

Analysis of Financial Statements

1. INTRODUCTION

Organisations have a purpose and it is generally stated in the mission or vision statement. To achieve the purpose, organisations need finance, which is raised from the capital market through debt or equity. Finance or capital is raised either directly from the investors or through intermediary institutions like banks. Once capital is raised, the capital is invested in assets, which can be broadly classified into fixed and current assets. Several factors determine the choice of assets and proportion of investments in different types of assets. A trading company or service company may not invest much on fixed assets whereas manufacturing company like automobile company would invest large amount in fixed assets. Some manufacturing industries may require more working capital, if the materials used by them are available only in certain seasons. After raising capital and acquiring assets, the business unit runs the operations and generates revenue. Since most business units are started with an objective of making profit, many of them report profit. Accounting statements typically reflect the above activities and allow the managers to examine whether their plan or strategy has resulted in positive impact on the company.

Balance Sheet, Profit and Loss Account and Cash Flow Statements are three principal financial statements and they reflect the above activities. Balance Sheet explains where from the organisation has raised money and where they have invested the money. Profit and Loss Account explains how efficiently the assets of the organisation have been used and what has been the net outcome of the operations. Cash Flow Statement shows operational outcome, capital raised and invested but all in terms of cash. While the principal financial statements provide wealth of information to investors and others, there is no ready answer to a question whether the organisation has achieved the goal or mission. Financial Statements are analysed further to get such an insight on the performance of the organisation and various parts or divisions of the organisation.

Investors and management perform the financial analysis to understand how productive the assets were in generating profit during the period. Lenders and suppliers of goods will look for ability of the firm in repaying the dues on time. Financial managers not only prepare financial statements but also analyse the same to get further insight on the performance of the organisation. They need to examine the organisation from the perspective of several users so that they can fulfil the needs of many of them.

While financial analysis is often used for evaluating current or historical performance, management uses the input of such analysis for planning exercise. In

preparing budgets, the inputs of financial analysis are extensively used. Financial analysis provides linkage between operating activities and funding activities. Normally, top management sets the goal and operational managers then determine the level of operations required in achieving the goal. It would be difficult to increase the level of operations without any investments unless there is a huge idle capacity. Thus increased activity demands more addition to assets and this in turn increase the demand for capital. The first step in this process is to know how much of additional assets we need and how much of capital we need to mobilise from various sources. Financial analysis, which provides historical linkage between various financial components, is useful. Suppose the top management fixes a goal to increase the net income by another 20% for the coming year. Using profit to sales linkage, managers can estimate additional turnover required in achieving the goal. Once additional turnover is estimated, it is possible to assess the investment requirement for additional assets (fixed and current assets in the case of manufacturing companies) and then additional funds required to buy such assets. Thus financial analysis is prerequisite for financial planning.

2. TECHNIQUES OF FINANCIAL ANALYSIS

Financial statements are analyzed to answer several questions and different techniques are followed for analysing financial statements. Some of the usual questions are:

- (a) How my company is comparable with others in the industry in terms of overall business?
- (b) How my company is growing over the years?
- (c) How is the overall financial health of my company? What are the strong and weak areas of performance?
- (d) Compared to industry or bench marked company, how is the performance of my company?
- (e) Is the company pursuing the financial performance and policies consistent with the strategy?

Analysts use several techniques to answer such questions. The details available in financial statements are converted into certain formats to facilitate such analysis. The most popular and often used techniques include preparing common size financial statements, statement showing growth of financial variables over the years, ratio analysis and inter-firm comparison.

3. COMMON SIZE STATEMENT ANALYSIS

Suppose an analyst would like to know how this company is different from other companies in the industry. One of the major problems when comparing different firms of the same industry is difference in size of the firm. It would be difficult to compare Asian Paints (India) Ltd. with Kansai Nerolac Paints Ltd. without adjusting the size since the Kansai Nerolac is less than half the size of Asian Paints (India) Ltd. In common size statement analysis, balance sheet, profit and loss account and cash flow statement are converted into percentage format. For balance sheet, the total value of

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the asset is treated as 100 and all sub-components of assets and liabilities are expressed as a percentage of total assets. In profit and loss account, the sales or total revenue is equated to 100 and all expenses are converted into as a percentage of revenue. For cash flow statement, the net cash flow of the year is treated as 100. When two firms are compared on this basis, it is possible to know how the assets, liabilities, expenses and component of cash flows are distributed among the various components. Common size statement analysis if performed across several years traces the changes in the allocation of assets or liabilities. Exhibit 5.1(a) to 5.1.(c) shows common size statements of Asian Paints (India) Ltd. for two years period.

An analysis of common size balance sheet improves the understanding of the readers on the distribution of assets and liabilities. There are changes in the funding structure of Asian Paints (India) Ltd. during the year 2014-15. The shareholders fund increased during the year while liabilities have declined. The company has reduced the borrowing during the year. If this trend continues, the debt level will approach to zero in next few years. The financial risk of the company in that process is considerably reduced and also, the company's debt capacity is very high compared to other firms in the industry. It is quiet possible that cash rich companies with low or zero debt are looking for acquisition through cash deals and low debt will allow the company to tap the resources at any time. Further, if the acquired firm is a sick firm and comes with some debt level, it is desirable to maintain low debt so that servicing of debt of sick firm in addition to bearing the cash loss of sick firm during initial period is feasible with low debt. In other words, it would be difficult for a highly levered firm to buy another sick or levered firm and bear the cash loss of the sick firm as well as servicing the debt of the sick firm.

Exhibit 5.1.(a)

Asian Paints (India) Ltd.		
COMMON SIZE BALANCE SHEET		
	As at 31.03.2015	As at 31.03.2014
FUNDS EMPLOYED		
Shareholders' Funds	58.16	53.59
Non-current Liabilities	3.92	4.22
Current Liabilities	37.92	42.19
Total	100.00	100.00
APPLICATION OF FUND		
Fixed Assets	28.94	30.51
Non-current Investments	10.67	10.82
Long-term Loans and Advances	3.07	1.51
Current Assets, Loans and Advances	57.32	57.16
Total	100.00	100.00

There are no major changes on the composition of assets. The proportion of investment in fixed assets and non-current investments have declined marginally during the year. Long-term advances and loans and current assets have increased. The spread between current asset and current liabilities is positive and also has shown an increase during the year. A positive spread indicates ability to service the current liabilities as and when such liabilities mature.

Common size profit and loss account shows composition of income and expenditure over the two years period or between firms. Analysis of common size profit and loss account of Asian (Paints) India Ltd.(Exhibit 5.1 (b)) shows no major change in the composition of income. On the expenditure side, material cost has declined marginally during the year but employee cost and other expenses have gone marginally. Material constitutes an important cost item and a decrease in the cost has a positive impact on the profitability of the firm. However, this benefit is offset by an increase in employee cost and other expenses. The profit percentage continues to be healthy.

The management of the company observes in the Management Discussion and Analysis that “... Over the long term, India continues to offer lot of opportunities that would continue to fuel the growth in the domestic paint industry for both, decoratives as well as industrial products. The current lower per capita consumption of paints in the country coupled with rising aspirations of the large, younger generation offer tremendous growth opportunities for the decoratives products. These rising aspirations of the well-informed younger generation would also spur the Home improvement category. At the same time, with continued focus on infrastructure development and with the Government's push for the “Make-in-India” play, even the industrial products could see a sustained growth phase in future. A large and growing market like India is bound to draw competition interest and your Company believes in its ability to address these opportunities and challenges to deliver strong and consistent performance in the coming years.”

Common size cash flow statement gives an idea about how the cash generated from the operations has been spent during the year and hence gives an idea about the direction of the firm. Exhibit 5.1(c) shows that the company was spending more on financing activities compared to investing activities. Dividend cash outflow, a component of cash flow of financing activities account most of the cash outflow. The statement also shows the company is spending less percentage of operating cash flows for investing activities compared to previous year. If a company spends a significant part of the operating cash flows for investing activities, it is an indicator of growth.

4. TREND ANALYSIS

Trend analysis shows the level of growth that the company has achieved over the years on each component of financial statements. Suppose the growth rate of sales is 20% but its cost has increased by 26%, then its profitability is affected. One can perform such analysis by observing the trends on each financial parameter. Normally a base year is selected and the values of base year are set to 100. Subsequent years' values are reported as a percentage of the base year value. Exhibit 5.2.(a) presents balance sheet

values for the last 10 years. The trend analysis of balance sheet gives some ideas about the financial policies and strategies of the company.

Exhibit 5.1.(b)

Asian Paints (India) Ltd.		
COMMON SIZE PROFIT AND LOSS ACCOUNT		
	For the year ended	
	March 2015	March 2014
INCOME		
Sales and operating income (Net of discounts)	108.81	108.96
Less: Excise	11.77	11.72
Sales and operating income (Net of discounts and excise)	97.04	97.24
Other Income	2.96	2.76
	<u>100.00</u>	<u>100.00</u>
EXPENDITURE		
Materials Consumed	54.41	56.08
Employees' remuneration and benefits	5.13	4.55
Manufacturing, administrative, selling and distribution Exp.	21.90	20.95
Less: Interest	0.23	0.25
Less: Depreciation	1.88	2.00
Profit Before Tax	<u>16.45</u>	<u>16.17</u>
Less: Exceptional Items	0.11	0.09
Less: Tax Expense	<u>5.12</u>	<u>5.04</u>
Profit After Tax	<u>11.22</u>	<u>11.04</u>

Exhibit 5.1.(c)

Asian Paints (India) Ltd.		
COMMON SIZE STATEMENT OF CASH FLOWS		
	For the year ended	
	March 2015	March 2014
Net Cash generated from Operating Activities	100.00	100.00
Net Cash used in Investing Activities	25.55	45.06
Net Cash used in Financing Activities	63.54	40.82
Cash added to (drawn from) Opening Cash Balance	10.91	14.12

Exhibit 5.2 (a)**Asian Paints (India) Ltd.
BALANCE SHEET TREND ANALYSIS**

Sources of Funds	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Share Capital	100	100	100	100	100	100	100	100	100	100
Reserves Total	785	666	556	454	357	278	190	158	123	100
Total Shareholders' Funds	680	579	486	400	317	250	176	149	120	100
Secured Loans	21	34	54	53	98	80	77	115	210	100
Unsecured Loans	200	176	193	372	192	73	84	98	99	100
Total Debt	43	52	59	185	81	75	82	104	138	100
Total	611	521	442	382	297	228	164	143	122	100

The year 2006 has been used as the base year for computing the percentages. The company is following the capital structure policy of low debt and high equity. In 2007, the secured borrowing increased but started declining in all other years. Unsecured loan increased in 2011 and 2012. Overall, the total debt is showing a downtrend. How Asian Paint has achieved such a major reduction in debt? It could be due to issue of fresh equity shares or changes in dividend policy or changes on the assets side of balance sheet like selling out some of the divisions. In this 10-year period, the company has not issued any fresh equity shares. There is no major change in the dividend policy and the company on average pays out is about 50 per cent of profit after tax as dividend. It is mainly on account of using the surplus profit to repay the debt. Against the maximum debt of Rs. 168.22 cr., the company posted huge profit during the last 10 years with a cumulative profit figure of Rs. 7250 cr., and hence repaid the loans as and when they become due. The company, like many other high profit companies in India, is currently almost debt free.

The trend analysis of asset side of the balance sheet shows the fixed asset of the Asian Paints has increased by four times over ten years period. Current assets have also gone up by four and half times during the same period. A further analysis of current assets shows a five time increase in inventory and four times increase in receivables. There could be several reasons for such a divergent trend in the movement of fixed assets and components of current assets. It could be on account of increase in asset efficiency. Investments in fixed assets is determined by the target sales and efficiency of fixed assets. Investments in current assets is determined by turnover and several other external factors like competitors' credit terms. If the company is producing more output per unit of investments in fixed assets, inventory requirement would also increase to handle increased output. It is also possible that Asian Paints is offering a number of new products or variation of existing products and that call for holding higher inventory. To meet the increased current assets needs, the company is raising

suppliers' credit equally and hence the current liabilities have increased by five times during the same period. Being a profitable company and distributing only about 50% of earnings a dividend, the balance amount is invested in the securities. Investments in securities thus have gone up by seven times during the period.

