

Understanding the P&L Statement (Part 1)

4.1 – Overview of the financial statements

You can think about the financial statements from two different angles:

1. From the maker's perspective
2. From the user's perspective

A maker prepares the financial statements. He is typically a person with an accounting background. His job involves preparing ledger entries, matching bills and receipts, tallying the inflows versus the outflows, auditing etc. The final objective of the is to prepare transparent financial statements which best represents the true financial position of the company. To prepare such a financial statement certain skills are required, usually these skills are developed through the rigor of a Chartered Accountant's training program.

The user on the other hand just needs to be in a position to understand what the maker has prepared. He is just the user of the financial statements. He need not really know the details of the journal entries or the audit procedure. His main concern is to read what is being stated and use it to make his decisions.

To put this in context, think about Google. Most of us do not understand Google's complex search engine algorithm that runs in the backend, however we all know how to use Google effectively. Such is the distinction between the maker and the user of financial statements.

A common misconception amongst the market participants is that, they believe the fundamental analyst needs to be thorough with concepts of financial statement preparation. While knowing this certainly helps, it is not really required. To be a fundamental analyst, one just needs to be the user and not the maker of the financial statements.

There are three main financial statements that a company showcases to represent its performance.

1. The Profit and Loss statement
2. The Balance Sheet
3. The Cash flow statement

Over the next few chapters we will understand each of these statements from the user's perspective.

4.2 – The Profit and Loss statement

The Profit and Loss statement is also popularly referred to as the P&L statement, Income Statement, Statement of Operations, and Statement of Earnings. The Profit and Loss statement shows what has transpired during a time period. The P&L statement reports information on:

1. The revenue of the company for the given period (yearly or quarterly)
2. The expenses incurred to generate the revenues
3. Tax and depreciation
4. The earnings per share number

From my experience, the financial statements are best understood by looking at the actual statement and figuring out the information. Hence, here is the P&L statement of Amara Raja Batteries Limited (ARBL). Let us understand each and every line item.

Particulars	Note No.	Year ended March 31, 2014	Year ended March 31, 2013
REVENUE			
Sale of products		38,041.27	32,949.37
Less: Excise duty		4,005.15	3,512.45
Net sale of products		34,036.12	29,436.92
Sale of services		309.32	137.02
Other operating revenue		21.15	15.21
Net revenue from operations	17	34,366.59	29,589.15
Other income	18	455.14	465.51
Total Revenue		34,821.73	30,054.66
EXPENSES			
Cost of materials consumed	19	21,011.95	17,603.12
Purchases of stock-in-trade	20	2,113.69	2,632.54
Changes in inventories of finished goods, work-in-process and stock-in-trade	20	(292.10)	(320.89)
Employee benefits expense	21	1,583.16	1,262.30
Finance costs	22	7.18	2.69
Depreciation and amortisation expense (includes impairment loss of ₹Nil (PY ₹75.52 million))	23	645.71	660.92
Other expenses	24	4,346.60	3,904.24
Total Expenses		29,416.19	25,744.92
Profit before exceptional items and tax		5,405.54	4,309.74
Less: Exceptional items (net)	33	38.84	91.57
Profit before tax		5,366.70	4,218.17
Less: Tax expense			
Current tax		1,580.00	1,377.97
Deferred tax (credit) / expense		106.23	(24.51)
Earlier year's (excess) / short provision		6.11	(2.34)
Profit for the year		3,674.36	2,867.05
Basic and diluted earnings per equity share of ₹1 each	37	21.51	16.78

4.3 – The Top Line of the company (Revenue)

You may have heard analysts talk about the top line of a company. When they do so, they are referring to the revenue side of the P&L statement. The revenue side is the first set of numbers the company presents in the P&L.



Before we start understanding the revenue side, let us notice a few things mentioned on the header of the P&L statement:

Statement of Profit and Loss for the year ended March 31, 2014		₹ million	
Particulars	Note No.	Year ended March 31, 2014	Year ended March 31, 2013

The header clearly states:

1. The statement of P&L for the year **ending** March 31, 2014, hence this is an annual statement and not a quarterly statement. Also, since it is as of March 31st 2014 it is evident that the statement is for the Financial Year 2013 – 2014 or simply it can be referred to as the FY14 numbers
2. All currency is denominated in Rupee Million. Note – 1 Million Rupees is equal to Ten Lakh Rupees. It is upto the company's discretion to decide which unit they would prefer to express their numbers in
3. The particulars show all the main headings of the statement. Any associated note to the particulars is present in the note section (also called the schedule). An associated number is assigned to the note (Note Number)
4. By default when companies report the numbers in the financial statement they present the current year number on the left most column and the previous year number to the right. In this case the numbers are for FY14 (latest) and FY13 (previous)

The first line item on the revenue side is called the **Sale of Products**.

Since we know we are dealing with a batteries company, clearly sale of products means the Rupee value of all the battery sales the company has sold during FY14. The sales stand at Rs.38,041,270,000/- or about Rs.3,804 Crore. The company sold batteries worth Rs.3,294 Cr in the previous financial year i.e FY13.

Please note, I will restate all the numbers in Rupee Crore as I believe this is more intuitive to understand.

The next line item is the excise duty. This is the amount (Rs.400 Crs) the company would pay to the government; hence the revenue has to be adjusted.

