market following India's inclusion in major bond indices. To further strengthen capital inflows, the RBI has increased the interest rate ceiling on Foreign Currency Non-Resident Account (FCNR) deposits for maturities between 1 year and less than 3 years. Additionally, RBI expanded the FX-Retail platform to increase transparency in forex pricing. The RBI will continue to remain vigilant of external developments mainly on the geopolitical front as it may impact global supply chains and impact energy prices.

Systemic liquidity surplus averaged ~Rs 0.1 trillion in the last week of November, down from an average of ~USD 1.5 trillion over the past couple of months. As a result, the weighted average call money rate has risen sharply, nearing the MSF rate and averaging 6.7% at the end of November. Increased forex interventions, higher government cash balances with the RBI and seasonal fluctuations in currency circulation, have reduced systemic liquidity. Ongoing volatility in capital flows and future tax outflows can further tighten liquidity conditions. Hence, the RBI decided to cut the CRR rate. This would increase liquidity and cool down the money market rates, potentially adding ~ Rs 1.2 trillion to the systemic liquidity. We expect that the RBI will continue to remain nimble and flexible in its liquidity management ensuring favourable money market conditions. The RBI will continue to ensure ample liquidity is available to support the credit demand. This will also prepare the ground for a rate cut going forward. The Governor reiterated the significance of financial stability in ensuring the stability of long-term economic growth.

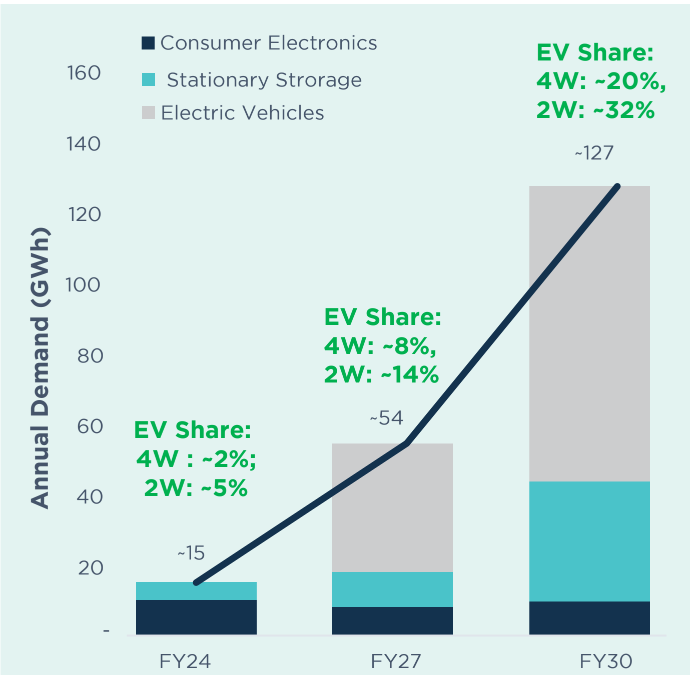
## Way Forward

We expect the RBI to go for a rate cut of 50-75 bps in CY2025 starting with 25 bps cut in February policy meeting. The CPI inflation is likely to moderate below 5% in Q1 CY2025 and that will provide the window for the RBI to start the rate-cutting cycle. There is no denying that there are some concerns on the growth front and as the RBI gets comfort on the food inflation front, they would initiate the rate cut cycle.



# LITHIUM-ION BATTERY STORAGE: INDIA'S IMPORT DEPENDENCY TO DECLINE TO ~20% BY FY27

**Annual demand for Lithium-ion battery storage is expected to reach ~54 GWh by FY27 and ~127 GWh by FY30**

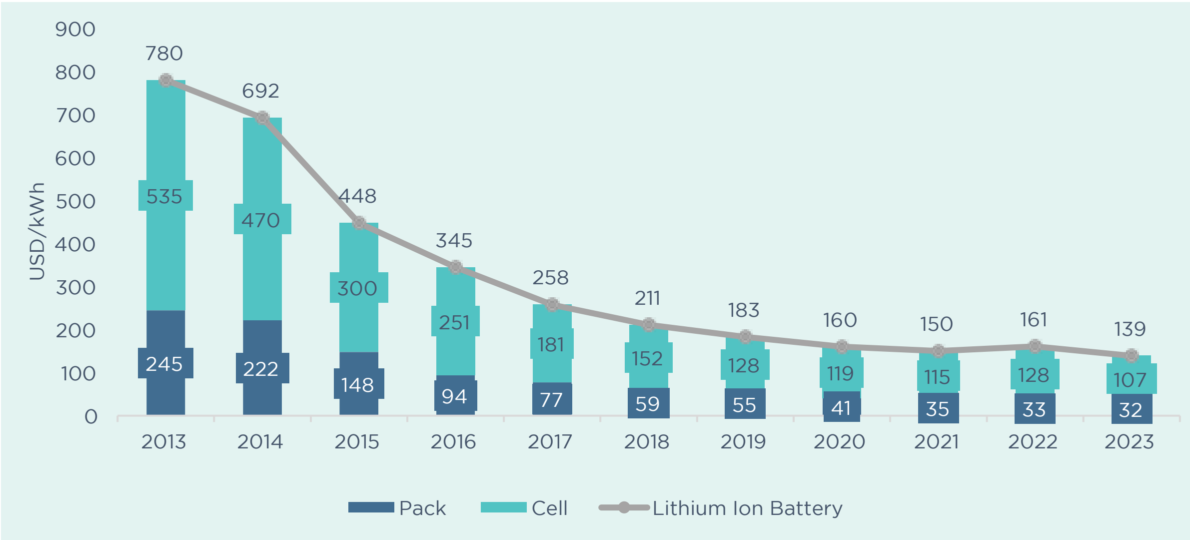



Currently, domestic lithium-ion battery storage demand of ~15 GWh is being entirely met through imports of lithium-ion cells/batteries. CareEdge Ratings expects Li-ion battery demand to grow exponentially to ~54 GWh by FY27 and later to ~127 GWh by FY30. The substantial growth in demand is primarily driven by an expected increase in EV penetration and decarbonisation of electricity grids, supported by ambitious government targets and policies/incentives from both central as well as state governments.