Exhibit 5.2 (a)

Asian Paints (India) Ltd. BALANCE SHEET TREND ANALYSIS

Application of Funds	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Gross Block	421	405	389	225	219	162	152	127	110	100
Net Block	654	670	700	336	352	235	207	143	111	100
Capital Work in Progress	598	163	225	2583	170	1631	381	473	50	100
Investments	690	609	169	197	200	256	86	154	122	100
Inventories	515	476	423	362	306	218	156	154	124	100
Sundry Debtors	394	385	342	270	192	179	168	136	127	100
Cash and Bank	218	367	1943	1765	1793	101	452	146	150	100
Loans and Advances	378	343	223	162	145	181	200	175	121	100
Total Current Assets	446	423	429	360	309	196	179	153	126	100
Current Liabilities	509	523	434	368	307	270	177	176	120	100
Net Current Assets	210	49	409	328	316	-82	188	65	147	100

Exhibit 2(b) compares major items of profit and loss account over the years. Though the growth rate of income is not uniform, it is moving upward over the years and increased nearly five times. There is not even a single year in which the income has shown a negative growth. In this restricted context, the business risk is very low for the company. Barring selling and distribution expenditure, all cost items are showing growth rate of less than or equal to income growth. It means the company is able to contain the cost and the profit is growing at higher rate than the sales. The reason for profit growth is declining trend in excise duty whose growth rate is significantly lower than income growth. The gross sales have gone up by 4.88 times over the years but the exercise duty has gone up only by 3.88 times during the same period. The reason is general decline in the excise duty rates over the years. The interest expenditure has also come down over the years. An interesting observation is significant increase in selling and administration expenses. With increased competition, the investment in advertisement and other promotional expenses have gone up significantly to protect and nurture the brand. The company was spending Rs. 91 Cr. towards advertisement in 2006. In 2014-15, expenditure on account of advertisement has gone up to Rs. 597 Cr. Analysts would like to check how other companies are managing the cost and revenue

to get more insight on competitive advantage of Asian Paints in the industry. Trend analysis provides an insight whether such competitive strength is seen over the years and whether they are sustainable in the long run or temporary.

Exhibit 2(b)

Asian Paints (India) Ltd. PROFIT AND LOSS ACCOUNT TREND ANALYSIS

	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Sales Turnover	488	434	374	326	259	206	180	146	121	100
Excise Duty	388	346	298	218	173	112	153	138	121	100
Net Sales	502	447	385	341	271	220	183	147	121	100
Other Income	559	483	351	394	208	471	167	168	118	100
Total Income	509	451	390	347	276	228	184	149	124	100
EXPENDITURE										
Raw Materials	495	457	405	373	285	220	197	148	128	100
Power & Fuel Cost	444	460	394	282	251	172	168	131	120	100
Employee Cost	505	386	323	273	240	206	186	151	115	100
Other Mfg Expenses	329	281	240	213	185	152	132	106	91	100
Selling & Admin Expenses	660	563	469	384	306	264	221	183	146	100
Miscellaneous Expenses	196	165	104	188	117	38	66	30	51	100
Total Expenditure	491	436	377	335	265	211	186	145	122	100
Operating Profit	612	544	469	418	345	331	173	174	131	100
Interest	382	355	416	384	200	234	195	165	146	100
Depreciation	490	466	279	219	208	133	126	96	98	100
Profit Before Tax	636	560	499	449	369	364	180	185	136	100
Tax	539	438	353	351	281	287	141	151	121	100
Profit After Tax	488	434	374	326	259	206	180	146	121	100

5. RATIO ANALYSIS

In common size and trend analysis, financial statements are examined independently. Financial statements provide additional insight if the analysts link these financial statements and such linking is achieved through ratio analysis. Ratios are aimed to assess profitability, productivity of assets or capital and risk associated with operations. Though one can get some basic idea about the company while evaluating common size statement and trend analysis, the level of comparison is however restricted. Ratio analysis integrates financial statements to assess financial health of the firm. Some of

the important ratios are discussed below. Exhibit 3 and 4 presents Balance Sheet and Profit and Loss Account of Asian Paints (India) Ltd.

6. PROFITABILITY RATIOS

Most of businesses have profit as primary objective. In assessing the health of the business, the starting point is assessing the profitability of the business. Asian Paints (India) Ltd. has reported an increase in profit in 2014-15 over the previous year. Its profit before depreciation, interest and tax (PBDIT) has increased from Rs. 1950.93 Cr. to Rs. 2197.34 Cr. Profit before depreciation, interest and taxes is also called operating profit. Profit before tax (PBT) and Profit after tax have also increased. It is good to see positive number against profit and that too a growing value in a competitive environment but it is not adequate. It is important to assess the profitability of the operations. There is a difference between profit and profitability. The concept of profitability is something similar to productivity of the machine or employee. Profitability measures the productivity of the capital. Since capital is raised from various sources, profitability is measured in different ways at different levels.

Return on Total Assets or Funds Employed

Return on total assets or funds employed measures the profitability of the business unit without differentiating suppliers of funds. It simply explains how much income that the firm has generated for the capital it has taken or used during the year. Depending on the definition of total assets, this ratio is also referred to as Return on Investments or Return on Capital Employed. Suppose total asset is defined as sum of fixed assets, investments and net current assets. Return on total assets under this definition can be called Return on Capital Employed (ROCE). Here capital employed means capital supplied by equity holders and debt holders and it excludes suppliers' contribution on working capital in the form of suppliers' credit. On the other hand, if the total asset is defined as sum of fixed assets, investments and current assets, then this ratio is called Return on Total Assets (ROTA) or Return on Investments (ROI).

The 'return' part of the ratio is defined normally as profit before interest and taxes less tax. In other words, the profit before interest and tax less tax is the amount available to the suppliers of capital. For the purpose of clarity, we will explain the profitability ratio without considering tax initially and then show the impact of tax separately. We prefer this approach because the impact of tax policies on profitability might cause confusion while examining the profitability of two firms. It is always preferable to attach a sheet defining all ratios used while communicating financial health of the business.

Return on Funds Employed or Capital Employed		
Return on Capital Employed	2014-15	2013-14
Profit before interest and taxes	1974.23	1738.61
FA+CA-CL	4515.38	3884.75
Return on Capital Employed	43.72%	44.75%

Return on Total Assets or Return on Investments

	2014-15	2013-14
Profit before interest and taxes	1974.23	1738.61
FA + Investments + CA	7273.20	6719.67
Return on Investment (ROI)	27.14%	25.87%

Return on Capital Employed (ROCE) of Asian Paints (India) Ltd. for the year 2014-15 is 43.72% compared to 44.75% for the previous year. It shows that the company is generating Rs. 43.72 for every Rs. 100 of capital invested for the suppliers of capital on pre-tax basis. There is a small decline in the profitability of the company. Return on Total Assets on the other hand marginally increased from 25.87% to 27.14% during the year¹. These two ratios might show divergent trend due to current liability differences. An increase in ROTA but a decrease in ROCE is due to lower usage of current liability in funding business operations. Similarly an increase in ROCE but a decline in ROI is due to increase in current liability source of funding. Many businesses use suppliers' credit as an important source of funding. ROCE and ROTA are generally used for business level evaluation and can be applied for a plant or a SBU or a department.

ROTA and ROI measure how the business unit or a division which has taken some resources or capital of the organization perform and contribute to the profit pool of the organization. There is no colour for this capital (debt or equity) and hence whatever the division or SBU generates out of this capital (without any concern on who will be the ultimate recipient of the return – equity holder, debt holder or government) is relevant for performance measurement. In measuring performance through ratio analysis, two aspects are important – consistency across the years and numerator – denominator issue. By changing the definition of denominator (gross current assets vs. net current assets), the profitability ratios changes significantly. Which one of the two profitable measures is correct? It is difficult to answer this question. Some users believe funds raised through current liabilities (particularly suppliers' credit) have no cost and hence what matters to a business is net current assets. These users will opt for ROCE where asset is defined as Fixed Assets plus Net Current Assets. Many other users of financial statements believe there is some implicit cost in current liabilities and hence would prefer ROI. Suppliers of goods and services on credit basis would have added some interest cost and hence indirectly the company would be paying the cost of funds. For these users, supplier credit is like any other loan and hence it is part of capital and hence would prefer to use ROI as a measure of profitability.

¹ Here is a word of caution. It is not difficult to mislead the readers with financial ratios by changing definition and hence one has to be very careful in both computing the ratio and also in its interpretation.

Exhibit 3

BALANCE SHEET as at 31st March 2015
of Asian Paints (India) Ltd.

Rs. In crores

	Notes	2014-15	2013-14
EQUITY AND LIABILITIES			
Shareholders' funds			
(a) Share capital	2	95.92	95.92
(b) Reserves and surplus	3	4,134.34	3,505.01
		4,230.26	3,600.93
Non-current liabilities			
(a) Long-term borrowings	4	32.09	39.51
(b) Deferred tax liabilities (Net)	5	167.78	177.07
(c) Other Long term liabilities	6	-	0.12
(d) Long-term provisions	7	85.25	67.12
		285.12	283.82
Current liabilities			
(a) Short-term borrowings	8	-	-
(b) Trade payables	9	1313.08	1498.84
(c) Other current liabilities	10	832.71	785.68
(d) Short-term provisions	7	612.03	550.60
		2757.82	2835.12
TOTAL		7273.20	6719.87
ASSETS			
Non-current assets			
(a) Fixed assets			
(i) Tangible assets	11 A	1886.42	1973.21
(ii) Intangible assets	11 B	79.07	38.99
(iii) Capital work-in-progress		139.54	37.95
		2105.03	2050.15
(b) Non-current investments	12	775.72	727.19
(c) Long-term loans and advances	13	209.54	94.64
(d) Other non-current Assets	18	13.64	6.60
		3103.93	2878.58
Current assets			
(a) Current investments	14	1118.06	943.96
(b) Inventories	15	1802.18	1665.05
(c) Trade receivables	16	728.87	712.36
(d) Cash and cash equivalents	17	61.81	104.12
(e) Short-term loans and advances	13	205.43	239.70
(f) Other current assets	18	252.92	176.10
		4169.27	3841.29
TOTAL		7273.20	6719.87

It is users of financial statements preference and they need to understand the difference before selecting one of the two profitable ratios. There is nothing wrong in computing both ratios and learn more from these two ratios. The substantial difference between the two profitable ratios shows the importance of current liabilities in Asian Paints

sources of funds. The current liabilities constitute nearly 50% of the total funds used in the business.

Exhibit 4

PROFIT AND LOSS ACCOUNT for the year ended 31st March 2015 of Asian Paints (India) Ltd.

(Rs. in Crores)

	Notes	2014-15	2013-14
Revenue from operations (net of discounts)	19	12,878.80	11,542.02
Less: Excise Duty		1,393.13	1,241.80
		11,485.67	10,300.22
Other Operating Revenue		163.16	118.56
Other income	20	186.82	173.66
Total Revenue		11,835.65	10,592.44
Expenses:			
Cost of materials consumed		6,191.72	5,758.71
Purchases of Stock-in-Trade		380.56	256.58
Changes in inventories of finished goods, work-in-		-132.43	-75.34
Employee benefits expense	21	606.94	482.43
Other expenses	23	2,591.52	2,219.13
Total expenses		9,638.31	8,641.51
Earnings Before Interest, Depreciation and Tax		2,197.34	1,950.93
Depreciation and amortization expense		223.11	212.32
Profit Before Interest and Taxes		1,974.23	1,738.61
Finance costs		27.13	26.08
Profit before exceptional and extraordinary items and		1,947.10	1,712.53
Exceptional items		13.53	9.96
Profit Before Tax		1,933.57	1,702.57
Profit Before Tax		1,933.57	1,702.57
Tax expense:			
(1) Current tax		616.42	498.63
(2) Deferred tax		-0.96	1.14
(3) Excess Tax Provision for Earlier Years		-9.29	33.74
Total Tax Expense		606.17	533.51
PROFIT AFTER TAX		1,327.40	1,169.06
Earnings per equity share:			
(1) Basic		99.92	80.81
(2) Diluted		99.92	80.81

There are four drivers for the profitability of a business organization. They are (a) Asset Management (b) Cost Management (c) Leverage or Debt Management and (d) Tax Management. The leverage and tax management are discussed first before taking up asset management and cost management.

Return on Equity or Net Worth or Shareholders' Funds²

The previous ratios (Return on Capital Employed and Return on Total Assets) combines all sources of capital but shareholders would be interested to know how much of return that the company has generated for them. This ratio is called return on equity (ROE) or return on net worth (RONW). Here equity or net worth means equity share capital and reserves and surplus. The definition of 'return' is profit before tax.

Return on Equity or Return on Net Worth		
	2014-15	2013-14
Profit before taxes	1947.10	1712.53
Shareholders' Fund	4230.26	3600.93
Return on Equity or Net Worth	46.03%	47.56%

Return on Equity is 1.70 times more than Return on Capital Employed for both periods. It is important to understand the source of additional earnings. Suppose the company has no borrowings. Then PBIT and PBT will be the same and also the sum of the debt and equity will be equal to equity. Under such a situation, both return on total assets and return on equity will be one and the same. The moment debt is introduced, the ROE is affected. ROE is positively affected when the company borrows money at a rate lower than return on total assets. Under this condition, the company borrows capital, uses to earn a higher ROCE, pays lower interest and adds the balance (or surplus) to the shareholders. On the other hand, if the ROCE is lower than interest rate, equity holders have to bear the difference and hence the ROE is negatively affected. The difference between ROTA and ROE can be explained as follows:

$$\text{ROE} - \text{ROCE} = (\text{ROCE} - \text{Interest Rate}) \times (\text{Debt/Shareholders' Funds})$$

The difference between ROE and ROCE is positive only when (a) ROCE is greater than interest rate and (b) debt/shareholders' fund is positive. To apply the above equation, it is necessary to find out the cost of debt or interest rate. There may be some challenges here too. While interest value given in profit and loss account is equal to interest for loan of the period, loan funds shown in balance sheet is loan outstanding as on that date. Suppose the company has repaid substantial part of the loan towards the end of the year. It will reduce the loan outstanding but interest expense will include interest on repaid part of the loan. It might give some abnormal interest rate if one divides interest expenses by loan outstanding. Assuming there no such abnormality, interest rate is computed as follows.