The revenue adjusted after the excise duty is the **net sales of the company**. The net sales of ARBL is Rs.3403 Crs for FY14. The same was Rs.2943 Crs for FY13.

Apart from the sale of products, the company also draws revenue from services. This could probably be in the form of annual battery maintenance. The revenue from sale of services stands at Rs.30.9Crs for FY14.

The company also includes “other operating revenues” at Rs.2.1crs.This could be revenues through the sale of products or services that is incidental to the core operations of the company.

Finally the revenue from Sale of products + Sale of services + Other operating revenues sums up to give the **total operating revenue** of the company. This is reported at Rs.3436 Crs for FY14 and Rs.2959Crs for FY13. Interesting, there is a note; numbered 17 associated with “Net Revenue from Operations” which will help us inspect this aspect further.

Do recall, in the previous chapter we had discussed about notes and schedules of the financial statement.

The following snapshot gives the details of note 17.

Notes forming part of the Financial Statements

NOTE 17: REVENUE FROM OPERATIONS

₹ million

Particulars	Year ended March 31, 2014	Year ended March 31, 2013
a) Sale of products		
Storage batteries (finished goods)	35,237.83	30,363.83
Storage batteries (stock-in-trade)	2,089.86	1,493.93
Home UPS (stock-in-trade)	713.58	1,091.61
Gross revenue from sale of products	38,041.27	32,949.37
Less: Excise duty	4,005.15	3,512.45
Net revenue from sale of products	34,036.12	29,436.92
b) Sale of services		
Installation and commissioning	49.14	17.36
Annual maintenance	146.91	96.09
Preventive maintenance	15.41	5.75
Other services	97.86	17.82
Net revenue from sale of services	309.32	137.02
c) Other operating revenue		
Sale of process scrap	21.15	15.21
Net revenue from operations	34,366.59	29,589.15

Clearly, the notes give a more detailed analysis of the split up of **revenues from operations** (does not include other income details). As you can see under the particulars, section 'a' talks about the split up under sales of products.

1. Sale of storage batteries in the form of finished goods for the year FY14 is Rs.3523 Crs versus Rs.3036 Crs in FY13
2. Sale of Storage batteries (stock in trade) is Rs.208 Crs in FY14 versus 149 Crs. Stock in trade refers to finished goods of previous financial year being sold in this financial year
3. Sale of home UPS (stock in goods) is at Rs.71 Crs in FY14 versus Rs.109 Crs FY13
4. Net sales from sales of products adjusted for excise duty amounts to Rs.3403 Crs, which matches with the number reported in the P&L statement
5. Likewise you can notice the split up for revenue from services. The revenue number of Rs.30.9 tallies with number reported in the P&L statement
6. In the note, the company says the "Sale of Process Scrap" generated revenue of Rs.2.1 Cr. Note that the sale of process scrap is incidental to the operations of the company, hence reported as 'Other operating revenue'.
7. Adding up all the revenue streams of the company i.e Rs.3403 Crs+ Rs.30.9 Crs +Rs.2.1 Crs gets us the Net revenue from operations = Rs.3436 Crs.
8. You can also find similar split up for FY13

If you notice the P&L statement, apart from net revenue from operations ARBL also reports 'Other Income' of Rs.45.5 Crs. Note number 18 reproduced below explains what the other income is all about.

NOTE 18: OTHER INCOME

₹ million

Particulars	Year ended March 31, 2014	Year ended March 31, 2013
Interest Income		
On bank and other deposits	131.22	112.29
Against trade receivables	6.72	10.27
Dividend income		
On current investments - mutual funds	142.68	143.96
On long term investments - equity instruments	1.51	1.31
Net gain on foreign currency transactions and translations	89.88	91.71
Insurance claims	32.27	13.48
Scrap Sales (non-process)	14.07	6.94
Cash discount earned on early payments	10.74	43.35
Provisions and credit balances written back	3.90	6.44
Bad debts recovered	15.15	0.25
Profit on sale of tangible fixed assets written off/discarded	4.49	0.04
Provision on doubtful trade receivables/advances written back	0.30	35.06
Royalty income	0.94	-
Sundry income	1.27	0.41
Total	455.14	465.51

As we can see the other income includes income that is not related to the main business of the company. It includes interest on bank deposits, dividends, insurance claims, royalty income etc. Usually the other income forms (and it should) a small portion of the total income. A large 'other income' usually draws a red flag and it would demand a further investigation.

So adding up revenue from operations (Rs.3436 Crs) and other income (Rs.45 Crs), we have the total revenue of for FY14 at Rs.3482Crs.

Key takeaways from this chapter

1. The financial statement provides information and conveys the financial position of the company
2. A complete set of financial statements include the Profit & Loss Account, Balance Sheet and Cash Flow Statement
3. A fundamental Analyst is a user of financial statement, and he just needs to know what the maker of the financial statements states
4. The profit and loss statement gives the profitability of the company for the year under consideration
5. The P&L statement is an estimate, as the company can revise the numbers at a later point. Also by default companies publish data for the current year and the previous year, side by side
6. The revenue side of the P&L is also called the top line of the company
7. Revenue from operations is the main source of revenue for the company
8. Other operating income includes revenue incidental to the business

9. The other income includes revenue from non operating sources
10. The sum of revenue from operations (net of duty), other operating income, and other incomes gives the 'Net Revenue from Operations'