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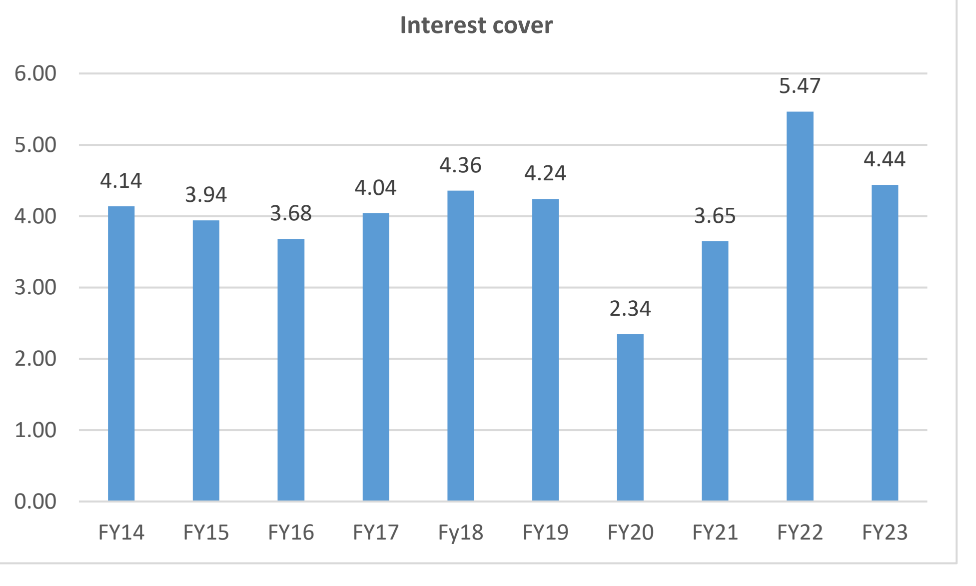
Interest cover of companies over the years

Interest cover is a good indication of the solvency of companies as it gives an idea on their ability to service their interest payments. The last few years have been quite volatile. At the policy level the RBI brought down interest rates sharply to protect growth; and last year reversed the direction as inflation increased. Corporates too have been through similar phases with curbs on operation, demand getting truncated, supply chain issues, high inflation, sudden rise in pent up demand etc. which have had an impact on their profits.

Interest cover (IC), defined here as PBIT to interest provides some indication of how companies have faced these challenges. To get a clearer perspective the following analysis traces this indicator for the last 10 years for a set of 1523 non-BFSI companies. The longer time period gives one an idea of how things looked in the past before covid set in.

Table1: Interest cover for 1523 companies

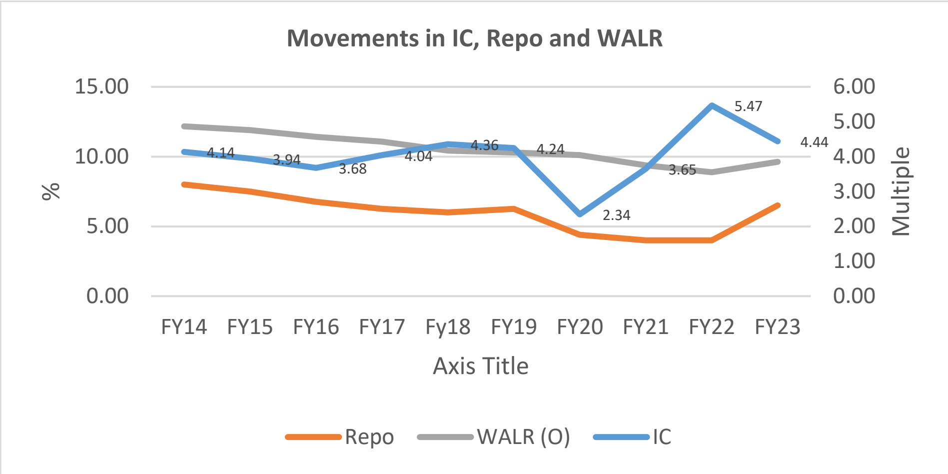


The chart above shows that the interest cover ratio for this set of companies showed varying trends over this period. It fell in FY15 and FY16 and then rose till FY18. It came down marginally in FY19 and dropped sharply in FY20 before recovering in the next two years. In FY23 there has been a drop again in the interest cover ratio.