² Equity, net worth and shareholders' fund are all refer the same value. It is equal to Equity Share capital plus Reserves and Surplus.

	2011-12	2010-11
Non-current Liabilities	285.15	283.82
Interest	27.13	26.08
Interest Rate or cost of debt	9.52%	9.19%

Applying the above interest rates in the equation, the impact of borrowings on return on equity can be shown as follows:

$$46.03\%^3 - 43.72\% = (43.72\% - 9.52\%) \times (285.12/4230.26) = 2.31\%$$

The impact of debt on return on equity is also called impact of financial leverage. Financial leverage refers to use of debt and can be measured in several ways. In the above equation, financial leverage is equal to non-current liabilities to equity value. The debt (which includes deferred tax liability) to equity value is 0.07⁴. Contribution of financial leverage has declined from 2.80% to 2.31% due to increase in equity and increase in interest rate. ROE of 46.03% is something very high and many companies with strong brand value report such profit. Exhibit 5 lists the Return on Equity of few large Indian companies with strong brand.

Exhibit 5.5: Return on Equity of Highly Profitable Companies

Company Name	2001	2005	2010	2015
Asian Paints Ltd.	38.1%	47.3%	71.3%	46.03%
Britannia Industries Ltd.	52.0%	51.7%	30.5%	71.2%
Colgate-Palmolive (India) Ltd.	44.5%	71.3%	148.7%	101.3%
Dabur India Ltd.	23.9%	49.7%	70.6%	41.6%
Glaxosmithkline Consumer Healthcare Ltd.	42.7%	21.9%	39.4%	42.1%
Glaxosmithkline Pharmaceuticals Ltd.	26.1%	52.5%	43.5%	40.4%
H C L Technologies Ltd.	26.5%	11.8%	23.4%	47.0%
Hero Motocorp Ltd.	61.9%	81.5%	81.7%	50.9%
Hindustan Unilever Ltd.	67.6%	72.6%	110.4%	165.2%
I T C Ltd.	47.3%	39.6%	43.0%	45.7%
Infosys Ltd.	50.4%	42.6%	35.6%	35.3%
Lupin Ltd.	15.8%	16.6%	28.0%	35.6%
Tata Consultancy Services Ltd.	-	63.6%	42.2%	52.8%
Tech Mahindra Ltd.	51.0%	17.7%	30.5%	26.1%
Titan Company Ltd.	12.5%	19.6%	44.0%	34.1%

However we should remember that this ratio is computed based on book value of equity. It is relevant for a shareholder who invested money in Asian Paints several

³ ROE before extraordinary items

⁴ When financial leverage concept is used for solvency purpose, deferred tax liability need not be considered as debt.

decades back when the company was formed. An investor of Asian Paints today has to pay a huge premium over book value. So another way to assess the shareholders return is computing ROE on market value of shares basis. Suppose Asian Paints is sold to someone today. At what price it would be able to effect this sales transaction. The current market price of the share in March 2015 is around Rs. 800 and the market capitalization is Rs. 77000 cr. Market capitalization is market price per share multiplied by number of shares issued by the company. That is a prospective buyer would at the minimum need to pay Rs. 77000 to acquire Asian paints. Actually, the amount will be significantly higher than this value since the buyer gets control sake and is expected to pay a control premium. Ignoring such control premium, what is the return that a prospective buyer will generate after acquisition of Asian Paints assuming the price paid is Rs. 77000 cr.? The profit before tax divided by market capitalization is 2.53% [i.e. 19470.10 cr/77000 cr]. It may not be an attractive return for acquirer and he would rather invest the amount in a bank and earn 8% to 10%. If this is true, why Asian Paints shares are bought and sold at Rs. 811 per share? Investors in Asian Paints shares are not just looking for Accounting Return on Market Equity (PBT/Market Capitalization) but they are looking for business growth and prospective capital gain when they sell the shares. Investors might also be over-valuing the stock at this point of time.

7. IMPACT OF TAX ON PROFITABILITY

Tax distorts profitability to an extent. That is, two companies with same profit before tax and pre-tax profitability may have different post-tax profit and post-tax profitability. The following table explain the impact of tax on profitability.

	Company A	Company B
Equity	300	300
Debt	200	200
Total Capital	500	500
Profit Before Tax	100	100
Tax Paid	35	10
Profit After Tax	65	90
Return on Equity (pre-tax)	33.33%	33.33%
Return on Equity (post-tax)	21.66%	30.00%

There are several reasons for the differences in tax paid. It could be due to differences in depreciation or inventory policies used by the two companies for accounting and tax purpose. It is also possible due to revenue mix (tax-exempted earning like export earnings and domestic earnings) or location of the plant where some tax incentives are given. The level of distortions in accounting statements has come down now to a great extent since companies have to show deferred tax liability separately. It is better to assess the impact of tax planning on profitability separately instead of mixing them up with operational efficiency. For this reason, our earlier computation of returns were all on pre-tax basis.

If a company has improved its profitability due to better tax planning, it has to be identified separately and those who have contributed to such additional profitability have to be rewarded. The impact of tax planning on profitability can be assessed by comparing pre-tax profitability and post-tax profitability separately. Suppose the pre-tax return on equity of a company is 20%. If there is no tax planning and the tax rate is 30%, the post-tax return on equity should be 14% $[20\% \times (1-30\%)]$. If the actual post-tax return on equity of the company is more than 14%, then the difference is on account of better tax planning. For instance, if the post-tax actual return on equity in the above example is 16%, then the company is able to show additional 2% due to better tax planning. In other words, the impact of tax planning on profitability can be defined as follows.

$$\text{Post-tax ROE} - [\text{Pre-tax ROE} \times (1 - \text{tax rate})]$$

Impact of Tax Planning on Profitability		
	2014-15	2013-14
Profit before taxes	1933.57	1702.57
Less: Current Year Tax	616.42	498.63
Profit Before taxes less current year tax	1317.15	1203.94
Shareholders' Fund	4230.26	3600.93
Return on Equity (pre-tax)	45.71%	47.28%
Return on Equity (post-tax)	31.14%	33.43%
Return on Equity (pre-tax) x (1-tax rate, 30%)	32.00%	33.10%
Post-tax ROE - Pre-tax ROE x (1-tax rate)	-0.86%	0.34%

For Asian Paints (India) Ltd., the impact of tax planning on profitability is marginal and negative for the year 2014-15 and positive last year⁵. In addition, analysts can also compare the contribution of deferred tax liability on the sources of funds. Deferred tax liability contributes about 2.30% during 2014-15 (2.64% in 2013-14). For Asian Paints, the impact of tax planning or contribution of funds due to tax planning is small because the company is not investing any large funds for acquisition of fixed assets. On the other hand, if we compute contribution of deferred tax funds for companies like Reliance Industries, it will be very large. As on March 2015, deferred taxes contribute Rs. 12677 cr. for the Reliance Industries.

8. PROFITABILITY DRIVERS

Return on Total Assets or Return on Investments measures the profitability of the firm at business level. Profitability is influenced by several factors. Profitability drivers can be broadly classified into asset-related drivers and cost or profit-related drivers. Asset-related drivers contribute to profitability by improving the efficiency of the assets. Cost-related profitability drivers improve the profitability by managing the cost or price realization better. In other words, firms need to manage asset and cost to improve the

⁵ This additional return is temporary until such time the company is in position to defer the tax. An alternative way of assessing impact of tax planning is amount of tax not paid during the current year (equal to deferred tax liability) multiplied cost of capital i.e. interest free funds.

profitability. While asset management improve the profitability by increasing the sales, cost management improves the profitability by improving the profit margin. In the following pages, we discuss several components of Asset Management and Cost Management.

9. ASSET MANAGEMENT

Firms employ set of assets to generate sales. Fixed assets are essential for converting the material into finished goods or providing services to the customers. Current Assets are used in the manufacturing process and some current assets are outcome of manufacturing process. Ideally fixed assets need to generate large volume and for that given volume, the firm should be efficient in using very little current assets like zero inventory and cash sales. However, in reality it is difficult to achieve such ideal situation. A set of ratios called turnover ratios measures the productivity of the assets.

Asset Turnover Ratio

The asset turnover ratio measures the total income that the firm is able to generate using the assets. Since total assets include fixed assets, investments and current assets, it is desirable to use total revenue while computing this ratio. As we break the total assets into its components, we can also do the same for total income. It is important to ensure consistency between the numerator and denominator of various ratios. Asian Paints (India) Ltd. has reported total revenue of Rs. 11835.65 crores by using assets worth of Rs. 7273.20 crores in 2014-15⁶. Instead of using year-end total assets value, many analysts recommend average value of total assets of two periods⁷. Total asset turnover ratio of Asian Paints (India) Ltd. is shown below.

Asset Turnover Ratio		
	2014-15	2013-14
Total Revenue	11835.65	10592.44
Total Asset	7273.20	6719.87
Asset Turnover Ratio	1.63	1.58

If we change the definition of assets to exclude current liabilities, the asset turnover ratio will be 2.62 and 2.73 respectively. It means to generate an income of Rs. 1.63, we need an investment of Re 1 in fixed assets and current assets. We generate revenue of Rs. 2.62 for every Rupee net investment in fixed assets. The performance of 2014-15 compared to previous year on efficiency of asset management shows different picture based on our definition of fixed assets. However, the difference is small and hence we can conclude that the company is maintaining the efficiency of asset utilization. Total

⁶ The company is not using capital work-in-progress. Hence, it is possible to add up fixed assets, investments and current assets, loans and advances and define the same as asset.

⁷ Wherever balance sheet values are used in computing ratios, it is possible to take average of two period's value and use the same instead of one-year end value. For the purpose of simplicity, we will be using only year-end values here.

Assets consists of three types of assets namely fixed assets, investments and current assets. It is possible to measure the efficiency of each type of assets. The numerator of the equation is changed according the denominator value. For instance, other income is not included in turnover when computing fixed assets turnover ratio and current assets turnover ratio. Similarly, sales and operating income are excluded while computing efficiency of funds deployed for investments.

Fixed Asset Turnover Ratio		
	2014-15	2013-14
Sales and operating income	11648.83	10418.78
Fixed Assets or Net Block	1965.49	2012.20
Fixed Asset Turnover Ratio	5.93	5.18

Note: Operating income is included since some fixed assets are used for generating operating income like processing charges and lease rental. Fixed assets exclude capital work-in-progress

Current Assets Turnover Ratio		
	2014-15	2013-14
Sales and operating income	11648.83	10418.78
Current Assets	4169.27	3841.29
Current Turnover Ratio	2.79	2.71

Investment Income to Investment		
	2014-15	2013-14
Interest, dividend and profit on sale of investments	107.06	106.94
Current and Non-current Investments	4515.38	3884.75
Investment income to Investments	5.65%	6.40%

Note: If average investments value is used, the percentage will be different.

The company is showing an improvement in both fixed assets and current assets turnover ratios. In other words, efficiency of asset utilisation has improved in 2014-15 compared to the previous year. Analysts also compare the ratios with other companies in the industry before judging the performance of the company.

Investments in current and non-current securities are yielding 5.65% and it is only a realised return. The dividend yield of many good investments is generally low but such investments offer high capital appreciation over the years. Investors' in Asian Paints stocks today is likely to get a dividend of Rs. 40 per share against an investment of Rs.4000 per share. This offers a dividend yield of 1% but investors buy Asian Paints stocks mainly for capital appreciation. The capital gains part of the income has not been recognised in computing the above return. For example, an investment of Rs. 100 in a subsidiary company may generate a net income of Rs. 30 but it might distribute only Rs. 5 as dividend. While the realised return is only 5% in this case, the unrealised return is 25%. Using information available in Consolidated Profit and Loss Account, Investments Schedule and current market prices of quoted investments, it is possible to evaluate the efficiency of the investments. The market value of quoted non-current

investment is Rs. 709.41 Cr. against the cost value of Rs.384.07 cr. In addition, the company is holding Rs. 808.06 cr. worth of mutual funds units (cost value) and the market value of such investments is not available. The company is holding investment worth of Rs. 1893.78 cr. This value is close to 40% of the total shareholders' fund. Many cash rich companies in India show such large investments in mutual funds and other securities⁸. To an extent, this distorts financial analysis of these companies. For example, the return on equity of Asian Paints is showing a declining trend over the years because of a large portion of shareholders' funds are used to buy mutual funds and other investments, where the return is low. If we split the shareholders' fund into two components (funds used for core-business and funds used for investing in mutual funds and other securities) and compute return on shareholders' funds for each component, we can assess true profitability of the core business.