The GoI has initiated several demand-side measures, such as the Faster Adoption and Manufacturing of Electric Vehicles (FAME) scheme, Viability Gap Funding (VGF) scheme for Battery Energy Storage Systems (BESS), which will help reduce the cost of EV and BESS, thereby stimulating demand.

The GoI has set the target of achieving 30% EV penetration by 2030 (as a % of annual sales). However, CareEdge Ratings has considered a 20% EV penetration by FY30, considering the slower-than-anticipated EV adoption in the 4- 4-wheeler segment, amidst consumer preference for hybrid 4W vehicles and the slow progress in EV charging infrastructure. In the case of BESS, CareEdge Ratings expects cumulative grid-level energy storage capacity to reach around 100 GWh by FY30.

**Significant decline in the cost of lithium-ion batteries in the last decade**




Source: Bloomberg New Energy Forum battery price survey 2023; Volume weighted average price trend of lithium-ion batteries across applications

The cost of lithium-ion batteries has declined over the decade ended CY23 on the back of technology advancement along with greater economies of scale which has supported its faster adoption by its end-use sectors resulting in significant growth in its demand.

## Giga-Scale Capacities to Reduce India's Import Dependency

Government policies and incentives are expected to support the build-up of giga-scale lithium-ion battery capacities, aided by the Advanced Chemistry Cell (ACC) Production Linked Incentive (PLI) scheme, along with various state government incentives such as capital subsidies, electricity tax and stamp duty exemptions, and interest subvention. The GoI has already allocated 40 GWh of integrated battery capacities under the PLI scheme, with the remaining 10 GWh expected to be awarded shortly. Additionally, existing conventional battery manufacturers and a few other companies in India are expected to set up battery capacities outside of the PLI scheme. A large portion of these capacities is expected to come on stream gradually by FY27. CareEdge Ratings expects India's import dependency to decline to ~20% by FY27, thanks to these capacity additions.

## CareEdge Views

"The demand for lithium-ion battery storage in India is expected to grow significantly, driven predominantly by migration towards EVs and renewable energy storage requirements. Consequently, India's dependence on imports is expected to decline sharply to ~20% by FY27 from near-full dependence presently, due to giga-size integrated battery capacities coming onstream in India. Previously, there was slow progress on domestic capacity additions for manufacturing lithium-ion batteries due to continuously declining costs driven by evolving technology. However, domestic capacity for Li-ion battery manufacturing is now expected to notice the back of an understanding that the lithium-ion technology has now matured. Also, existing Li-ion chemistries rely heavily on scarce minerals such as lithium, cobalt, nickel etc., wherein India has limited natural reserves. Therefore, domestic players need to secure long-term supply agreements with countries having sizable reserves along with the focus on battery reuse and recycling, which provides environmental benefits and reduces price and supply risk associated with imports. Furthermore, the relative cost-competitiveness of Indian manufacturers, in the context of capacity addition and pricing policies of large global integrated players, especially Chinese manufacturers, will be a key factor to monitor," said Hardik Shah, Director at CareEdge Ratings.

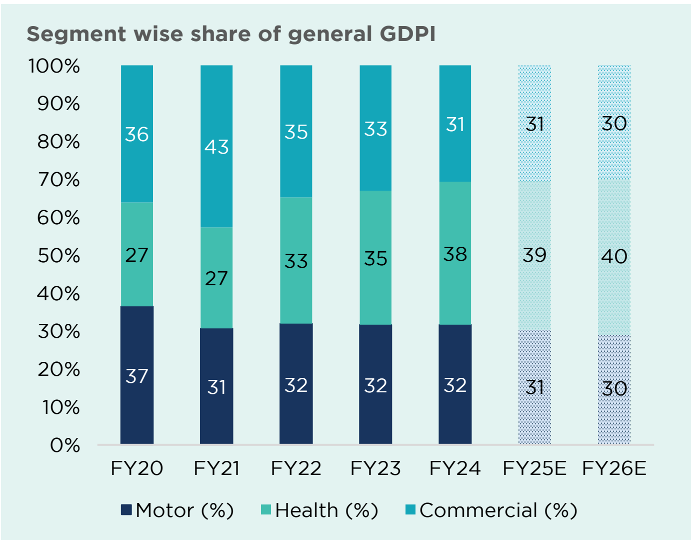
# SAHIs DOMINATE RETAIL MARKET SHARE AMID RISING HEALTH INSURANCE DEMAND

**Health insurance segment to enable the Upcycle for general insurers**

The Indian general insurance sector has been growing steadily, aided by healthy economic growth, a growth in middle-class population, low penetration, digitisation, regulatory support and government initiatives. India's general insurance remains low at 1% (measured as the percentage of insurance premium to gross direct product [GDP]), compared to penetration rates of 4%-9% in developed countries.