To get a better idea of how interest rates moved during these years, Chart 2 maps the interest cover ratio with both the repo rate and the weighted average lending rate on outstanding loans for the sample companies. The repo rate has followed generally a downward path starting from FY14. There was one spike by 25bps in FY19 and then a major push in FY23 by 250 bps. The trend suggests a downward path for the policy rate.

The WALR on the other hand came down continuously during this period until FY22. In fact, the descent was quite sharp from 12.17% in FY14 to 10.12% in FY20 and then to 8.88% in FY22 as the RBI keep the repo rate at a low of 4% for 2 years.

Chart 2: Interest cover, repo rate and WALR



There is hence no clear relation between the IC and WALR as the latter has been coming down quite continuously while the IC has varied over time. The IC has hence been more affected by the growth in profits which are linked directly to the business and wider economic environment. Chart 3 below juxtaposes the IC with growth in PBIT. A better relation emerges in this case. A simple coefficient of correlation here works out to 0.63 which means that higher growth in PBIT is associated with higher levels of interest cover. When the same is done with WALR, a negative coefficient is seen which is however lower at -0.25. (Using the concept of coefficient of correlation for a small sample of 10 observations has limitations). It may be concluded that IC has been affected more by the growth in PBIT than interest rates as the latter has been coming down continuously during the period of study.