Current assets are required for running the business and there are several factors that influence the current assets. Technology, distance, business practices and risk aversion determine the need and amount of investment required for various current assets. Investments in current assets consume cost but expected to bring additional benefit to justify such investments. Following ratios are useful in this context.

Gross Current Asset Turnover Ratio

Current Assets consist of inventories, receivables or sundry debtors and cash and bank balances⁹. These assets are called current assets because they are expected to be liquidated within a year and change their form. For instance, dues from debtors as on March 31, 2014 are collected before March 31, 2015. Though the debtors value on March 31, 2015 may be more than the value as on March 31, 2014, it should be noted that such debtors are new debtors. Gross current assets turnover ratio and components of current assets turnover ratio are used to assess the management's efficiency in using current assets.

Gross Current Assets Turnover Ratio		
	2014-15	2013-14
Sales and operating income	11648.83	10418.78
Current Assets (Inventory+Drs+Cash)	2592.96	2481.53
Current Assets Turnover Ratio	4.49	4.20

Since investments in current assets have gone up from Rs. 2481.53 Crores to Rs. 2592.9 Crores, it is expected to generate additional sales to justify such investments. Since the gross current asset turnover ratio has marginally improved during the year, it means additional investments in current assets has not only brought additional sales but

⁸ Many analysts complain this behavior of companies keeping a large part of profit in the form of mutual funds and other securities. If the percentage of investments in shareholders fund cross 50%, you will wonder how to classify the company? Paint Industry or Investment Company?

⁹ Current assets, loans and advances are clubbed together and reported in the balance sheet. Though loans and advances, interest accrued but not due, advance payment of tax, etc. which form part of this group are also realised within one year, normally they are not part of working capital cycle. Analysts combine all the values to compute such ratio for the sake of simplicity.

also improved the efficiency of conversion cycle. We can demonstrate this efficiency in two ways. The inverse of this ratio explains the amount required to be invested in current assets to generate for every Re. 1 sales. In 2013-14, the company required 24 paise for every Re. 1 sales and it has gone down marginally to 22 paise to generate same Re. 1 sales in 2014-15. If we divide 365 with gross current asset turnover ratio, we get the number of days the company takes to covert cash into materials, work-in-progress, finished goods, receivables and finally cash. This is called gross working capital cycle. Asian Paints took 87 days to get the cash back after investing in working capital in 2013-14. In 2014-15, it reduced the conversion days to 81 days. Five years back, it took more than 100 days to complete the conversion cycle. There are different ways of presenting the same data to draw different inferences.

Inventory Turnover Ratio

Inventory Turnover Ratio and other inventory related ratios are used to check efficiency of the firm in managing inventory. The faster it turns around the inventory, it is good for the business. Efficiency of inventory management can be assessed in three forms namely, inventory turnover ratio, amount required to be invested in inventory to generate Re.1 sales and number of days of inventory. In the earlier turnover ratios, sales or income was used as the numerator. Since inventories are valued at cost, the numerator of inventory turnover ratio should exclude profit. Normally cost of goods sold (in case of trading company) or cost of goods manufactured (in case of manufacturing company) is used instead of sales value in the numerator of the equation. The definition of cost of good sold or cost of goods manufactured depends on inventory valuation policy. Sometime it may be difficult to get these values directly from the annual report and hence many analysts prefer to use sales for computing all turnover or activity ratios. Since Asian Paints is a manufacturing company, we will use cost of good manufactured and we define cost of good manufactured as equal to the sum of material consumed, employees' remuneration and benefits and manufacturing expenses¹⁰.

Inventory Turnover Ratio		
	2014-15	2013-14
Cost of Good Manufactured	7549.84	6853.54
Inventories	1118.06	943.9
Inventory Turnover Ratio	4.19	4.12
No of Inventory Days	87 days	89 days

¹⁰ This definition is also not perfect since manufacturing expenses are not directly given. For instance, firms may consider depreciation relating to production facilities as part of manufacturing expenses and hence allocate part of the depreciation to inventory. But this calls for bifurcation of depreciation into production related and non-production related. We computed manufacturing expenses from the list of expenses given in Schedule 22 of the Financial Statements of Asian Paints (India) Ltd.

Inventory turnover ratio has marginally improved compared to previous year value. The inverse of this ratio shows the investments in inventory per Rupee of cost of goods manufactured. For every Rupee of cost of good manufactured, the company required an investment of 24 paise for inventory in both periods. It is also possible to compute the number of days the inventory is maintained at different points of time. This can be computed by taking a ratio of value of inventory to average daily value of cost of goods manufactured. For computing average daily value of cost of goods manufactured, the number of days in a year can be defined as total days (365 days) or working days (300 days). An easy shortcut to compute number of days of inventory is dividing 365 or 300 days by inventory turnover ratio. The number of days of inventory that the company was holding as on March 2015 was 87 days (365 divided by 4.19) and for the previous year, it was 89 days.

Inventory turnover ratio can be further dividend into raw materials turnover ratio and finished goods turnover ratio, the two major component of inventory in many companies. Efficiency of managing raw materials and finished goods can be assessed in the form of turnover ratio or amount invested to generate one Rupee of cost of good manufactured or number of days of material or finished goods held by the company. In the case of material related ratios, raw materials consumed is relevant than cost of goods manufactured. It is possible to drill down these ratios further for principal raw materials or finished good separately. For the year 2014-15, the raw material days are 29 and finished goods days are 49 days. The corresponding values related to previous year were 32 days and 48 days. While finished goods efficiency is at same level, there is an improvement in raw material holding period.

Debtors Turnover Ratio

Debtors constitute an important part of current assets. Credit is often used to attract more sales. Like other components of current assets, such increased sales come with a cost. Hence incremental debtor and incremental sales are also compared to understand the level of competition. For instance if the sales and debtors of period 1 are Rs. 1000 and Rs. 100 respectively and debtors value increased Rs. 120 in period 2, the expected sales for period 2 is Rs. 1200. In other words, additional investment of Rs. 20 on debtors is expected to bring 10 times of its value as additional sales (i.e. Rs. 200). On the other hand, if the additional sale is only Rs. 100, it might mean that the company is finding it hard to push additional units in the market. Management of debtors can also be evaluated in terms of number of days of debtors that the company is holding compared to others. It is called 'Average Collection Period' or 'Average Days Outstanding'.

Debtors Turnover Ratio		
	2014-15	2013-14
Sales	11485.67	10300.22
Trade Receivables (Sundry Debtors)	728.87	712.36
Debtors Turnover Ratio	15.76	14.46

Average Collection Period		
	2014-15	2013-14
Sundry Debtors	728.87	712.36
Sales/365 days	31.47	28.22
Average collection period (days)	23 days	25 days

Debtors turnover ratio has improved and collection period has declined by 2 days. Collection period is expressed in terms of number days. Sometime the denominator is expressed in term of average monthly sales to avoid the complications relating to holidays and working days. Whenever balance sheet values are used in the form of ratio, one can expect marginal variation in ratios of one period to another period. Though the debtors' collection period has to be compared with the credit policy of the company.

Assessing Short Term Liquidity

Liquidity of firm refers to the ability of the company in meeting the short-term liabilities on time. Lack of liquidity often affects production since suppliers may reduce the supply unless old dues are cleared. In such illiquid environment, managerial time often is wasted in handling creditors or finding money. Liquidity can be assessed in two ways: Average time taken to pay the suppliers and proportion of long-term funds used in buying current assets.

Average time taken to pay the dues can be computed by following the same logic used in computing average time taken to collect dues from the debtors. Two alternative methods are used in computing this ratio depending on the availability of data. Since sundry creditors or trade payables are related to purchases, the ratio requires purchase value. If purchase value is not readily available, cost of material consumed or good manufactured or sold is used as an approximation of this ratio. Since purchase values are normally provided by the Indian companies in the Notes (Refer No 20 A in the Asian Paints annual report 2014-15) relating to materials consumed, this ratio is defined as follows. Here we assume, trade payables are mainly related to purchase of raw materials and all other service providers are paid on cash basis.

Time taken to pay suppliers' due		
	2014-15	2013-14
Trade Payables	1313.08	1498.84
Average purchases per day*	17.90	16.74
Days taken to pay suppliers' due	73	90

* [Raw materials purchase + packing material purchase + purchase of paints]/365

The company avails about 73 days credit from suppliers during the year but takes only 23 days to collect from its customers. A good business indeed! Why do cash rich companies like Asian Paints or Hindustan Unilever require suppliers' credit? Why not they buy by paying cash and avail discount? It may be on account of routine activity of purchase department to negotiate with the suppliers for credit and this way the purchase department shows its performance. It may also be on account of unattractive discount

they get from suppliers for cash purchase. For example, Asian Paints can use the investment amount to pay off the suppliers and get cash discount if the discount is attractive. The risk is it will lose the comfort of having some part of cash reserve. Professional managers, particularly financial managers would like to have comfort of holding cash called financial flexibility.

Current Ratio

Current ratio measures the amount of long-term funds used to procure current assets. Suppose a firm requires total gross current assets of Rs. 1000 to run the business. A part of it can be met through suppliers' credit and another part of it can be arranged through short-term loans like working capital loan or commercial paper. Suppose credit facility is available for Rs. 200 and another Rs. 200 is raised through short-term loan. The balance amount of Rs. 600 has to come from long-term funds in the form of equity or long-term loan. In other words, sixty per cent of current assets are funded by the long-term funds. The same can be expressed in term of a ratio called current ratio. Current ratio is equal to current assets divided by current liabilities. Current liability in this example is equal to supplier credit plus short-term working capital loan normally provided by commercial banks.

Till 2010-11, Indian companies show the current liabilities on the asset side of the balance sheet as a reduction from the current assets. They also do not consider short-term loans as a part of current liabilities. Such short-term loans are shown under 'Loan Funds' of Sources of Funds or Funds Employed side of the Balance sheet. So it was necessary to make considerable adjustments in computing current ratio. From 2011-12, the new Balance Sheet format requires to companies to show current liabilities along with equity and non-current liabilities. Current liabilities include short-term borrowings, trade payables, other current liabilities and short-term provisions. The format is now clean and provides the data required for current ratio without any further adjustments. These are the liabilities which are to be paid within one year. The current ratio for Asian Paints is computed as follows.

Current Ratio		
	2011-12	2010-11
Current Assets	4169.27	3841.29
Current Liabilities & Provisions	2757.82	2835.12
Current Ratio	1.51	1.35

An increase in current ratio normally means increase of liquidity position. Normally, current ratio of 2 is considered good since it means current assets are twice that of current liabilities and hence even if there are temporary delays in collections, still current liabilities can be met. At current ratio of 2, the company is bringing 50% of long-term funds for acquiring current assets and only 50% is used through suppliers' credit and short-term sources. A current ratio of 2 normally means that the firm will honour the payments on due dates with a small delay even if 1 out of 2 customers pays

their dues. If the current ratio is 1, it is possible for the firm to meet current liability provided current assets are realised on time. Any further delay in realisation of current assets will affect liquidity. In the case of Asian Paints (India) Ltd. the current ratio is below 2 but improved during the year. Before concluding that the liquidity position of Asian Paints (India) Ltd. is low for Asian Paint, one need to look into the ability of the company in raising funds in short period when there is a delay in realising current assets. The company is holding Rs. 1118 cr. worth of investments in the form of mutual funds units. Further, with low debt level of both long-term and short-term in nature, it may not be difficult for the company to get loans to meet such crisis. Also, the top management might want to create such tight liquidity position to make sure prompt collection of dues.

Quick Ratio or Acid-test Ratio

This ratio compares liquid part of current assets with current liabilities to measure the liquidity position of the company. Generally, inventories are less liquid. Hence, in arriving at the quick ratio we need to remove the inventory from the current assets and compare the same with current liabilities. Since some part of inventories may be more liquid than other current assets, one has to apply judgement and identify illiquid part of current assets in computing the ratio. Assuming the entire inventory is illiquid and all other components of current assets are liquid for Asian Paints (India) Ltd. the quick ratio is computed as follows.

Quick Ratio		
	2014-15	2013-14
Current Assets - Inventory	2367.09	2176.04
Current Liabilities	2757.82	2835.12
Quick Ratio	0.86	0.77

Quick ratio has improved from 0.77 to 0.86. Normally a quick ratio of 1:1 is acceptable. The expectation is if most liquid assets of firm are equal to current liabilities, then the firm would be in a position to meet such liabilities on time. While this line of thinking holds good for a normal company, as mentioned earlier, one should not go strictly by these numbers to assess the liquidity. We need to see overall position of the company. For instance, if Asian Paints buys the material from suppliers for 90 days credit, the payable days show it is able to pay the dues by 73 days. There is no abnormality in meeting the liabilities. The liquidity ratios are below the textbook norms for Asian Paints mainly because the company is in a position to manage the current assets and liabilities in a tight position. One needs to really worry if the liquidity ratio is low along with poor profitability ratio.

