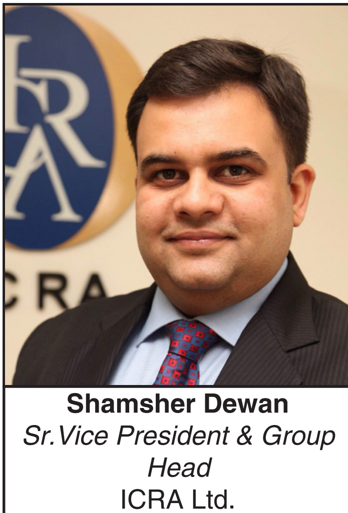
India Inc. penned a story of revenue growth in FY2022 even as it grapples with margin headwinds; earnings uncertainty persists over the near term



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The revenue growth of Corporate India in FY2022 was expectedly positive, aided by economic growth due to healthy demand scenario and price hikes across several sectors, leading to higher realisation levels. The aggregate revenues of 583 listed companies evaluated by ICRA (excluding financial sector entities) grew by 28.2% Y-o-Y in FY2022. These trends were visible across sectors, although to a varying degree. While sectors like airlines, auto ancillary, hotels, FMCG, iron & steel, oil & gas, among others had significant Y-o-Y growth in revenues in FY2022, few other sectors like pharmaceuticals, real estate, sugar and telecom had modest growth, while gems & jewellery witnessed a de-gowth.

On the demand side, ICRA notes that the recovery momentum was most pronounced in infrastructure-oriented sectors such as iron & steel, metals & mining, oil & gas, cement, and also travel and leisure sectors such as aviation and automotive, wherein both volume and realisation growth supported revenues during the year. Although FMCG sector had remained relatively resilient to the pandemic given its essential nature, there were some temporary disruptions, primarily emanating from subdued rural demand. Combined with price hikes taken by most players to offset the input cost inflation, the revenue growth for most of the players was modest. While automotive sector witnessed a sharp recovery in demand, it faced supply chain disturbances (mainly due to semiconductor chip shortage and partial lockdown imposed in China), thus hampering the pace of production.

While revenues of ICRA sample set in FY2022 grew at a healthy pace on a Y-o-Y basis, favourably supported by lower base of FY2021, operating profit margin (OPM) of India Inc. for the year contracted marginally by ~10 bps on a Y-o-Y basis. Despite the operating leverage benefits, OPM contracted due to unprecedented input cost inflation (largely fueled by the ongoing Ukraine-Russia geo-political tensions and the partial lockdown imposed in China), with commodity prices and energy costs on a steep upward trend, which could not be entirely passed on to the customers. Increased freight costs also continued to pose challenge to margins, especially for entities with sizeable revenue share from exports.

In addition to sharp increase in input costs and supply chain disruptions, several sectors also faced rural distress, which hampered demand prospects and thus impacted revenues and margins to an extent. Although companies have been exploring several ways to protect their earnings such as periodic price hikes, cost rationalisations, design and process optimisation etc., these have been inadequate to arrest the margin decline. However, select sectors like metals & mining, auto ancillary, capital goods, hotels and iron & steel reported improvement in OPM in FY2022 mainly on account of efficient passing on of the input cost hikes to the customers, helping arrest the extent of overall margin contraction.

ICRA believes that Q1 FY2023 performance of India Inc. has faced similar constraints as supply chain issues are easing only gradually, while commodity-led headwinds continue, especially in the wake of rising crude oil prices, INR depreciation vis-à-vis US$ and geo-political developments. Furthermore, rising inflation is likely to have adverse impact on consumer-sentiment and thus demand in select sectors. The margin recovery is expected from H2 FY2023; however, above challenges may constrain the recovery and thus remain key monitorable.

The interest coverage ratio of ICRA's sample, adjusted for sectors with relatively low debt levels (IT, FMCG and pharmaceuticals) witnessed a Y-o-Y improvement in FY2022 to 5.2 times (3.7 times in FY2021), despite the moderation in OPM. The improvement in credit metrics was on account of a) expansion in absolute operating profits as the demand situation improved and b) reduction in interest costs, given the lower interest rate regime and general deleveraging trends across most sectors. Notable sectors which reported a sharp improvement in credit metrics over the course of the past one year include iron & steel, textiles and capital goods, wherein improvement in realisations supported earnings, while focus on deleveraging helped reduce the interest burden also significantly.

While the credit metrics improved in H2 FY2022 with the Omicron wave having a limited impact on the business environment, the combined impact of multiple headwinds, as mentioned above, on the debt servicing indicators remains to be seen. The stress would be especially visible in sectors which have limited ability to pass on these inflationary pressures through price hikes to end customers. Further, increase in borrowing cost following 90 bps hike in Repo rate will also constrain the interest coverage ratio for debt-heavy sectors and companies.

Accordingly, earnings uncertainty over the near term persists due to limited visibility on resolution of these challenges. Fear of global recession also remains an evolving risk for export-focused industries such as IT, automotive and industrials.