During FY24, the size of the general insurance sector's GDPI stood at Rs 2.89 lakh crores, up from Rs 2.57 lakh crores during FY23. The total GDPI has grown with a four-year CAGR (FY20-24) of 11%. While motor insurance (FY24: 32% of total GDPI, FY23: 32% of total GDPI) and health insurance (FY24: 38%, FY23: 35%) have been key contributors to this growth, the health segment has emerged as one of the fastest-growing segments over the last few years.

The Indian health insurance segment is growing due to increased awareness of the pandemic, rising medical inflation, government initiatives, and affordability. Despite a 21% CAGR from FY20-24, only 40% of the population is covered, with just 4% under retail policies. That said, the coverage is concentrated in five states (Maharashtra, Tamil Nadu, Rajasthan, Gujarat, and Karnataka), which account for 71% of the total lives covered. The significant penetration gap, along with other growth factors, is expected to drive continued growth in the health insurance segment. Growth over the last four years came in at a CAGR of 21% due to pandemic-induced health insurance awareness and industry-wide price due to adverse claim experience. Despite some moderation, CareEdge Ratings expects the health segment to grow in the range of 17-18% over the next two years.




Source: General Insurance Council and CareEdge Ratings
Note: Health excludes PA

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## Health insurance growth to continue; driven by growth in SAHIs and private multi-line insurers

Health insurance premiums have grown at a four-year CAGR of 21% (2020-2024), compared to a pre-pandemic four-year CAGR of 19% (2015-2019). Both SAHIs (four-year CAGR [FY20-24] of 24%) and private multi-line general insurers (four-year CAGR [FY20-24] of 24% specifically for a health insurance premium) have contributed to the overall growth in the health insurance segment. SAHIs have been gaining market share at the expense of public multi-product insurance companies (four-year CAGR [FY20-24] of 14% specifically for health insurance premiums).

SAHIs have gained a 3% market share between FY20 to FY24 in the overall health insurance segment, driven by their rising market share in the retail health insurance segment (SAHIs have gained a 6% market share between FY20 to FY24 in retail health insurance, reaching a 56% market share during FY24). CareEdge Ratings expects SAHIs to continue to gain market share in the health insurance business, supported by considerable growth in the retail health insurance space.

Also, the growth in health insurance premiums is driven by price hikes rather than volume growth (the number of policies in force remained flat in FY24 compared to 9% YoY growth in FY20).

## SAHI Focuses on Retail Health via Strong Agency Channel; Group Health Key for Private Insurers

SAHIs, monoline companies focusing solely on health insurance, prioritise retail health, which contributes 73% to their GDPI and drives business growth. Their exclusive focus allows them to offer specialised products, customer service, and claims handling tailored to the healthcare market. SAHIs have a strong retail distribution network, with five SAHIs having 13.06 lakh agents in FY24, compared to 6.49 lakh agents of twenty-five multi-line insurers. Brokers and direct channels also contribute significantly to SAHIs' business.
Group insurance remains a major contributor to the health insurance sector, accounting for 50% of total premiums in FY24, compared to 39% for retail policies. It is the primary focus for private and public multi-line insurers, contributing 60% and 61% to their total health GDPI, respectively. Multi-line insurers leverage their existing networks to capture group health business, which is mainly driven by direct channels.

While SAHIs are retail-focused with a granular nature of business, a single LOB exposes them to business concentration risks in the event of adverse selection, pandemics, or health crises. Going forward, CareEdge Ratings expects SAHIs to continue dominating the retail health segment in the medium term. Since private multi-product general insurance companies have now started building out their retail health business and are investing in their agency channel, claim processing units, hospital tie-ups etc., competition is expected to intensify for the retail health insurance business. Therefore, market share and profitability will be key to monitoring the industry.

## SAHI Excels in Underwriting; Multi-Line Insurers Benefit from Scale and Diversification

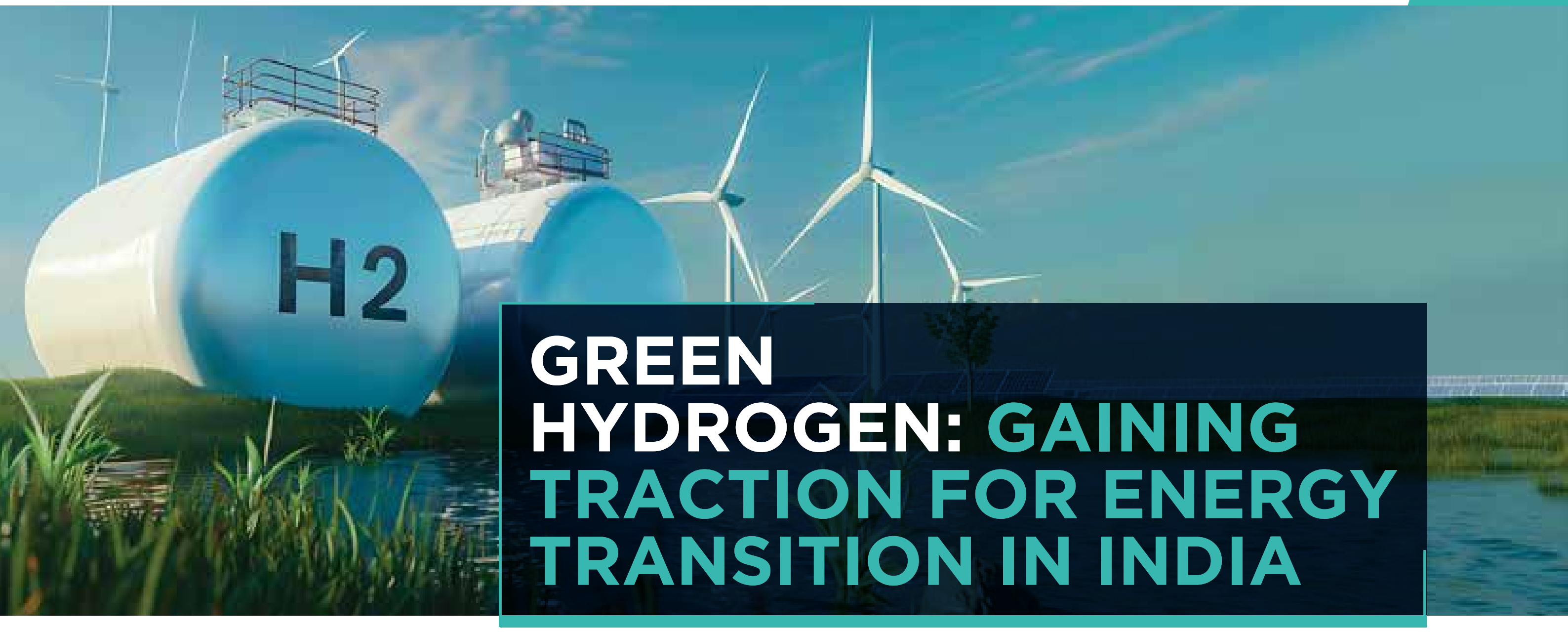
The retail health insurance business is capital and resource-intensive, requiring superior claim processing, constant product innovation, and a deeper distribution network. Due to granular underwritings, the claims ratio for retail policies is lower than for group insurance policies, resulting in a lower loss ratio for SAHIs compared to multi-line insurers. In FY24, the claims ratio for private companies was 81% versus 63% for SAHIs. Retail health's resource intensity leads to high operating expenses and commission payouts, with a commission ratio of 27% for private companies and 37% for SAHIs. SAHIs have shown better underwriting performance, with a combined ratio of 100% in FY24, compared to 108% for private and 125% for public multi-line insurers. CARE Ratings expects SAHIs' EOM to improve with scale in the medium term.