10. COST OR PROFIT MANAGEMENT

The second important profitability driver is cost or profit management. That is profitability can be improved by cutting cost or moving upward on value chain and

selling high-end premium products. Efficiency of the firm in managing cost or profit is measured through profit margin and cost ratios.

Profit Margin

Since the term 'profit' may mean different things to different users, it is better to be specific in defining the term profit. Normally, some prefix or suffix is used to define profit. Profit is measured at different levels like operating profit, gross profit, net profit, profit before interest and depreciation, profit before tax and profit after tax, disposable profit, etc. As we are separating the decision on usage of debt and tax planning from operating performance, we define profit margin as Profit before Interest and Taxes (PBIT) to Sales. This ratio shows profit before interest and taxes earned by the firm per Rupee of sales.

Profit Margin (Profit before interest and taxes to Sales)		
	2014-15	2013-14
Profit before interest and taxes	1974.23	1738.61
Sales and other income*	11835.65	10592.44
Profit Margin (PBIT to Sales)	16.68%	16.41%

* Since numerator includes other income, denominator should also include other income. Alternatively, other income can be reduced from both numerator and denominator but it might call for further adjustments.

Profit margin was marginally improved from 16.41% to 16.68%. The reasons for the change in profit margin can be examined through cost ratios. Cost ratios are defined as elements of cost divided by sales or cost of goods sold. Such cost ratios can be restricted to select major cost items or computed as many as possible using cost information available in the Schedules of Profit and Loss account. The following are few major cost ratios of Asian Paints (India) Ltd. expressed as a percentage of Sales.

Cost Ratios		
	2014-15	2013-14
Material to Sales	53.91%	55.91%
Employee Cost to Sales	5.28%	4.68%
Other Expenses* to Sales	22.56%	21.54%
Interest to Sales	0.24%	0.25%
Depreciation to Sales	1.94%	2.06%

* Since the break-up of this expenditure is available, more cost ratios can be computed with the help of Schedule of Profit and Loss Account.

The cost ratios show a decrease in material cost and an increase in employees and other expenses. In the Management Discussion and Analysis, Asian Paints briefly mentioned the increase in input cost and their difficulty in passing on all costs to customers immediately. Companies with strong brands will eventually pass on all increase in costs but it takes time.

11. LEVERAGE MANAGEMENT

In discussing Return on Capital Employed and Return of Equity, the importance of debt was highlighted. Debt brings positive effect to equity shareholders if the debt funds are used at a rate (ROI) more than cost of debt or interest rate. However, such positive difference should not be leveraged too much since the negative impact of debt is also high when the return declines and particularly below the cost of debt. In other words, debt adds risk to firm and such risk is called financial risk. The source of such risk is commitment to pay fixed interest rate irrespective of profit or loss of the company. Financial institutions, banks and other lenders of long term debt are concerned about the financial leverage of the company. They expect the firm to manage the leverage such that it doesn't affect the solvency of the firm. Two ratios namely debt to total capital or debt to equity and debt service coverage ratio are normally used for this purpose.

Debt to Total Capital or Debt to Equity Ratio

Debt to total capital or debt to equity ratio measures the proportion of debt in the capital structure. If the proportion is very high, it shows that the equity holders transfer most part of the risk to debt holders. Prospective lenders would avoid such firms. Lenders work out debt capacity of the firm and then find out how much of debt capacity that the firm has already used before lending new debt. Debt capacity can be related to cash flows or simply a policy statement. Earlier, prior to 1990, development financial institutions and banks restrict the lending to an extent of 66.67% or two-thirds of total capital. Today with increased business risk, many companies are reluctant to have a debt to total capital of more than forty per cent.

Suppose the acceptable level of debt to total capital is 40%. If the firm's existing debt to total capital is 30%, the firm has additional debt capacity to an extent of 10% of the total capital for the given equity level. In computing debt capacity, normally long-term debt is considered. As stated earlier, Asian Paints (India) Ltd. has reduced the debt level significantly in recent years and hence improved its additional borrowing capacity. The debt to total capital and debt to equity ratio of the company are as follows.

Long-term Debt to Total Capital Ratio		
	2014-15	2013-14
Long-term Debt	32.09	39.51
Total Capital	7273.20	6719.87
Long-term debt to total capital ratio	0.44%	0.59%

Long-term Debt to Equity Ratio		
	2014-15	2013-14
Long-term Debt	32.09	39.51
Equity or Shareholders' Fund	4230.26	3600.93
Long-term debt to equity ratio	0.76%	1.10%

For all practical purposes, we can say Asian Paints is zero debt company. It has huge potential borrowing capacity.

Debt Service Coverage Ratio

Debt service coverage ratio (DSCR) evaluates whether the firm has adequate cash to meet the pre-determined financial obligations. Financial obligations are mainly interest liability, lease rentals and amount payable during the year on debt (instalment due for the year). Such financial obligations are compared with profit before depreciation, interest and taxes (PBDIT) or cash flow from operations. DSCR for Asian Paints (India) Ltd. is as follows.

Debt Service Coverage Ratio (DSCR)		
	2014-15	2013-14
PBDIT	2197.34	1950.93
[Interest + Lease Rent + Installment]	27.13	26.08
Debt Service Coverage Ratio	80.99	74.81

Debt Service Coverage Ratio (DSCR)		
	2014-15	2013-14
[Cash Flow From Operations + Lease]	1143.57	1370.89
[Interest+Lease Rent+Short-term Loan]	27.13	26.08
Debt Service Coverage Ratio	42.15	52.56

* The company has no leased assets and short-term loans

Since loan and other fixed obligations are low, DSCR for Asian Paints (India) Ltd., is very high. Suppose the preferred DSCR is 2 or more, then the borrowing capacity of the company is several times of the current borrowing level.

In Exhibit 5.6, the definition of all the ratios is given in a chart popularly called DuPont Chart. Through DuPont chart, one can get quick insight on the health of the company, compare the current year performance of the company with previous year and compare the health of the company with industry average or competitor. Exhibit 5.7 summarises the financial ratios of Asian Paints (India) Ltd. for the year 2014-15 and 2013-14 in DuPont Chart.

A quick analysis of the Exhibit 5.7 shows the profitability of the business (Return on Total Assets) has improved during the year. The improvement is attributed to both improvement in asset efficiency (Asset Turnover Ratio) and cost management (Profit Margin). Asset management is improved and such an improvement is seen both on fixed assets as well as current assets and its components (inventory and collection days). The liquidity (current ratio) is improved but lower than the expected norm of 2. However, considering the profitability of the company, there is no major concern on the same. The financial risk of the company is negligible and the company carries a huge unused borrowing capacity, which can be used if the company plans to acquire either domestic or foreign company. Overall, the year 2014-15 is a happy year for Asian Paints Ltd.

12. INTERFIRM COMPARISON

Kansai Nerolac Paints Ltd.(GNPL), the Indian subsidiary of Japan based Kansai Paint Co. Ltd, is manufacturing and selling decorative paints as well as industrial paints, marine paints, enamels, varnishes, coatings, resins etc. It is the market leader in the Industrial paints segment. The company markets its products under the brand names Nerolac, Glossolite, Goody, Allscapes, Excel. Though the company was started some twenty two years before Asian Paints (India) Ltd., it is roughly one-third size of Asian Paints (India) Ltd. and is also the second largest paint company in India. In Exhibit 5.8, the financial performance of Asian Paints (India) Ltd. is compared with Kansai Nerolac Paints Ltd.

An independent analysis on the performance of Kansai Nerolac Paints Ltd. shows that the company is doing well and it is improving over the years. However, the performance of Asian Paints (India) Ltd. is better on several segments. Asian Paints derives its strength both on managing the assets and managing costs. A further analysis of asset management shows Asian Paints has reported superior performance on all components of assets except inventory management. Inventory turnover ratio of Asian Paints (4.19) is lower than Kansai's value of 5.73. On cost management side, the relative position of the two companies is mixed. Asian Paints scored well on material consumption whereas Kansai controlled manufacturing and other expenses well. On employees cost, Asian Paints incur more employee cost, which may be on account of rewarding employees due to superior financial performance. Overall, Asian Paints is not only the market leader in paints industry but also shows superior financial performance. Such superior performance is also reflected in the stock prices of Asian Paints (India) Ltd. The price-earnings (P/E) ratio of Asian Paints (India) Ltd. as on March 2015 was 58.44 against Kansai Nerolac's P/E ratio of 42.90.

	Asian Paints	Kansai Nerolac
Market Price (31/03/2015)	808.75	216.20
Earnings Per Share	13.84	5.04
Price - Earnings Ratio	58.44	42.90
Book Value per share	44.10	29.63
Price – Book Ratio	18.34	7.30

13. SUMMARY

Financial statement analysis completes our journey on understanding financial statements. While financial statements provide wealth of information to users reflecting various activities of the organisations, financial statements analysis integrates them and assess whether the business has achieved the goal of maximising the wealth of the shareholders. Financial statements are analysed in several ways depending on the objective of such analysis. Common size analysis, trend analysis and financial ratio analysis are three important methods. The analysis of financial statements consists of a mixture of steps that interrelate and affect each other. It would lead to wrong conclusion and strategy if the analysis were done on piecemeal basis. For instance,

higher turnover ratio doesn't mean good for the company since the company might aggressively selling by cutting down the price. Such aggressive selling could influence the collection or increase the bad debts. An integrated analysis would be useful in this context.

The goal of wealth maximisation is achieved when the firm increases ROE without increasing the financial and business risk. At the firm level, managers need to maximise the return on assets (ROA). This profitability measure is driven by two drivers namely, asset management and cost management. Asset management refers to the ability of the firm to generate maximum revenue for a given level of assets. Cost or profit management refers to ability of the firm in controlling the cost or maximising profit margin. There are two possible strategies that firms can follow to improve cost minimisation or profit maximisation.

Cost leadership requires the company to spend their efforts to reduce the cost and then set competitive price to acquire larger volume or market share. Product differentiation strategy would require the firm to move upward on value chain and get premium price and profit. Companies generally pursue both strategies and develop products for different segments. For instance, Asian Paints (India) Ltd., the company we have analysed in this book, has developed a range of products and services over the years to serve the needs of different segments of market. Managers, who have access to more information, can measure profitability for each product or brand or division or plant or region. The primary purpose of accounting and accounting information system should enable the managers to get such details.

