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What does interest cover of industries indicate?

A quick indicator of solvency of companies is the interest cover. It indicates whether the company has the ability to service the interest component of its debt from the profits earned in a particular period. We have examined the results of 1789 companies excluding financial units and traced the trend of PBDIT/Interest expense, to analyze whether they are in a position service the interest component of debt obligation.

Some interesting results from the aggregate sample from FY16 onwards:

- Since Mar-16, PBDIT/Interest expense ratio for the sample companies increased from 4.4% in FY16 to 5.0% in FY19.
- In FY20, the ratio deteriorated to 3.6, as profits were impacted partly due to the lockdown announced in the last week of March. The WALR on fresh loans had declined from 9.76% in April 2019 to 8.82% in March 2020. Therefore interest cost was not the cause for lower performance.
- In FY21, the ratio rose to 4.8, reflecting a turnaround in their performance. This was due to a combination of the sharp reduction in interest rates by the RBI which also lowered the borrowing cost. The average WALR on fresh loans of banks declined from 9.26% in February 2020 to 8.03% in March 2021. This combined with improved profit more due to cost cutting helped to improve the interest cover ratio. Further, the moratorium that was given to borrowers also helped in containing interest cost.
- For the 9-month period of FY22, interest cover of companies has dipped marginally to 4.5 from 4.8 in FY21.
- In the current cycle, where oil and other commodity prices are surging, margins of companies may be impacted, due to higher raw material cost. Thus, PBDIT may come under pressure. Further, when market interest rates are rising, interest expenses will also increase. Hence the ratio may decline further in the near term.

Period wise picture:

- **FY20** The ratio fell for 72% (1281 out of 1789) of companies. (Table 1) Sectors such as communication, mining, auto ancillaries, rubber products and roads noted considerable decline. Notably, for communications industry the ratio was -0.6 in Mar’20 as the telecom sector grappled with *issues related to AGR dues*. Only cement, electricity, drugs and pharma and edible oils and vanaspati witnessed increase in the interest cover ratio.

- **FY21 - Recovery is visible:** 46% (827 out of 1789) of companies noted improvement in the PBDIT/Interest expense ratio. Among them, the notable ones are from sectors such as communication, cement, drugs and pharma, metals and products, rubber and wood products. However, for gems and jewelry, edible oils and vanaspati and hotels and tourism, the ratio noted considerable deterioration.

- **9Month FY22:** 51% (921 out of 1789) have noted a deterioration in the interest cover. Among them, communication, gems and jewelry, sugar, paper and textiles are the notable ones.

Table 1. Distribution of companies by interest coverage ratio

Percentage of companies falling in different interest cover	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	9MFY22
<1	9.8%	1.2%	12.9%	0.4%	1.9%	2.9%	3.0%
1-3	32.5%	49.9%	21.9%	24.8%	29.0%	19.9%	19.9%
3-5	23.8%	12.6%	29.8%	36.6%	40.7%	40.3%	28.6%
>5	34.0%	36.4%	35.4%	38.2%	28.4%	36.9%	48.5%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Bank of Baroda Research

The positive takeaway from the table is that the proportion of companies with interest cover of less than 1 has been steady in the last three years even though it has increased.

Table 2 below gives the interest cover ratio across important sectors for the last 7 years. Some of the emerging trends are:

- Sectors which have tended to witness declining ratios are communications, mining, gems and jewelry, hotels and tourism and airlines. These sectors will require special attention.
- The industries that have witnessed a good turnaround in the last two years are cement, electricity, chemicals and machinery. This is good news as these are the sectors that form the fulcrum for the infrastructure push that the government is working on and would be progressively seeking access to the financial markets.
- Two sectors which have witnessed rather erratic trends which can still persist are edible oils and textiles.