Due to scale and diversified business, private general insurance companies have better return metrics. As SAHIs achieve scale their return metrics are expected to further increase.

## CareEdge Views

Investment in Insurtech, digitisation, and the expanding middle class will drive growth in the health insurance sector. In FY24, IRDAI's initiatives like "Bima Sugam," "Bima Vistar," and "Bima Vahak" will further support sector growth. The anticipated regulation on composite licences will be a game changer, increasing competition in the medium term.

With the penetration gap and market positions of SAHIs and private multi-line general insurance companies, the health insurance sector's growth is expected to continue. CareEdge Ratings forecasts a 17-18% growth in the health segment over the next two years, with SAHIs growing at 20-22%. The health insurance segment's share within general insurance is expected to rise to 39-40% in FY25.



# GREEN HYDROGEN: GAINING TRACTION FOR ENERGY TRANSITION IN INDIA

## Cost dynamics of Green Hydrogen vis-a-vis alternatives

Green Hydrogen, unlike grey hydrogen (from natural gas) and brown hydrogen (from coal), is produced through water electrolysis using renewable energy, eliminating CO2 emissions. It has the potential to significantly aid India's decarbonisation and reduce fossil fuel dependence. However, its levelised cost of $GH_2$, including capital expenditure and operational expenditure, is currently ~1.75 times that of Grey Hydrogen and ~1.50 times that of Brown Hydrogen. This cost disparity, despite the waiver of interstate transmission charges (ISTS) for renewable power, remains a major barrier to the widespread adoption of $GH_2$.

Besides, as per CareEdge Ratings, a significant capex outlay of Rs 2.40 lakh crore is required there to produce one million metric tonnes (MMT) of GH2. Capex for renewable energy generation and capex for electrolyzers are the two major cost components with an estimated contribution of 48% and 34% respectively in the overall cost of the project.

## Economic viability

LCOGH is particularly sensitive to electrolyser cost& efficiency and renewable energy tariff. CareEdge Ratings has outlined various scenarios for LCOGH based on the capex of electrolysers, their efficiency, and the cost of renewable energy.

It is inferred from the table that LCOGH is influenced not only by reductions in electrolyser capex and renewable energy tariffs but is also sensitive to enhancements in electrolyser efficiency. Considering the waiver of interstate transmission charges, LCOGH was estimated at USD 3.74 per kg as of CY23. In the years ahead, CareEgde Ratings opines that reduction in electrolyzer cost and efficiency improvement are prerequisites to achieve a targeted levelised cost of USD 2.1 /kg. Additionally, PLI incentives announced by the Government of India (GoI) such as a direct production incentive of up to $0.50/kg of GH2 production for the first two years and an incentive on electrolyzer capex of $54/Kw are a welcome move to help achieve targeted LCOGH.