Exhibit 5.6: DuPont Chart - Financial Statement Analysis

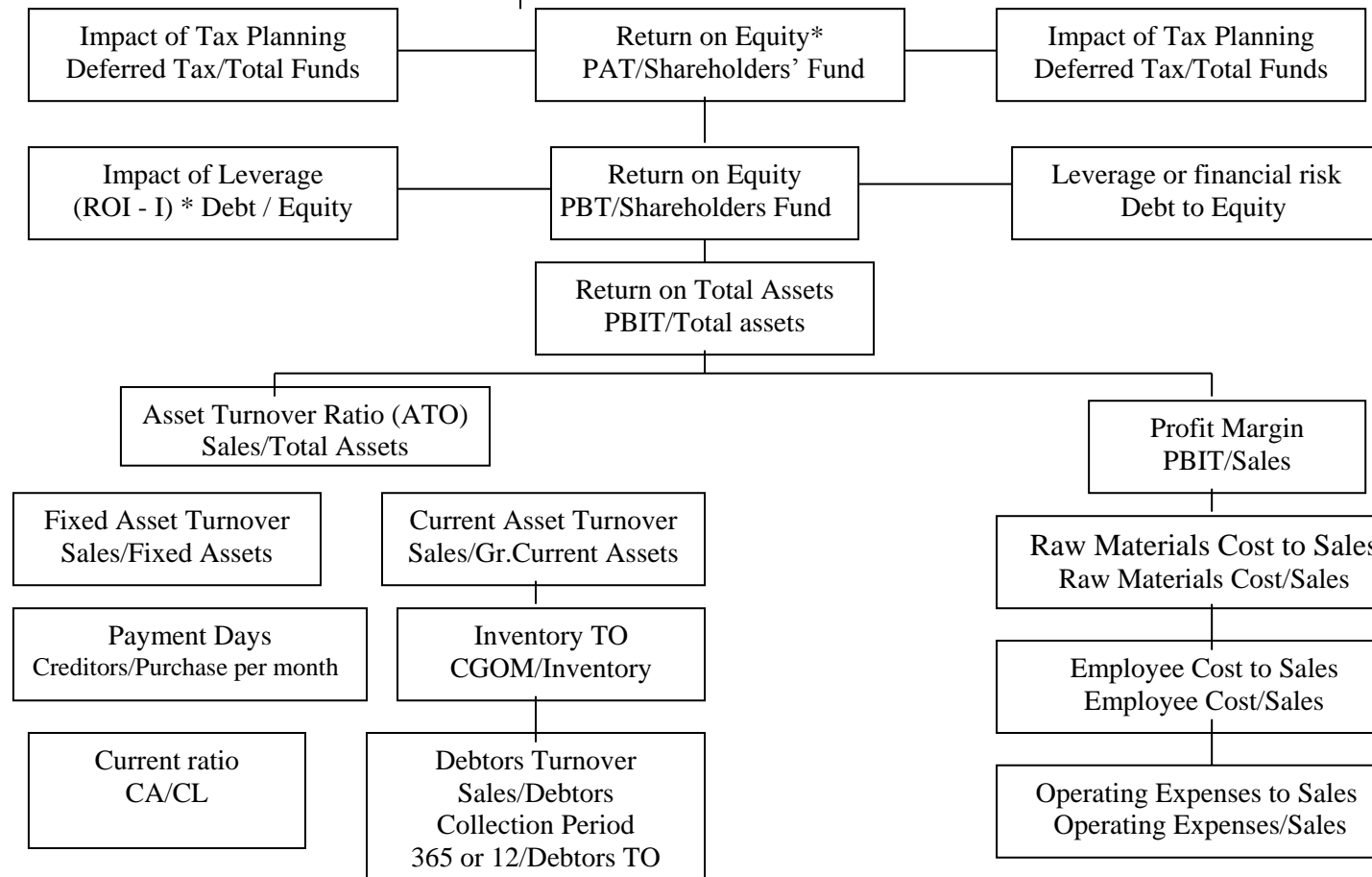


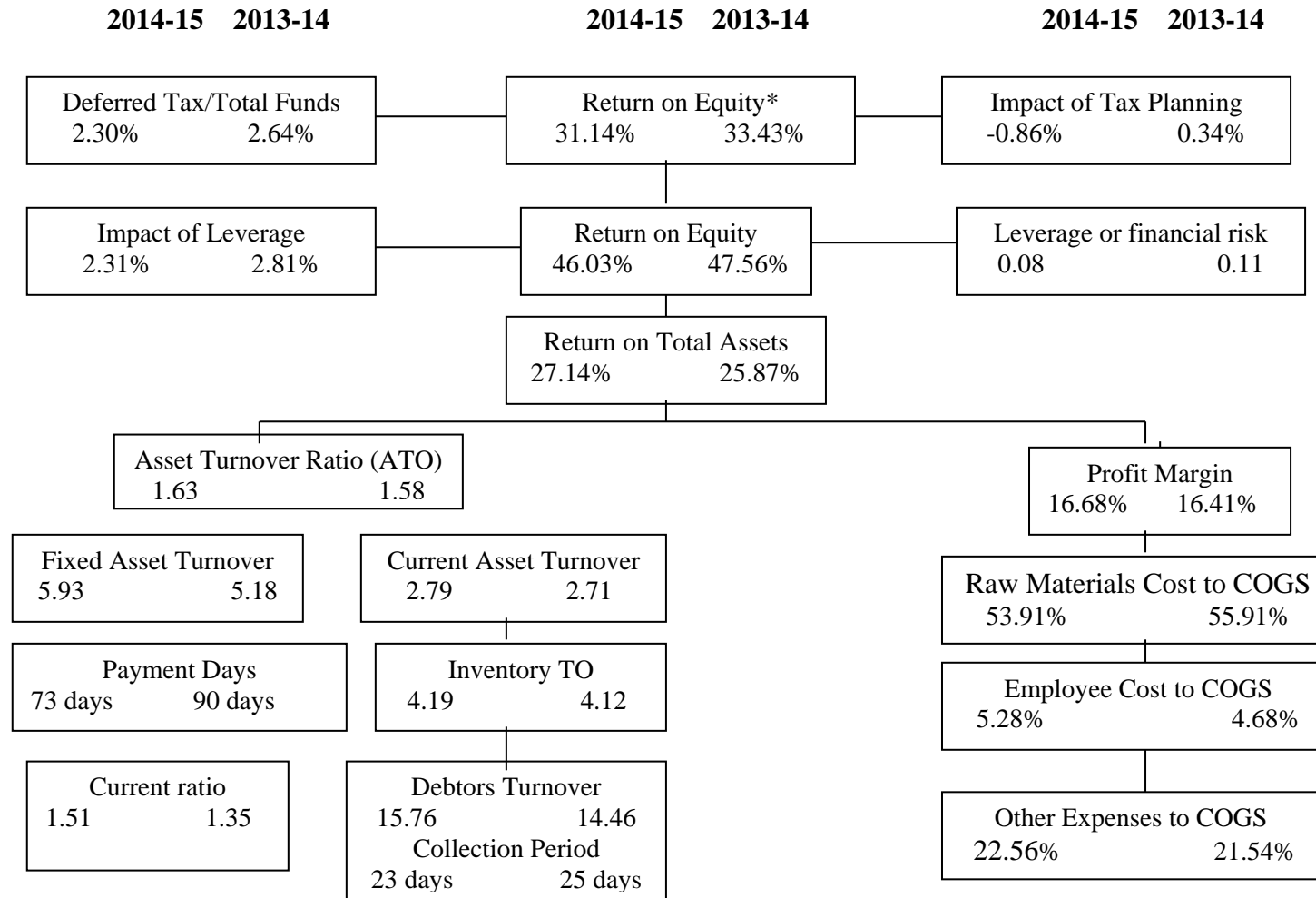
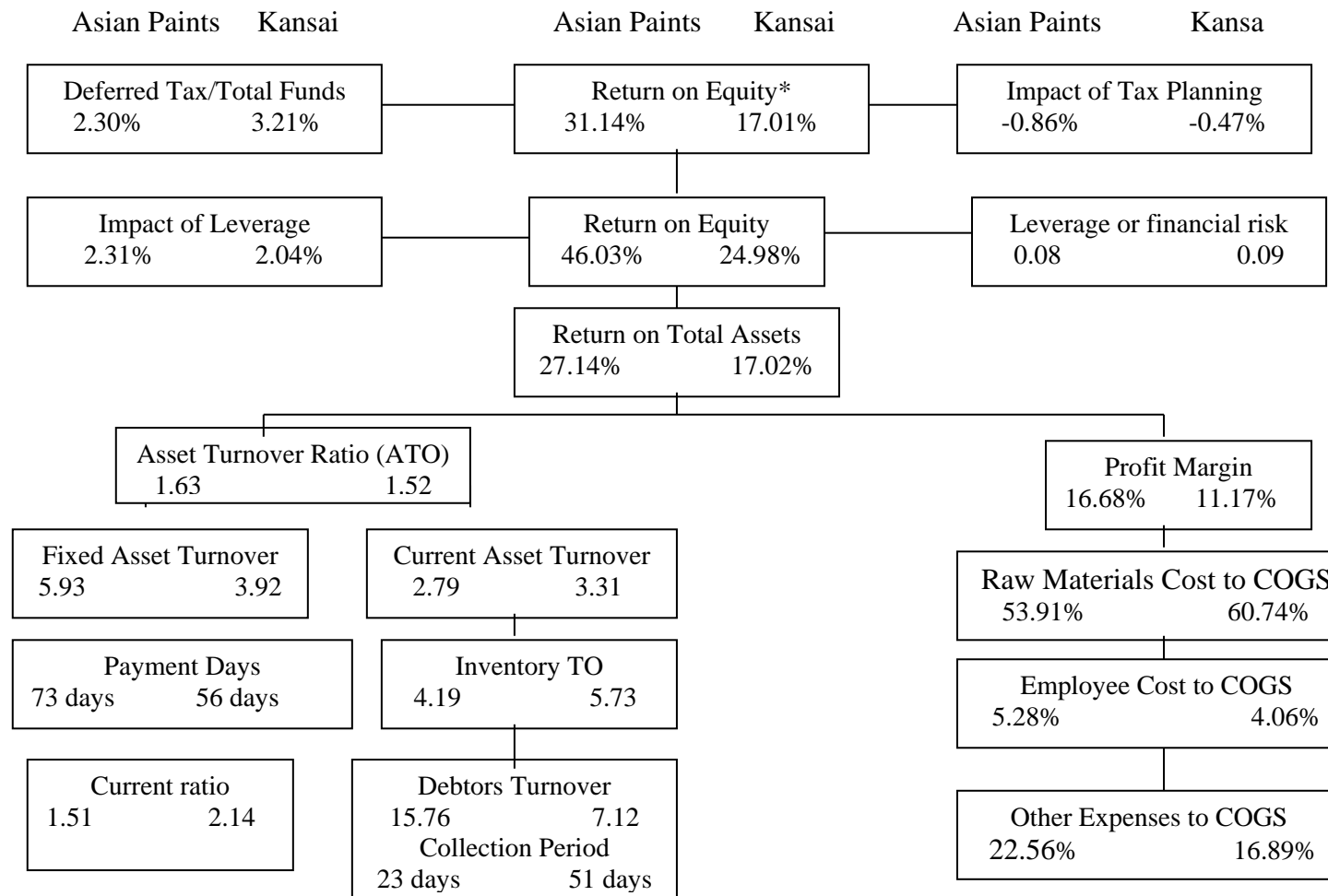
Exhibit 5.7: DuPont Chart - Asian Paints (India) Ltd.

Exhibit 5.8: DuPont Chart - Asian Paints vs. Kansai Nerolac



Problems

Problem 5-1

Hero MotoCorp and TVS Motor are two major players in the two-wheelers segment of Automobile industry. Income Statement and Balance Sheet of the two companies for the year ending 2015 are given below. Though they operate in the same market and target same customers with powerful brands, the profitability of the two companies are completely different. The return on total assets (PBIT/Total Assets) of Hero MotoCorp is three times more than return on total assets of TVS Motor.

Required:

- Compute financial ratios for Hero MotoCorp to explain how Hero generates superior profit.
- If you are advising TVS Motor, how would you present your report of financial statement analysis by comparing the results of TVS Motor with Hero MotoCorp.

	Hero MotoCorp March 2015	TVS Motor March 2015
INCOME		
Net Sales	27,615.27	10,190.29
Other Income	492.74	32.61
Total Income	28,108.01	10,222.90
EXPENDITURE		
Raw Materials	19,783.88	7,389.20
Power & Fuel Cost	158.47	91.29
Employee Cost	1,172.87	585.42
Other Manufacturing Expenses	245.40	114.00
Selling and Administration Expenses	1,933.00	994.18
Miscellaneous Expenses	934.51	411.90
Depreciation	539.97	153.33
Total Expenditure	24,768.10	9,739.32
Profit Before Interest and Taxes	3,339.91	483.58
Interest	11.09	27.42
Profit Before Tax	3,328.82	456.16
Tax	898.91	80.26
Deferred Tax	44.27	28.07
Profit After Taxes	2,385.64	347.83

	Hero MotoCorp March 2015	TVS Motor March 2015
SOURCES OF FUNDS		
Shareholders' Funds	6,541.33	1,645.36
Debt	0.00	970.47
Current Liabilities	3,906.83	1,988.37
Total	10,448.16	4,604.20
APPLICATION OF FUNDS		
Fixed Assets	2,912.69	1,329.63
Capital Work in Progress	712.55	89.36
Investments	3,154.11	1,012.46
Inventories	815.49	819.68
Sundry Debtors	1,389.59	503.86
Cash and Bank	159.25	5.39
Loans and Advances	1,304.48	843.82
Total Assets	10,448.16	4,604.20

Problem 5-2

Aarti Industries Ltd is engaged in manufacturing of dyes, pigments, pharmaceuticals, agrochemicals and rubber chemicals. They primarily produce Benzene-based basic and intermediate chemicals in India. Pidilite Industries Ltd., is the market leader in adhesives and sealants, construction chemicals, hobby colours and polymer emulsions. Its brand name Fevicol has become synonymous with adhesives to millions in India and is ranked amongst the most trusted brands in India. Using financial data drawn from Income Statement and Balance Sheet, compute working capital ratios listed below and then assess the working capital efficiency of the two companies.

Year: March 2014	Aarti	Pidilite
Income Statement		
Net Sales	2,632.78	3,878.24
Raw Materials	1,567.10	2,182.33
Conversion Cost	623.05	727.70
Cost of Goods Manufactured	2190.15	2910.03
Balance Sheet		
Raw Materials, Stores and Packing Materials	181.94	146.20

Work-in Progress	192.77	53.77
Finished Goods	228.61	308.23
Total Inventories	603.32	508.20
Receivables	465.77	453.60
Payables	367.84	587.09

	Aarti	Pidilite
Raw Material Days		
WIP Days		
Finished Goods Days		
Total Inventory Days		
Collection Days		
Gross Working Capital Cycle Days		
Payable Days		
Net Working Capital Days		
Current Ratio		

Problem 5-3

Financial summary of two large companies in Tyre industry is provided below. JK Tyre employs large amount of debt funds compared to Apollo tyres. The Return on Capital Employed of JK Tyre is significantly lower than Apollo Tyres. However, Pre-Tax Return on Equity and Post-tax Return on Equity of both companies are close to each other. Compute profitability ratios and assess the impact of financial leverage on the profitability.

Hint: The average interest rate is equal to Interest divided by debt. Return on capital employed is equal to PBIT divided by FA+Investments+CA- CL.

