Revenue growth of corporate sector remained muted in Q1 FY 2017 but earnings grew at a faster pace

- The aggregate revenues of Indian Corporate sector, comprising 502 listed companies grew by 0.2% in Q1 FY 2017 on YoY basis as many of the commodity-oriented sectors such as Oil & Gas and Metals reported lower revenues vis-à-vis Q1 FY2016 on account of lower commodity prices.
- However, even as revenue growth remained muted, the earnings improvement continued across many of the sectors during the quarter as benefits of lower commodity prices (notwithstanding partial commodity price reversals in recent periods) and uptick in consumption-driven sectors supported performance. The aggregate EBITDA margins of 502 companies (in our sample) continued to expand in Q1 FY 2017 at 19.1%, highest since FY 2008. Margins expanded by 100 bps on YoY basis and almost 170 bps on QoQ basis.
- Out of 29 sectors in our coverage, 14 sectors reported more than 50 bps improvement in EBITDA margins during the quarter, while another 13 sector reported stable margins on YoY basis. Margin contraction was limited to companies engaged in Oil & Gas (Production), Mining (Coal & Iron Ore) and Shipping.

Consumption-driven sectors, Cement and Steel were key sectors that witnessed margin improvement

- Despite partially recovery in commodity prices, the profitability indicators of companies in sectors such as Cement, Power, FMCG and Consumer Durables expanded on both yearly and sequential basis. Apart from these sectors, steel producers also witnessed sharp improvement in EBITDA margins during Q1 FY 2017 aided by recovery in international steel prices, lower competition from cheaper imports by virtue of Minimum Import Price (MIP) and lower operating costs.
- While these factors supported margin recovery over the last couple of quarters, the scenario remains fairly cautious for steel manufacturers on account of the recent increase in coal and coke prices as well concerns to related to shrinking global demand and over-capacity.
- During the quarter, sugar producers also continued to reap benefits of sharp recovery in international sugar prices amidst global supply constraints. The EBITDA of Fertilizer companies (both in percentage and absolute terms) also improved on YoY basis on account of correction in domestic gas prices and higher profitability in associated chemicals and trading business.
- The Capital Goods sector, which have been reeling under the pressure of weak order inflows and challenges in execution of existing orders didn't witness further contraction in margins as initiatives to cut cost, focus on higher margin businesses and diversification have started yielding results.

Credit metrics are yet to see improvement as pace of deleveraging in stretched sectors has been slow

- Despite improvement in profitability indicators in the last few quarters, limited investments in capital expenditure and reduction in working capital requirements, the aggregate debt servicing indicators of Indian Corporate sector didn't see much improvement as balance sheets across many of the highly indebted sectors like Steel, Construction, Power, Real Estate and Telecom remained overleveraged.
- As a result of these factors, the aggregate interest cover of 502 companies our sample remained stable at 4.3x as on June 2016 compared to 4.3x as on Q4 FY2016 and Q1 FY 2017. If adjusted for sectors that have low debt levels (i.e. IT, FMCG and Pharmaceuticals), the ratio stood at 3.5x for Q1 FY 2017.
- Notably, the Interest Cover for entities in some of stressed sectors like Steel, which had fallen below 1x in the past few quarters, improved marginally in Q1 FY 2017. The pressure on debt servicing indicators in Infrastructure & Construction sectors (i.e. Average interest coverage for last four quarters stood at 1.0x) also saw some improvement but limited deleveraging of balance sheets and the impact of persisting structural challenges (like slow pace of project execution, delays in land acquisition, non-availability of natural gas etc.) continued to weigh down on debt servicing indicators.
- As per ICRA's estimates, nearly 20% of the entire debt (Rs. 29,579 Billion) of the sample had interest cover less than 1x as on March 2016. Approximately 65% of this (with interest cover < 1x) is contributed by companies in three sectors viz. Infrastructure & Construction and Steel.
- During FY 2016, proportion of debt with entities having interest cover below 1x had increased in the steel sector as earnings of steel manufactures declined sharply on back of cheaper imports. Among the most the stretched sectors – Airlines and Sugar were the only two sectors where Interest Coverage improved during the year on back of favorable industry specific developments.

The following report presents an update on Corporate Credit trends in Q1 FY2017 along with outlook on 15 sectors.

Key Financial Indicators of Corporate Sector:

In Rs. Billion	Q1 FY2016	Q2 FY2016	Q3 FY2016	Q4 FY2016	Q1 FY2017
Operating Income	9,447	9,715	9,614	10,119	9,505
Change (%)	-4.7%	-3.4%	-4.4%	1.2%	0.6%
OPBDIT	1,713	1,654	1,633	1,765	1,820
PAT	787	751	629	559	809
OPBDIT/OI (%)	18.1%	17.0%	17.0%	17.4%	19.1%
PAT/OI (%)	8.3%	7.7%	6.5%	5.5%	8.5%
Interest Coverage (x)	4.3	4.2	4.3	4.3	4.3