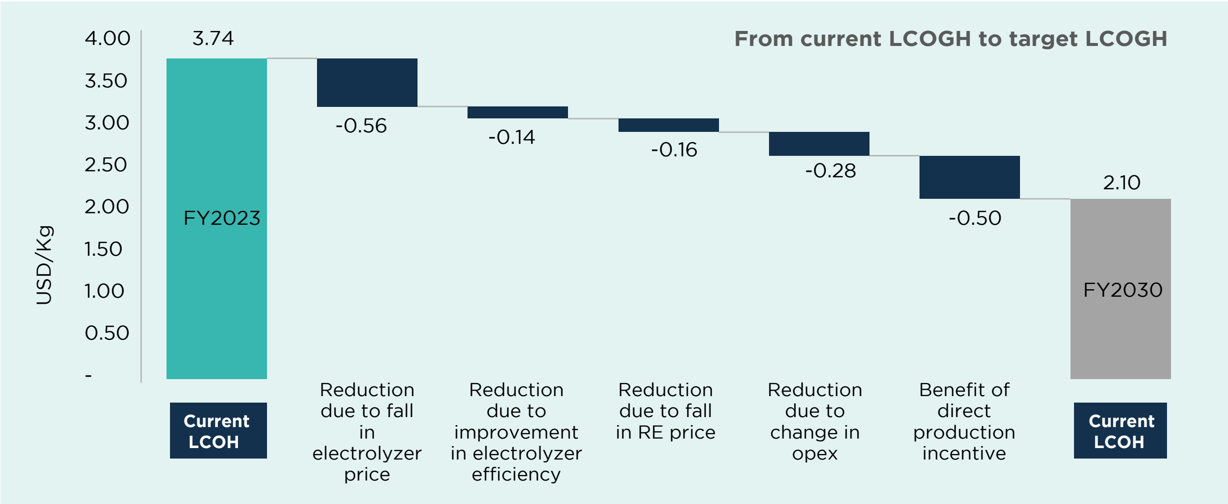
CareEdge Ratings believes a significant reduction in the capex cost of renewable energy is unlikely, however, there is adequate headroom for the reduction in the electrolyser cost. Economies of scale, advancement in manufacturing automation, the use of less expensive materials in the stack, and the scaling up of stack sizes shall be the key drivers for the reduction in the cost of electrolysers going forward.

## Key demand drivers for Green Hydrogen

The demand drivers for GH2 can be categorised as

- Near term – Greening the existing grey hydrogen users
- Medium term – Wider adoption for industrial use such as green steel, blending in city gas distribution along with natural gas
- Long term- Application in transportation, shipping, auxiliary power generation etc

CareEdge Ratings has assessed demand potential from




Source: CareEdge Ratings

two aspects: existing market share in hydrogen demand which is on the horizontal axis and the cost of hydrogen in overall production cost plotted on the vertical axis. Currently, refineries holding a 43% share of India's six million metric tonnes hydrogen demand, have low hydrogen costs in production, making them immediate potential users of green hydrogen. This could lead to a demand of 2.70-3.00 MMT of $GH_2$ from FY27-FY30, increasing the need for higher desulphurisation in feedstock.

The fertiliser sector, accounting for ~50% of India's hydrogen demand, is highly sensitive to hydrogen costs due to overall production costs. Achieving cost parity with green hydrogen and incentivising demand is crucial for its adoption in ammonia and non-urea fertilisers. Green ammonia could drive demand of 3.75-4.25 MMT of $GH_2$ from FY27-FY30, with non-urea fertilisers leading early adoption.
Adoption of green hydrogen for methanol is less economically viable due to the lower cost of imported methanol. Yet, the adoption of green hydrogen in heavy-duty vehicles can be explored in the long term in case of a reduction in the total cost of ownership vis-à-vis electric, diesel and CNG vehicles.

In the steel sector, green hydrogen can replace coking coal in blast furnaces and natural gas in electric arc furnaces, promoting wider adoption. It can also blend with natural gas in city gas distribution. Reducing carbon emissions will drive demand, needing policy support and industrial acceptance.

### Storage and transportation challenges

The low volumetric energy density of Green Hydrogen increases its storage and transportation costs. This is also one of the constraints for its adoption. The development of a manufacturing cluster of Green Hydrogen nearer to the consumption centre may help in addressing this risk. Moreover, the lower cost for transportation of green ammonia and competitive renewable energy cost in India augur well for the port-based facilities for exports of green ammonia.

## CareEdge Views

"Achieving cost parity of $GH_2$ with alternatives is crucial for its widespread adoption. A significant constraint is the high capex of approximately Rs 2.4 lakh crore/MMT GH2 plant. With limited scope for reducing renewable energy capex, lowering of electrolyser costs by 35-40%, improving efficiency by 12-14%, and continued policy support are vital to achieving cost viability of GH2 to around USD 2.1 per kg. Technological advancement in the electrolyser manufacturing, cost reduction in stack material and economies of scale will l be key drivers future cost reduction," says Maulesh Desai, Director, CareEdge Ratings.

"The absence of long-term offtake arrangement of $GH_2$ is a key issue for developers and lenders. Incentivising downstream users of $GH_2$ over alternatives is critical for gradual adoption. Refineries could be early users, potentially demanding 2.70-3.00 MMT of $GH_2$ over FY27-FY30. Ammonia production could also adopt for $GH_2$, contingent on price parity with natural gas-based ammonia, leading to a potential demand of 3.75-4.25 MMT over the same period. Besides, green ammonia has significant export potential due to India's competitive renewable energy costs, provided storage and transportation issues are managed," says Hardik Shah, Director, CareEdge Ratings.

# CORPORATE PROFITABILITY CONTRACTS FURTHER IN Q2 FY25 AMID SLOWING SALES

The corporate performance of the non-financial firms softened in Q2 FY25 as net sales further slowed, and profitability contracted more deeply. Expenditure growth continued to outpace net sales growth. Factors like muted government expenditure, slowing urban demand, escalating geopolitical tensions, high inflation in primary articles, sluggish external demand, and weather-related disruptions have impacted corporate profitability.

This report analyses the corporate performance of listed non-finance companies. Part I examines the quarterly performance of 2,337 companies.