	JK Tyre & Industries		Apollo Tyres Ltd	
	Mar-13	Mar-14	Mar-13	Mar-14
INCOME				
Revenue	5,498.81	5,943.19	8,572.24	8,906.84
EXPENDITURE				
Raw Materials	3,917.26	4,012.40	6,121.26	5,974.58
Power & Fuel Cost	215.50	233.46	261.00	276.04
Employee Cost	333.72	398.39	426.85	453.25
Other Manufacturing Expenses	113.66	131.96	276.87	277.45
Selling and Administration Expenses	319.14	396.16	478.29	614.07

Miscellaneous Expenses	130.04	175.00	46.63	198.54
Depreciation	112.65	152.47	220.07	248.05
Total Expenditure	5,141.97	5,499.84	7,830.97	8,041.98
Profit Before Interest and Taxes	356.84	443.35	741.27	864.86
Interest	206.53	248.30	266.75	250.40
Profit Before Taxes	150.31	195.05	474.52	614.46
Tax	0.28	0	106.01	132.72
Deferred Tax	44.49	60.37	55.98	39.11
Profit After Taxes	105.54	134.68	312.53	442.63

Year	Mar-13	Mar-14	Mar-13	Mar-14
SOURCES OF FUNDS				
Shareholders' Funds	741.93	848.42	2,341.43	2,739.82
Debt	2,709.30	2,722.63	2,114.86	1,531.95
Total [Shareholders Fund & Debt]	3,451.23	3,571.05	4,456.29	4,271.77
APPLICATION OF FUNDS				
Fixed Assets	2,280.38	2,273.64	3,071.36	3,253.58
Capital Work in Progress	54.68	143.32	248.97	34.97
Investments	97.59	101.76	612.70	651.46
Current Assets, Loans & Advances				
Inventories	809.80	765.70	1,120.83	1,283.69
Sundry Debtors	916.68	1,186.37	302.01	240.55
Cash and Bank	94.66	177.78	154.19	221.11
Loans and Advances	479.49	471.19	356.02	426.63
Total Current Assets	2,300.63	2,601.04	1,933.05	2,171.98
Less : Current Liabilities and Provisions	1,282.05	1,548.71	1,409.79	1,840.22
Net Current Assets	1,018.58	1,052.33	523.26	331.76
Total Assets	3,451.23	3,571.05	4,456.29	4,271.77

Problem 5-4

Ajanta Lab is considering a proposal to acquire Jupiter Pharmaceuticals. The current market capitalization of Jupiter Pharma is Rs. 250 cr. However, the investment bankers suggest the offer should be attractive for the existing shareholders to submit their shares for sale and hence recommend the

acquisition value of Rs. 600 cr. Ajanta feels that after acquisition, it would be able to increase the revenue of Jupiter Pharma by 30% and reduce the cost of combined entity by 5%. Ajanta plans to borrow the required funds (Rs. 600 cr.) at an interest rate of 14%. If the Jupiter Pharma Shareholder agree for the acquisition, Ajanta will borrow Rs. 600 cr. and pay the amount to shareholders of Jupiter Pharma to acquire their shares. After acquiring the shares, Ajanta Lab and Juptier Pharma will be merged and operate as a single entity.

Required:

- (a) Assess the impact of the acquisition on the profitability of the combined entity after preparing the Balance Sheet and Income Statement of Merged Entity on the assumption that the above expectations hold hood.
- (b) Assess the impact of acquisition if the price paid for the acquisition is Rs. 400 cr., and the cost of borrowing is 9%.

Hint: The difference of the amount paid and Shareholders' Fund of Jupiter Pharma will be shown as Goodwill in the merged entity books and will be part of the Fixed Assets.

Balance Sheet as on March 31, 2014 Year	Ajanta Drugs Mar 14	Jupiter Pharma Mar 14	Merged Entity Mar 14
SOURCES OF FUNDS :			
Total Shareholders' Funds	536.32	467.41	
Total Debt	134.27	291.83	
Total	670.59	759.24	
APPLICATION OF FUNDS :			
Fixed Assets	433.79	512.63	
Current Assets	446.08	323.39	
Less: Current Liabilities & Provisions	209.28	76.77	
Net Current Assets	236.80	246.62	
Total	670.59	759.25	

Income Statement-March 31, 2014 Year	Ajanta Drugs Mar 14	Jupiter Pharma Mar 14	Merged Entity Mar 14
INCOME :			
Total Income	1,120.50	528.79	
Total Expenditure	799.22	433.76	
Profit Before Interest and Taxes	321.28	95.03	
Interest	8.22	29.29	
Profit Before Taxes	313.06	65.74	
Tax	92.20	4.78	
Profit After Taxes	220.86	60.95	

Problem 5-5

Income statements of Future Lifestyle and Arvind Lifestyle, the two top textile brands are provided below. Future Lifestyle profits declined in 2014-15. Though Arvind Lifestyle posted loss in both periods, the loss is declined.

Required:

- Examine the performance of Future Lifestyle for the two years and explain why profit has declined despite increase in revenue.
- Examine the performance of Arvind Lifestyle for the two years and explain how Arvind Lifestyle improved its performance.

- (c) Compare the performance of the two companies for the year ending March 2015 and explain the differences in the performance of two companies.

Hint: Prepare common size income statement to analyse the cost structure of two companies.

	Future Lifestyle		Arvind Lifestyle	
	Mar-14	Mar-15	Mar-14	Mar-15
INCOME				
Revenue	3,122.86	3,305.58	1,764.95	2,291.08
EXPENDITURE				
Raw Materials	1,744.20	2,069.12	1,053.74	1,297.29
Power & Fuel Cost	77.76	92.66	24.40	29.16
Employee Cost	129.09	169.19	128.14	158.84
Other Expenses (Note 1)	589.43	622.71	546.13	696.25
Depreciation	385.19	170.09	58.51	68.22
Total Expenditure	2,925.67	3,123.77	1,810.92	2,249.76
Profit Before Interest and Taxes	197.19	181.81	-45.97	41.32
Interest	162.95	158.33	68.08	89.05
Profit Before Taxes	34.24	23.48	-114.05	-47.73
Tax	7.26	4.46	0.00	0.00
Deferred Tax	3.70	0.47	-8.51	-15.40
Profit After Taxes	23.28	18.55	-105.54	-32.33

Note 1: Details of Other Expenses

	Mar-14	Mar-15	Mar-14	Mar-15
Repairs	16.44	18.47	34.12	35.13
Rent, Rates and Taxes	298.52	354.22	153.38	179.40
Insurance	3.04	3.44	1.40	1.66
Advertisement	90.48	69.22	94.78	119.69
Audit Expenses	0.57	0.69	0.40	0.57
Bad Debts written off	0.56	6.73	2.33	0.01
Miscellaneous Expenses	179.82	169.94	259.72	359.79

Total of Other Expenses	589.43	622.71	546.13	696.25
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Case 5-1: Amara Raja Batteries Ltd

Amara Raja Batteries Ltd is the largest manufacturer of Standby Valve Regulated Lead Acid (VRLA) batteries in the Indian Ocean Rim comprising the area ranging from Africa and the Middle East to South East Asia. They are in the business of Industrial Battery, Automobile Battery and Power System. The manufacturing facility is located at Tirupati in Andhra Pradesh. The company is the largest supplier of stand-by power systems, catering to Indian utilities such as, Departments of Telecommunication, Indian Railways, Power Generation Stations, MTNL, VSNL, ITI and HTL. They are also having prestigious Automotive clients including Ford, GM, Daimler Chrysler, Ashok Leyland, Tata Motors, and Mahindra & Mahindra.

The business has seen unprecedented growth in the last five years. Revenue increased from Rs. 1800 cr. to Rs. 4300 cr. during this period. Net Profit increased from Rs. 148 cr. to Rs. 411 cr. Stock prices increased nearly 10 times during the five year period (from Rs. 102 to Rs. 973). Your friend is impressed with the past performance of the company and considering investing money in the stocks of the company. A reading of the extracts of the directors' report also shows the growth story will continue in the future with few greenfield projects being implemented by the company.

Required

- Analyse the financial statements of the company and identify how the company is performing on different drivers of profitability.
- Based on your analysis, what advice you offer to your friend?
- What additional information you would need to decide on investing in the equity shares of a company like Amara Raja Batteries?

Income Statement (Rs. In cr.)	2010	2011	2012	2013	2014
INCOME :					
Revenue	1,797.14	2,382.63	3,037.55	3,511.37	4,301.63
EXPENDITURE :					
Raw Materials	1,186.13	1,597.21	2,023.57	2,312.56	2,824.12
Power & Fuel Cost	48.34	53.98	97.81	92.26	115.08
Employee Cost	88.46	100.26	126.23	158.32	195.09
Other Manufacturing Expenses	38.04	38.27	45.88	62.39	86.32

Selling and Administration Expenses	158.58	203.87	224.09	263.64	311.87
Miscellaneous Expenses	12.43	21.48	31.81	20.26	25.05
Depreciation	41.71	46.47	66.09	64.57	133.99
Total Expenditure	1,573.69	2,061.54	2,615.48	2,974.00	3,691.52
Profit Before Interest and Taxes	223.45	321.09	422.07	537.37	610.11
Interest	3.06	2.45	0.27	0.72	0.24
Profit Before Taxes	220.39	318.64	421.82	536.67	609.86
Tax	73.43	102.11	137.56	158.61	192.28
Deferred Tax	-1.14	1.47	-2.45	10.62	6.72
Profit After Taxes	148.10	215.06	286.71	367.44	410.86
Earnings Per Share	8.67	12.59	16.79	21.51	24.06
Book Value per Share	37.82	48.21	62.05	79.78	99.51
Equity Dividend %	230.00	189.00	252.00	323.00	361.00

Balance Sheet (Rs. in cr.)	2010	2011	2012	2013	2014
SOURCES OF FUNDS					
Shareholders' Funds	645.93	823.47	1,059.81	1,362.70	1,699.57
Debt	110.37	100.15	125.74	122.65	120.26
Current Liabilities & Provisions	359.62	427.90	584.91	498.20	568.26
Total	1,115.92	1,351.52	1,770.46	1,983.55	2,388.09
APPLICATION OF FUNDS :					
Fixed Assets	315.08	354.57	358.86	623.20	944.26
Capital Work in Progress	37.54	31.53	102.98	144.67	86.32
Investments	16.08	16.08	16.08	16.08	16.08
Inventories	284.70	266.62	292.86	335.01	418.13
Sundry Debtors	305.66	319.68	380.68	452.79	554.10
Cash and Bank	45.12	229.19	410.79	294.57	222.17
Loans and Advances	111.74	133.85	208.21	117.23	147.03
Total	1,115.92	1,351.52	1,770.46	1,983.55	2,388.09

Cash Flow Statement	2010	2011	2012	2013	2014
Net Cash from Operating Activities	86.12	298.48	335.46	278.75	388.22
Net Cash Used in Investing Activities	-61.23	-72.73	-119.35	-342.26	-386.14
Net Cash Used in Financing Activities	-42.24	-41.78	-34.96	-53.10	-74.74

Stock Price	102.00	237.70	336.00	821.40	973.90
NSE-50 (NIFTY) Index	4624.30	5905.10	6304.00	8282.70	8518.55

Extracts from the Directors' Report (2014-15) of Amara Raja Batteries Ltd.

Performance overview

The financial year 2013-14 was yet another significant year in which your company continued its record of clocking highest ever turnover and profit. The Company has recorded total revenue (net of excise duty) of Rs 34.37 billion as against Rs 29.59 billion in the previous year registering a growth of 16%. The operating profit (Earnings Before Depreciation, Interest, Tax and Amortisation-EBIDTA) for the year stood at Rs 5,758 million (previous year Rs 4,658 million) representing 16.75% of net revenue. The Profit Before Tax (PBT) and Profit After Tax (PAT) for the financial year ended March 31, 2014 was at Rs 5,367 million and Rs 3,674 million as against Rs 4,218 million and Rs 2,867 million of the previous financial year respectively. The profit after tax has registered an impressive 28% growth.

Industrial battery business

The Company's Industrial Battery business registered double digit revenue growth over the previous financial year despite capacity constraints by better product mix. The demand from the telecom sector grew during the year primarily driven by growth in data and for energy optimisation by tower companies. The adverse macro economic conditions had moderated the demand for UPS during the first three quarters and improved in the fourth quarter mainly due to finalisation of projects in the banking sector.

Amidst these challenges, our efficient after sales service, customer relationship management, consistent product performance of both PowerStack and Quanta batteries coupled with continued preferred supplier status accorded by all major customers resulted in the improved performance of the industrial battery business.

During the year the Company had successfully introduced new range of Quanta series UPS batteries (120 AH and 150 AH), which were well received by the market resulting in improved market share in IT&ITES and Banking sector. The Quick Recharge Series large VRLA battery introduced for telecom application consolidated its position in the market.