Table 2. Trend in interest cover ratio: Sector wise

Sl No:	Industry Group	No: of companies	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	9MFY22
A	**Communication**	**14**	**4.3**	**1.6**	**1.3**	**1.6**	**-0.6**	**1.2**	**0.4**
B	**Construction**	**184**	**2.4**	**2.4**	**3.2**	**3.4**	**2.9**	**3.8**	**3.7**
B.1	Cement	29	4.8	5.9	4.9	4.7	5.9	8.6	9.1
B.2	Others	155	2.0	1.9	2.8	3.0	2.1	2.8	2.7
C	**Mining**	**13**	**22.1**	**24.0**	**23.8**	**20.0**	**11.8**	**12.3**	8.7
D	**Electricity**	**22**	**4.0**	**3.9**	**4.2**	**3.6**	**4.0**	**4.2**	**4.3**
E	**Manufacturing**	**1171**	**4.3**	**5.3**	**4.9**	**5.7**	**4.5**	**6.3**	**6.7**
E.1	**Chemicals and products**	**323**	**9.1**	**10.9**	**10.4**	**7.6**	**4.9**	**7.6**	**8.4**
E.1.1	Drugs & Pharma	100	10.1	11.1	9.4	10.4	11.8	17.6	17.7
E.1.2	Fertiliser	19	1.9	2.4	2.9	**2.8**	**2.6**	3.9	5.3
E.1.3	Others	204	9.8	12.0	11.4	7.7	**4.4**	6.9	7.5
E.2	**Consumer goods**	**62**	**8.3**	**9.5**	**11.2**	**9.9**	**9.3**	**8.5**	**8.8**
E.2.1	Footwear, Leather & related products	12	4.8	4.9	6.0	5.6	7.0	8.2	8.2
E.2.2	Gems & jewellery	14	4.7	5.3	6.6	5.6	**5.1**	3.6	2.6
E.2.3	Others	36	13.3	15.6	19.5	16.8	17.6	17.8	23.6
E.3	**Food Processing**	**142**	**4.7**	**5.6**	**4.9**	**9.2**	**11.6**	**10.7**	**11.5**
E.3.1	Edible oils & vanaspati	13	1.2	0.9	-3.6	12.8	35.5	6.2	6.5
E.3.2	Sugar	29	1.3	2.5	0.1	2.2	2.5	4.0	3.5
E.3.3	Tea	22	2.5	2.9	4.2	2.6	3.4	4.4	7.4
E.3.4	Others	78	12.1	11.8	15.1	17.7	19.1	19.3	21.3
E.4	**Glass & glassware**	**6**	**2.1**	**2.5**	**2.2**	**2.3**	**2.4**	**2.1**	**2.2**
E.5	**Machinery**	**133**	**4.3**	**4.7**	**4.2**	**2.6**	**1.7**	**3.3**	**3.8**
E.6	**Metals and product**	**167**	**0.5**	**2.1**	**1.6**	**3.2**	**2.5**	**4.9**	**5.3**
E.7	**Paper and paper products**	**38**	**2.9**	**3.9**	**4.1**	**5.7**	**5.4**	**3.8**	**3.1**
E.8	**Rubber products**	**18**	**11.3**	**10.2**	**8.5**	**8.8**	**6.9**	**8.3**	**8.2**
E.9	**Textiles**	**181**	**3.1**	**2.1**	**0.5**	**2.7**	**3.2**	**1.9**	**1.1**
E.10	**Transport Equipment**	**84**	**11.9**	**13.8**	**14.4**	**16.7**	**9.3**	**8.1**	**7.2**
E.10.1	Auto ancillaries	65	7.4	8.7	9.7	9.7	**6.2**	6.9	5.9
E.10.2	Others	19	13.8	16.0	16.1	20.1	**10.7**	8.5	7.7
E.11	**Wood & wood products**	**7**	**5.3**	**7.2**	**8.4**	**5.7**	**5.7**	**8.3**	**7.5**
E.12	**Misc Manufacturing**	**10**	**11.4**	**13.3**	**15.7**	**7.9**	**6.5**	**8.6**	**8.0**
F	**Services excl. financial**	**385**	**6.4**	**6.4**	**7.8**	**8.2**	**6.6**	6.4	**6.5**
F.1	**Hotels and tourism**	**30**	**1.6**	**2.1**	**1.7**	**2.5**	**3.9**	**-1.3**	**-0.9**
F.2	**IT**	**56**	**54.4**	**66.3**	**78.8**	**73.6**	**42.1**	**57.5**	**63.5**
F.3	**Transport Services**	**30**	**3.9**	**3.7**	**3.4**	**1.9**	**1.6**	**1.4**	**1.5**
F.3.1	Air	2	10.3	**9.2**	11.1	1.9	2.9	0.8	0.6
F.3.2	Road	12	3.2	3.4	3.3	4.7	0.3	0.9	4.0
F.3.3	Shipping	8	0.9	0.7	0.0	0.5	0.1	0.0	0.2
F.3.4	Others	8	4.6	4.3	3.9	2.6	**1.7**	3.2	3.1
F.4	**Misc Services**	**269**	**2.8**	**2.7**	**4.0**	**4.6**	**3.8**	**3.5**	**3.6**
	Total	**1789**	**4.4**	**4.7**	**4.7**	**5.0**	**3.6**	**4.8**	**4.5**

Source: Bank of Baroda Research, Note: Sectors whose interest coverage ratio currently (9MFY22) is below the long –run average have been highlighted. Numbers in red refer to sectors where the interest cover ratio has declined. (IT is excluded as this sector is not a big borrower)

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