## Corporate Performance – Q2 FY25

In Q2 FY25, the growth in net sales of non-financial firms slowed to 5% Y-o-Y from 6.4% Y-o-Y in the previous quarter (Table 1). Despite marginal moderation compared to the last quarter, expenditure growth remained high, growing by 7.1% Y-o-Y in Q2 FY25. Consistent with the trend from the previous quarter, expenditure growth continued to outpace revenue growth. This divergence between revenue and expenditure growth impacted profitability. Consequently, operating profit margins fell from 17.2% in Q1 to 16.6% in Q2. The contraction in profit after tax (PAT) also deepened, failing by 2% Y-o-Y in Q2, a sharper drop than the 0.4% YoY decline seen in Q1.

Within expenditures, employee cost rose in Q2, increasing by 7.5% Y-o-Y from 7.3% Y-o-Y growth in the prior quarter. Meanwhile, the growth in the cost of services and raw materials moderated to 7.9% Y-o-Y in Q2 from 8.9% Y-o-Y in Q1, though it remained elevated. However, over the past year, the growth in employee cost has moderated from 12.2% in Q2 FY24. This could be indicative of weakness in labour market and wage growth, with implications for consumption demand.

The moderation in the sales growth can be attributed to a weakening urban consumption demand and sluggish external demand. Slowing government capex also impacted the cement, iron and steel sales. On the brighter side, recent high-frequency data suggests a recovery in the rural demand scenario.

The cost of goods and raw materials has remained elevated, reflecting a sharp rise in industrial metals and Brent crude prices in Q1FY25. The Bloomberg industrial metals price index and Brent crude prices were up 4.7% Y-o-Y and 9% Y-o-Y, respectively, in Q1FY25. Higher commodity prices generally impact the costs of goods sold with a lag. However, the commodity prices corrected in Q2 FY25. The Bloomberg commodity price index fell by 8% Y-o-Y in Q2, largely due to a fall in energy prices. Global energy prices corrected amid demand concerns, particularly from China. The cost of logistics has also risen due to supply chain disruptions, as major shipping lanes like the Red Sea and Panama Canal

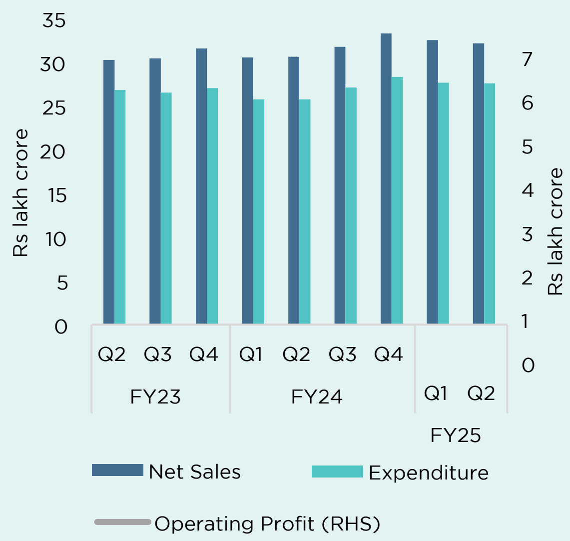
**Table 1: Overall Quarterly Analysis**

| Particulars | Unit | Q2 FY24 | Q3 FY24 | Q4 FY24 | Q1 FY25 | Q2 FY25 |
|---|---|---|---|---|---|---|
| Net Sales | Rs Lakh Cr | 30.7 | 31.8 | 33.3 | 32.5 | 32.2 |
| | % y-o-y | 1.2 | 4.3 | 5.4 | 6.4 | 5.0 |
| Expenditure | Rs Lakh Cr | 25.8 | 27.1 | 28.3 | 27.7 | 27.6 |
| | % y-o-y | -4.0 | 2.3 | 4.8 | 7.3 | 7.1 |
| Cost of Services and Raw Materials* | Rs Lakh Cr | 11.0 | 11.5 | 12.0 | 11.7 | 11.8 |
| | % y-o-y | -3.0 | 3.4 | 4.4 | 8.9 | 7.9 |
| Employee Cost* | Rs Lakh Cr | 2.5 | 2.6 | 2.6 | 2.7 | 2.7 |
| | % y-o-y | 12.2 | 10.4 | 6.4 | 7.3 | 7.5 |
| Operating Profit | Rs Lakh Cr | 5.5 | 5.3 | 5.7 | 5.6 | 5.3 |
| | % y-o-y | 39.2 | 18.0 | 10.3 | 2.6 | -3.4 |
| Profit After Tax (PAT) | Rs Lakh Cr | 2.3 | 2.3 | 2.6 | 2.4 | 2.2 |
| | % y-o-y | 50.1 | 22.6 | 18.8 | -0.4 | -2.0 |
| **Ratios** | | **Q2 FY24** | **Q3 FY24** | **Q4 FY24** | **Q1 FY25** | **Q2 FY25** |
| Operating Profit Margin | % | 18.0 | 16.7 | 17.2 | 17.2 | 16.6 |

Source: Ace Equity & CareEdge; Note: Results based on a sample of 2337 listed non-finance companies; * Data pertains to a smaller sample of companies (1803 listed non-finance companies)

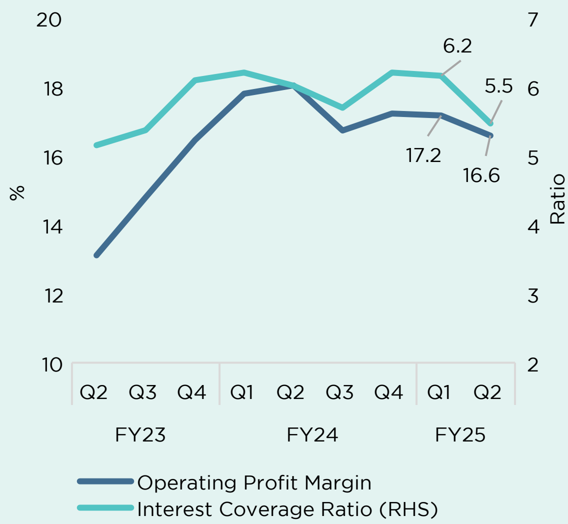
were impacted by geopolitical and environmental issues. On the financing front, higher policy rates and tighter liquidity conditions throughout FY25 have kept borrowing costs elevated for corporates. Falling profitability and higher interest costs have resulted in a fall in interest coverage ratio, which fell to 5.5% in Q2 FY25 from 6.2% in the previous quarter.