Chart 3: IC and growth in PBIT

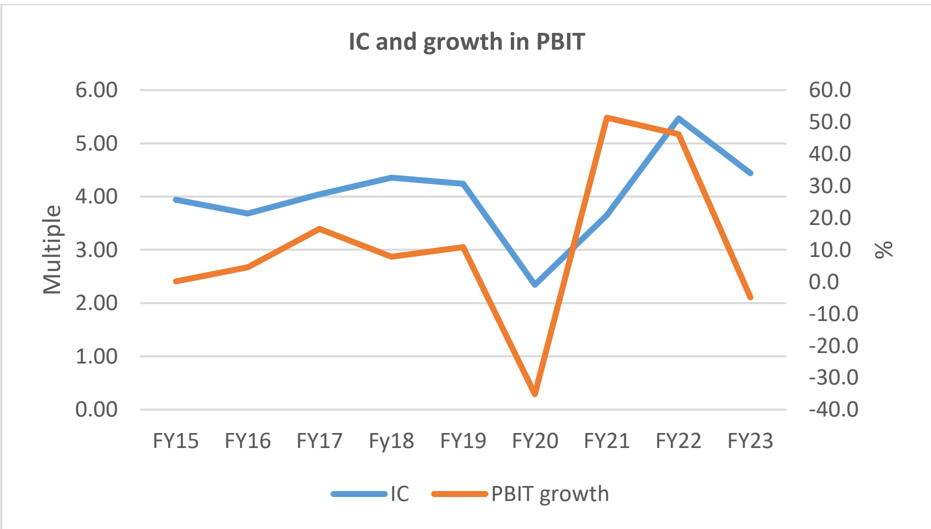


Table 1: Sector wise movement in interest cover ratio

	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Crude Oil	7.86	10.15	11.17	13.44	12.02	7.79	2.95	5.39	7.97	5.13
Power	2.92	2.62	2.40	2.02	2.22	2.08	2.31	2.53	3.15	3.09
IT	36.22	42.05	45.14	57.75	68.98	61.63	37.16	49.16	64.85	39.60
Automobile & Anc	5.99	6.22	9.63	10.62	11.01	11.94	5.99	5.76	8.74	9.55
Iron & Steel	2.36	1.95	-0.06	1.19	1.80	2.83	1.85	4.11	10.15	3.68
FMCG	15.00	18.28	12.97	16.72	15.21	34.51	30.25	26.41	32.53	36.20
Non - Ferrous Metals	3.05	3.39	-0.36	4.58	5.33	4.05	0.68	5.88	9.45	8.67
Chemicals	3.69	3.49	3.98	5.24	6.34	6.76	6.03	9.13	13.00	9.96
Healthcare	10.04	8.20	9.36	9.95	8.10	8.33	9.43	12.59	11.38	10.82
Infrastructure	2.11	1.89	1.69	1.54	2.02	1.84	1.74	1.47	2.00	1.81
Capital Goods	4.23	1.43	2.82	3.63	4.13	5.29	1.11	2.20	6.62	7.99
Construction Mat	1.60	1.47	1.24	1.37	2.50	2.37	2.48	4.34	4.69	3.68
Inds. Gases & Fuels	13.32	9.42	5.59	13.14	25.19	54.68	24.51	23.51	38.96	20.00
Textile	2.22	2.28	2.61	2.62	2.18	2.82	1.44	3.70	5.07	3.42
Telecom	4.38	3.83	2.25	-0.10	-0.64	-0.34	-2.88	-0.99	0.10	0.24
Realty	1.94	2.16	2.36	2.14	1.87	2.05	2.07	1.67	3.42	3.97
Logistics	2.63	3.16	3.87	3.19	2.99	2.17	1.12	2.60	2.25	2.93
Diversified	3.39	3.00	3.46	5.08	7.33	6.35	5.33	6.20	12.46	10.91
Agri	0.69	0.68	1.17	2.17	0.40	1.94	2.19	3.90	3.85	4.22
Plastic Products	1.71	1.61	2.43	2.96	3.14	2.90	2.65	5.03	8.18	6.35
Trading	1.10	1.82	2.01	1.76	2.00	1.50	2.52	0.90	3.48	5.98
Paper	1.28	1.30	1.80	2.86	3.07	4.76	4.10	2.12	4.23	8.33
Diamond & Jewellery	5.70	5.09	4.85	5.16	6.44	5.30	4.88	3.31	4.81	6.36
Consumer Durables	3.64	5.46	6.80	9.47	15.24	9.62	7.51	7.97	8.65	14.02
Hospitality	0.04	0.66	1.48	2.15	2.12	2.77	1.76	-1.55	0.80	8.60
Alcohol	-4.09	-0.63	1.83	1.63	3.56	4.88	6.49	4.89	11.35	12.16
Electricals	1.72	1.79	2.68	3.70	4.42	5.45	3.23	4.08	4.60	4.74
Media & Entertain	5.86	5.26	6.22	6.93	5.56	4.13	1.21	2.88	2.67	1.68
Gas Transmission	8.74	10.32	14.89	23.09	49.93	10.29	14.25	21.78	54.59	163.33
Retailing	1.15	1.48	1.50	2.16	2.83	3.54	1.40	-0.12	1.19	1.96
others	-0.65	0.44	2.76	3.45	1.92	-1.86	-0.88	3.40	9.59	8.57
Aggregate	**4.14**	**3.94**	**3.68**	**4.04**	**4.36**	**4.24**	**2.34**	**3.65**	**5.47**	**4.44**

Table 1 does reveal that on the whole the IC has been fairly good over the years. While a regime of higher interest rates can affect interest costs, aggregate financial performance is expected to be better in FY24 and hence this ratio should remain stable. The telecom industry can be disregarded as it has specific issues relating to tax. There are 3 industries which have an IC of less than 2 which are retailing, media and entertainment and infrastructure. In case of the first 2, the pandemic has come in the way and posed challenges while for infra it has traditionally had low IC.

Power is another sector which has an IC in the range of 2-3 and has crossed 3 in the last two years. Iron and steel, construction material, textiles and realty are the other sectors with IC of less than 4.

These industries would depend a lot on how the economy does especially in investment while for textiles it would be related to a large extent on exports.

Hence on the whole the picture on debt servicing ability of companies does look satisfactory and the levels attained in FY23 are more or less than at those before the lockdown. While interest costs will play a role, overall profitability will be the critical factor which drives this ability.

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