Source: ACE Equity Database, ICRA research; for a sample of 502 listed companies

Sector-wise Outlook

Sector	Outlook
Automobile OEMs	• The outlook for the automobile sector continues to be 'Stable' with expectations of pick-up in demand owing to favorable impact of normal monsoon on rural consumption and 7th pay commission on disposable incomes. ICRA expects both the Two Wheeler and Passenger Vehicle segment to register a growth of 10-12% in FY 2017. • The outlook on the Commercial Vehicle industry also remains 'Stable' despite decline in M&HCV (Truck) sales over the past three months as we believe that the current slowdown is transitory and is like ease out as clarity on GST rates emerges. Owing to expectations that vehicles prices would fall once GST is implemented, fleet operators have deferred purchase of new vehicles, which was otherwise expected to get a boost from pre-buying following the implementation of BS-IV emission norms from April 2017 onwards. In addition, the overall sluggish demand for freight and its impact on freight rates has also contributed to the slowdown. • As a result, we have revised our growth estimates for the segment to 5-8% from 13-15% earlier for FY 2017. Likewise, for Buses, the growth outlook stands revised at 7-9%. Comparatively, the LCV (Trucks) would continue to grow at 11-12% supported by pick-up in consumption-driven sectors and low-base.
Tractors	• During the current fiscal, the domestic tractor industry also witnessed healthy recovery in sales (up 13.8% in 5m FY 2017) on account of improvement in farm sentiments after better rabi production and forecast of a healthy south west monsoons. In addition, Government support programmes in select states have also supported sales. ICRA expects that industry will register a growth of 9-10% in FY 2017 as better rainfall would boost agriculture output and restore purchasing power of the farm sector.
Pharmaceuticals	• The outlook on the Indian Pharmaceutical Industry remains 'Stable' based on expectations of growth prospects for pharmaceutical companies supported principally by patent expirations in the U.S., healthy product pipeline of leading Indian generic companies and continued healthy demand from domestic market. • The pharmaceutical industry has been facing certain headwinds in key markets, especially in the US and India. The opportunities in US market, though, have become much more competitive given increased number of filers, consolidation of supply chain, increased regulatory scrutiny from FDA and marginal presence of domestic companies in fast growing bio-similar space. Domestic market has also seen challenges as reflected by recent expansion of NLEM and ban FDCs.
Real Estate	• The outlook on the Indian Real Estate sector remains 'Negative' given the weak consumer sentiment and low affordability levels which are expected to keep the residential real estate demand under pressure. The developers' cash flows are expected to remain subdued given the slowdown in sales and lack of new launches as well as delays in execution of projects, owing to the construction liked nature of customer advances. • While residential market remains subdued, there has been a gradual improvement in commercial real estate, with improved occupancy levels and stable rentals, supported by the limited fresh supply coupled and resurgence of corporate sector demand. • With banks adopting a more cautious approach towards the real estate borrowers, developers are increasingly looking at alternative sources of funding. Of late, private equity investments in the real

	estate space have increased. However, these have been limited to leading developers. The funding avenues for mid-rung developers have come either in form of pure debt or structured instrument or land monetization to bigger developers. The recent policies changes are however expected to help create a more favorable operating environment for foreign investors and ease financing scenario.
Cement	• ICRA estimates demand growth at 6% during FY2017. The demand outlook for FY2017 remains relatively more favorable when compared to FY2016, driven mainly by the pick-up in the infrastructure segment, majorly road projects and the likelihood of a recovery in the rural demand from H2 FY2017, given expectations of a better monsoon.
Construction	• The operating performance of companies in the sector have witnessed marginal improvement led by improved order inflows (mainly from public sector), and lower raw-material costs. However, the leveraged balance sheets and weak liquidity position of most of the players in the sector will make the recovery slow paced. Furthermore, execution is also impacted due to weak liquidity position of the players in the sector. ICRA expects, the recent measures announced by CCEA will help in improving liquidity and will lead to pick-up in pace of execution.
Oil & Gas	• The outlook for the Indian Oil & Gas segment remains 'Negative' due to challenging environment for the upstream and oil field services in view of lower crude oil prices notwithstanding marginal recovery in recent months amidst volatility in crude oil prices. Moreover, the correction in the domestic gas price from October 2016 could lead to further fall in profit levels of the upstream players despite lower under-recovery linked subsidy sharing.
Iron & Steel	• The outlook on the Indian steel sector remains 'Negative', despite the recent imposition of anti-dumping duties (ADD) by the Government on certain hot-rolled (HR) and cold-rolled (CR) products to protect domestic steelmakers from cheaper imports. Weakness in China and the Euro region is expected to keep the capacity utilisation rates of other economies, including India, under check. • ICRA believes that revival in rural demand following a normal monsoon after two years and the rise in consumption, post the 7th Pay Commission payouts, would drive domestic steel demand to some extent in the near term. • However, a sharp increase in coking coal prices recently is likely to keep the margins of domestic blast furnace players under check, despite an expected improvement in realisations. Given the significantly high debt levels contracted by steel players in the last few years, ICRA expects debt protection metrics of steel players to remain depressed in the near term.
Telecom	• The outlook on the Telecom sector remains 'Negative', given the expected pressure on the capital structure of the industry following the upcoming spectrum auctions In addition, the industry would need to undertake capital expenditure for steady 3G/4G rollouts and to improve the quality of services. • These developments come at a time when the industry is already burdened by weak capital structure and rising competitive pressures with the foray of Reliance Jio, the industry is expected to witness pressure on its operating parameters and profitability metrics primarily on account of weakness in both voice and data realizations.
Power	• On the generation front, the power sector continues to face challenges on account of a) weak demand from state utilities (leading to absence of incremental PPAs), slow progress in resolution of tariff compensation (for competitively-bid IPPs) and uncertainty related to domestic gas availability. • Given the slow progress on some of these measures, the credit profile of some of the standalone power generation SPVs continues to remain weak in absence of fuel supply agreements (especially gas-based) and long-term PPAs. Further, the timely and adequate implementation of tariff revisions remains critical for distribution utilities to benefit from UDAY scheme, which provides opportunity for de-leveraging and refinancing.

Source – ICRA report