**Exhibit 1: Overall Corporate Performance**




Source: Ace Equity and CareEdge

**Exhibit 2: Key Ratios**




Source: Ace Equity and CareEdge

## Sectoral Overview

We have closely analysed the financial performance of 21 select sectors for Q2 FY25. Among these, 11 sectors reported double-digit growth in both net sales and operating profit. Key performers include capital goods, telecom, white goods, pharmaceuticals, logistics, and retailing, all of which sustained double-digit growth in both metrics. Among the major sectors, the performance of iron and steel, crude oil, cement, automobiles, and power lagged in Q2. The capital goods sector benefited from increased domestic order inflows following the general elections and lower commodity prices in Q2. The telecom sector saw positive effects from the upward revision of tariffs by major service providers. The white goods sector, particularly air conditioners and refrigerators, experienced higher demand due to recovering rural consumption and seasonal weather changes. Similarly, the pharmaceutical sector performed well, driven by several factors contributing to growth in the domestic market. The sector saw a notable increase in demand across both acute and chronic segments, and the 4% to 5% price revision allowed under the National Pharmaceutical Pricing Authority (NPPA) positively impacted revenue growth. Additionally, easing input pricing pressures, the revival of biotech funding, the launch of speciality products, and deeper penetration into the generic market all supported export growth for pharma companies.

Among the sectors with weak performance in Q2, the cement and iron and steel industries were particularly affected by a slowdown in government capital expenditure. The slowdown in infrastructure spending, lower international steel prices, and higher imports from China due to oversupply in their domestic market impacted the profitability of the iron and steel sector. Although growing domestic demand supported sales in the aviation sector, profitability was negatively impacted by issues such as aircraft groundings and rising aviation turbine fuel (ATF) costs. Oil marketing companies faced adverse performance due to rising global uncertainty and declining refining margins. Recent economic data suggests a slowdown in urban demand, which has affected the automotive industry as elevated inventories persisted ahead of the festive season.

## Way Forward

While sales and profitability for Indian firms remained subdued in Q2 FY25, we anticipate improvement in the coming quarters. Factors such as a prolonged monsoon, declining urban demand, and reduced public capital expenditure negatively affected economic growth and consequently corporate performance. GDP growth for H1 FY25 slowed to 6% Y-o-Y compared to 8.2% in FY24. Nevertheless, we expect this slowdown to be temporary, with a projected growth rate of 6.8% Y-o-Y in H2. As the government increases its capital expenditure spending, investment is expected to improve, and policy support from the RBI will further boost growth. However, we project GDP growth to be lower at 6.5% in FY25 compared to our earlier estimate of around 7%. We anticipate a 25-basis point cut in the RBI's February policy meeting. A future reduction in the repo rate is expected to support private capital expenditure, but a sustained recovery in consumption will be crucial for driving a meaningful increase in corporate capex. Healthy agricultural production and likely moderation in food inflation should be supportive of consumption in the coming quarters. However, the extent of recovery in urban demand needs to be closely monitored.

On the external front, global growth remains relatively weak, with the IMF projecting a 3.2% growth rate for both 2024 and 2025. While growth in developing Asian countries is expected to slow, the growth outlook for developed economies like the US and Japan has been revised upward. Stronger growth in the US should support export demand, particularly for IT services. Commodity prices, including Brent Crude, are likely to remain subdued due to weak demand from China and anticipated increases in US petroleum production under the new administration. Lower global commodity prices should benefit the margins of domestic manufacturing firms.

However, the depreciating pressure on the Indian rupee remains a concern, as the US dollar strengthens. Markets now anticipate fewer rate cuts from the Federal Reserve, as policies proposed by the new administration, such as tax cuts and higher tariffs, are likely to be inflationary. The US Federal Reserve is now expected to reduce policy rates by 25 basis points in 2024 and by approximately 50-75 basis points in 2025, lower than previously estimated. This has intensified the downward pressure on the rupee. While a weaker rupee can support domestic exports, it may adversely impact the overall economy, given India's status as a net importer. Going forward, it will be crucial to monitor the implementation of the new US administration's policies and China's response, as these will play a significant role in shaping market dynamics. Geopolitical risks will also remain an important factor to watch.

Thus, the overall performance of corporates in the coming quarters will depend upon the unfolding of the global growth scenario and domestic demand conditions. It is also crucial to monitor any external risks associated with geopolitical tensions, commodity price shocks and weather events. On the domestic front, key budgetary announcements in February and RBI's monetary policy decisions will be closely watched.

CareEdge RATINGS

# HEAT MAP AND PROJECTION TABLE

| | | Nov-23 | Dec-23 | Jan-24 | Feb-24 | Mar-24 | Apr-24 | May-24 | Jun-24 | Jul-24 | Aug-24 | Sep-24 | Oct-24 | Nov-24 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| PMI-M | Unit | 56.0 | 54.9 | 56.5 | 56.9 | 59.1 | 58.8 | 57.5 | 58.3 | 58.1 | 57.5 | 56.5 | 57.5 | 56.5 |
| PMI-S | Unit | 56.9 | 59.0 | 61.8 | 60.6 | 61.2 | 60.8 | 60.2 | 60.5 | 60.3 | 60.9 | 57.7 | 58.5 | 58.4 |
| GST Collections | Rs lakh crore | 1.7 | 1.6 | 1.7 | 1.7 | 1.8 | 2.1 | 1.7 | 1.7 | 1.8 | 1.7 | 1.7 | 1.9 | 1.8 |
| E-Way Bill | Crore | 8.8 | 9.5 | 9.6 | 9.7 | 10.4 | 9.7 | 10.3 | 10.0 | 10.5 | 10.5 | 10.9 | 11.7 | 10.2 |
| Air Passenger Traffic | Crore | 3.1 | 3.4 | 3.3 | 3.1 | 3.3 | 3.2 | 3.5 | 3.3 | 3.2 | 3.3 | 3.2 | 3.4 | |
| PV Sales | Lakh | 3.4 | 3.0 | 3.9 | 3.7 | 3.8 | 3.4 | 3.5 | 3.7 | 3.6 | 3.7 | 3.8 | 4.1 | 3.6 |
| 2-3-Wheeler Sales | Lakh | 19.9 | 15.7 | 18.3 | 19.3 | 19.0 | 21.4 | 20.1 | 19.9 | 18.5 | 21.5 | 25.0 | 26.3 | 20.5 |
| Tractor Sales | Lakh | 0.8 | 0.5 | 0.6 | 0.5 | 0.7 | 0.8 | 0.9 | 1.1 | 0.7 | 0.6 | 1.1 | 1.5 | 0.8 |
| IIP | y-o-y% | 2.5 | 4.4 | 4.2 | 5.6 | 5.5 | 5.2 | 6.3 | 4.9 | 5.0 | -0.1 | 3.1 | 3.5 | |
| Core Sector | y-o-y% | 7.9 | 5.1 | 4.2 | 7.1 | 6.3 | 6.9 | 6.9 | 5.0 | 6.3 | -1.6 | 2.4 | 3.1 | |
| Power Consumption | y-o-y% | 6.1 | 1.6 | 6.1 | 8.4 | 9.1 | 10.5 | 15.3 | 8.9 | 8.2 | -4.9 | 0.6 | 1.1 | 4.0 |
| Petroleum Consumption | y-o-y% | -2.2 | 3.7 | 7.3 | 8.2 | 1.7 | 7.8 | 1.9 | 2.3 | 10.7 | -3.1 | -4.4 | 2.9 | 9.3 |
| Outstanding Bank Credit - Total | y-o-y% | 20.6 | 19.9 | 20.3 | 20.5 | 20.2 | 19.0 | 20.8 | 17.3 | 13.6 | 13.6 | 13.0 | 11.7 | |
| Capital Goods Import | y-o-y% | 4.3 | 3.7 | 4.2 | 10.0 | 0.9 | 3.2 | 7.0 | 11.6 | 6.2 | 8.7 | 8.6 | 4.1 | |
| Merchandise Exports | y-o-y% | -3.3 | 0.8 | 4.3 | 11.9 | -0.5 | 2.0 | 13.3 | 2.4 | -2.0 | -9.7 | 0.5 | 17.2 | |

| Indicator | FY18 | FY19 | FY20 | FY21 | FY22 | FY23 | FY24 | FY25 Forecast | FY26 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Gross Domestic Product (y-o-y%) | 6.8 | 6.5 | 3.9 | -5.8 | 9.7 | 7.0 | 8.2 | 6.5 | 6.7 |
| CPI Inflation (y-o-y%) | 3.6 | 3.4 | 4.8 | 6.2 | 5.5 | 6.7 | 5.4 | 4.8 | 4.5 |
| Fiscal Deficit (As % of GDP) | 3.5 | 3.4 | 4.6 | 9.2 | 6.8 | 6.4 | 5.6 | 4.8 | - |
| Current Account Balance (As % of GDP)* | -1.8 | -2.1 | -0.9 | 0.9 | -1.2 | -2.0 | -0.7 | -0.9 | - |
| Rupee (USD/INR) (Fiscal year-end) | 65.0 | 69.2 | 75.4 | 73.5 | 75.8 | 82.2 | 83.4 | 84.0 | 84.0-86.0 |
| 10-Year G-Sec Yield (%) (Fiscal year-end) | 7.3 | 7.5 | 6.1 | 6.3 | 6.8 | 7.3 | 7.1 | 6.5-6.6 | 6.1-6.3 |

*(-) Deficit / (+) Surplus; #Fiscal deficit data for FY25 as per Budget estimates

## About Us

CareEdge is a knowledge-based analytical group offering services in Credit Ratings, Analytics, Consulting and Sustainability. Established in 1993, the parent company CARE Ratings Ltd (CareEdge Ratings) is India's second-largest rating agency, with a credible track record of rating companies across diverse sectors and holding leadership positions in high-growth sectors such as BFSI and Infra. The wholly-owned subsidiaries of CareEdge Ratings are (I) CARE Analytics & Advisory Private Ltd (previously known as CARE Risk Solutions Pvt Ltd), (II) CARE ESG Ratings Ltd,( previously known as CARE Advisory Research and Training Ltd) and (III) CareEdge Global IFSC Ltd. CareEdge Ratings' other international subsidiary entities include CARE Ratings (Africa) Private Ltd in Mauritius, CARE Ratings South Africa (Pty) Ltd, and CARE Ratings Nepal Ltd.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