The medium VRLA battery for Home UPS application which was introduced in the African markets helped to broad base the export business. The capacities of medium and large VRLA product lines were enhanced to 3.00 million standard equivalent units per annum and 900 million Ah in standard equivalent units per annum respectively during the Q4 of FY 2014.

Automotive battery business

The Company's Automotive battery business reported double digit revenue growth supported by volume increase of 9% in four-wheeler and 63% in two-wheeler batteries, over the previous financial year, despite capacity constraints in the automotive four-wheeler batteries .

During the year, the Company commenced bulk supplies to two-wheeler OEM business, consolidating its position in this space and witnessed a flat volume growth in four-wheeler OEM business due to slowdown in automobile production on account of various macro-economic conditions. The volume growth in both four-wheeler and two-wheeler aftermarket business continued during the year due to strong preference for Company's products, supported by complete product offering, strengthening of brands Amaron and PowerZone™, and leveraging customer relationship.

The volume of inverter batteries witnessed a drop mainly on account of early onset of monsoon during the year. A separate task force was created to focus and develop this business vertical as the Company sees a promising future for this business.

The revenue from export business grew significantly during the year aided by the quality of the product, moderation in import tariff and depreciation rupee. The Company will continue its efforts to increase the exports in the Indian Ocean RIM by strengthening and expanding the distributor's network and entering into new markets.

During the year, the capacity of two-wheeler battery and four-wheeler battery was enhanced to 8.40 million and 6.00 million units per annum respectively. The green field expansion of four-wheeler battery capacity to 8.25 million units is progressing as per schedule and is expected to commence supplies in the second half of FY 2015.

Financial position

The Company's financial position has shown immense improvement over the years. The networth as at March 31, 2014 improved to Rs 13,627 million with

the addition of Rs 3,029 million to the reserves and surplus during the year. There is no interest bearing debt as of March 31, 2014. The surplus cash as at the year end stood at Rs 2,446 million. CRISIL had re-affirmed the ratings on the Company's loan-term bank loan facilities at 'CRISIL AA+/Stable' and on the short-term bank facilities at 'CRISIL A1+.'

During the year under review, the gross fixed assets including capital work in progress increased by Rs 3,570 million (net of deletions of Rs 161 million) and are at Rs 11,402 million (previous year - Rs 7,832 million). The entire additions were funded through internal accruals. The earnings per share of Rs 1 each for the financial year 2013-14 grew by 28% at Rs 21.51 as against Rs 16.78 for the previous financial year, while the book value per share as at March 31, 2014 was at Rs 80 as against Rs 62 as at March 31, 2013.

Dividend

The Board of Directors of the Company at their meeting held on May 19, 2010 had approved a policy on payment of dividend to shareholders i.e., to pay dividend (excluding corporate dividend tax) up to 15% of the profit after tax of the Company. In line with the said dividend policy your directors have pleasure in recommending a dividend of Rs 3.23 per equity share of Rs 1 each (323%) for the financial year ended March 31, 2014, subject to the approval of the shareholders.

Case 5-2: Shree Renuka Sugars Ltd

Shree Renuka Sugars Ltd (SRSL) after reporting consistent profit for more than a decade suddenly reported loss for the year ended March 2014. The balance sheet of the company shows bank have lent Rs. 39000 (about 60% of total capital) against shareholders' investment of 20% of total capital and the balance (20%) is accounted by suppliers due. Though the company has not defaulted any loan obligations, the lenders are worried about the company's ability to pay interest and principal due if the loss continues in the future. The profile of the company, financial statements of the company and extract of director reports are provided in the following pages.

Required

- (a) As an analysts working for a state-owned bank and have a large loan exposure, you are required to analyse the financial health of the company and prepare a note for the Credit Reviewing Committee.
- (b) If the company submits the loan application for Rs. 500 cr. to augment working capital, would you consider the same favourably?
- (c) Suppose you are working for a Private Equity firm. The company has approached you to place 20 million shares at a price of Rs. 15 per share (The current market price is Rs. 12). The company plan to use the amount to pay-off some of the debt. Do you recommend the investment?
- (d) Explain how your analysis as a lender differ from your analysis as an equity investor.

Shree Renuka Sugars Limited: Profile

Shree Renuka Sugars Limited (SRSL) is a global agribusiness and bio-energy corporation. The Company is one of the largest sugar producers in the world, the leading manufacturer of sugar in India, and one of the largest sugar refiners in the world. The Company was incorporated on 25th October 1995, and has factories in different parts of Karnataka and Maharashtra.

Sugar

The Company operates eleven mills globally with a total crushing capacity of 20.7 million tonnes per annum (MTPA) or 94,520 tonnes crushed per day (TCD). The Company operates seven sugar mills in India with a total crushing capacity of 7.1 MTPA or 35,000 TCD and two port based sugar refineries with capacity of 1.7 MTPA. The Company also has significant presence in South Brazil, through acquisitions of Renuka Vale do Ivai and Renuka do Brasil. Renuka Vale do Ivai was acquired on 19th March 2010 and is 100% owned by the Company. The Company currently holds 59.4% equity stake in Renuka do Brasil which was acquired on 7th July 2010. The combined crushing capacity of the Brazilian subsidiary companies is 13.6 MTPA. The Company is the only sugar producer globally with year round crushing due to complementary seasons in India and Brazil.

Ethanol

The Company manufactures fuel grade ethanol that can be blended with petrol. Global distillery capacity is 6,240 KL per day (KLPD) with Indian distillery capacity at 930 KLPD (630 KLPD from molasses to ethanol and 300 KLPD from rectified spirit to ethanol) and Brazil distillery capacity at 5,310 KLPD.

KBK Chem-Engineering (100% subsidiary) facilitates turnkey distillery, ethanol and bio-fuel plant solutions.

Power

The Company produces power from bagasse (a sugar cane by product) for captive consumption and sale to the state grid in India and Brazil. Total Cogeneration capacity increased to 555MW with exportable surplus of 356 MW. Indian operations produce 242 MW with exportable surplus of 135 MW and Brazilian operations produce 313 MW with exportable surplus of 221 MW.

The Company's presence in the largest sugar producing country, Brazil and the largest sugar consuming country, India provides access to information on movements in market price and the know-how of the global supply-demand situation. The Company's operations in Brazil are favoured by low operating cost, high scalability and highly conducive climatic conditions. The Company's Indian operations are present in sugar rich belt of South and West India, ensuring high sugarcane yields and sugar recovery from cane. The strategically located port-based refineries in Gujarat and West Bengal states of India cover India, South Asia and Middle-East markets competitively.

Extracts from Management Discussion and Analysis

Global Sugar Industry facts

- Sugar is one of the world's major agro-based industries and is also one of the most actively traded soft commodities on the exchanges
- Brazil, India, the EU, China and Thailand rank amongst the top global producers of sugar
- India, the EU, China, Brazil and U.S. are the major sugar consuming countries
- More than 80% of sugar is produced from sugarcane, while the balance is from sugar beet
- Brazil and India are the largest sugar producers from sugarcane and EU and U.S. are the major sugar producers from beet

Production and consumption

In 2013/14, global sugar production declined by 1% to 175.7 Million MT, whereas consumption rose by 1.8% to 167.5 Million MT. The industry witnessed yet another year of a surplus, albeit a lower one, at 8.2 Million MT. The quantum of inventory built-up declined to 1.5 Million MT in 2013/14 from 9 Million MT in 2012/13 and 5.7 Million MT in 2011/12. This marked the fourth consecutive year of a pile-up in global inventory, making it one of the longest down-cycles witnessed by the industry. Both Brazil and India, two of the largest sugar producers, posted a decline of 1.4% and 3.3% in production, to 37.7 Million MT and 24.3 Million MT in 2013/14 respectively. Thailand and China were among the few countries that saw their respective production increase by 13.6% and 2.5%. Despite increase in sugarcane availability in Brazil by 11% to 653 Million MT, sugar production was impacted as a higher proportion of sugarcane was diverted in producing ethanol. In India, despite an increase in acreage, production was lower by

3.3% to 24.3 Million MT, on account of lower sugar recovery in the key producing states of Karnataka and Maharashtra. Global sugar consumption rose by 1.8% to 167.5 Million MT in 2013/14, compared to the 3.3% growth seen in 2012/13. Consumption continued to remain below production levels, leading to a further build-up in inventory levels and adversely impacting stock to consumption ratio.

Global sugar price trend

The build-up in global sugar inventories for four consecutive years and depreciation of currencies of major sugar producing countries against USD have impacted prices, which have remained weak for a large part since February 2011, when the benchmark raw sugar price peaked at \$35 cents/lb. Average raw sugar prices in fiscal 2014 stood at \$16.95 cents/lb compared to \$20.11 cents/lb in fiscal 2013. At present, prices are ruling between \$16-\$18 cents/lb for the benchmark contract. Sugar prices did see some recovery from the lows of around \$15 cents/lb witnessed in January 2014, as prospects of a weaker crop in Brazil and India raised hopes of the industry dynamics finally turning to a sugar deficit year from a four-year surplus.

Indian Sugar Industry facts

- Second largest producer and the largest consumer of sugar in the world
- Key developments in the sector impact global demand-supply dynamics and prices
- Second largest agro processing industry after cotton, involving over 60 Million farmers and dependants
- Sugarcane is cultivated in over 5 Million hectares in 2013/14, with Uttar Pradesh and Maharashtra accounting for a combined 63% of the total acreage
- Unique industry structure with large number of stakeholders, including millers, farmers, Government, industrial and retail consumers
- 65% of sugar consumed by bulk consumers
- Small average farm size of around 1-2 hectares

Production and consumption

Sugar production is estimated to decline by 3.3% in 2013/14, to 24.3 Million MT compared to 25.1 Million MT in 2012/13. Though production is estimated to decline, it is still higher than the initial estimates of around 24 Million MT, as Maharashtra and Karnataka have recorded improved agricultural yields. With consumption estimated at 24 Million MT and net exports of 2.2 Million MT, closing inventory is expected to fall to 7.5 Million MT compared to 9.3 Million MT in 2012/13.

In February 2014, the government approved a subsidy on export of 4 Million MT of raw sugar over a two-year period, to enable mills to liquidate their surplus stocks and clear any arrears due to the farmers. The quantum of subsidy was to be reviewed every two months, taking into account global raw sugar prices and currency movements. At present, the subsidy amount stands at Rs. 3,371/MT for August - September 2014. The initial subsidy amount stood at Rs. 3,300/MT for February - March 2014, Rs. 2,271/MT for April - May 2014 and again Rs. 3,300/MT for June - July 2014. The Central government had also announced 12% interest subsidy on loans worth Rs. 66 Billion to help mills clear their cane arrears.

For 2014/15, Indian Sugar Mills Association (ISMA) estimates domestic production of 25.3 Million MT, an increase of 4.1%, due to higher production in Maharashtra and Karnataka which would offset the decline in production in Uttar Pradesh and Tamil Nadu. With consumption estimated at 24.8 Million MT, the industry would have to rely on exports and improved world prices to reduce the inventory levels in 2014/15. More clarity on the production for 2014/15 will emerge over the

next few months, after reviewing the monsoon situation and assessing the impact of the situation in Uttar Pradesh, where mills have cited inability to commence crushing activities until there is clarity on sugarcane pricing reforms.

Trend in domestic sugar prices

Domestic sugar prices remained largely stable throughout the financial year 2013/14. Though there were periods when prices firmed up on events like announcement of export subsidy and interest-free loans, these did not sustain as working capital pressure led to mills liquidating their excess inventories. Post the removal of the levy obligation and abolishing of monthly release mechanism, there have been no quantitative restrictions on mills to sell their sugar.

Current state of the industry

The industry is passing through a very challenging period, as profitability is impacted by weak sugar prices coupled with higher sugarcane costs. The situation in Uttar Pradesh is even more precarious with higher sugarcane State Advised Price (SAP) much above the Fair & Remunerative Price (FRP) announced by the Central Government. As on 31st July, 2014, the industry has outstanding arrears of Rs. 92.5 Billion, amounting for 16.2% of the total cane bill payable to farmers for the 2013/14 season. Out of Rs. 92.5 Billion of arrears, Uttar Pradesh millers owed Rs. 57.4 Billion, followed by Karnataka at Rs. 17.9 Billion and Tamil Nadu at Rs. 5 Billion.

Ethanol blending programme

In January 2013, the Cabinet Committee on Economic Affairs (CCEA) notified the Fuel Ethanol Mandate, requiring the Oil Marketing Companies (OMCs) to sell 5% ethanol blended petrol across the country. However, due to various reasons, the mandated 5% blending on an all India basis has not been achieved. Recently, ethanol blending programme has received a major boost as OMCs have come up with the largest tender ever for the requirement of 1,560 Million Litres for supply between November 2014 and October 2015. The new Government at the Centre is also assessing the feasibility of increasing the mandatory blending from the current 5% to 10%. Achieving the current 5% blending level would also go a long way in helping the cash strapped sugar industry secure a stable source of income.

Income Statement (Rs. in crores)	Sep 09	Sep 10	Mar 12	Mar 13	Mar 14
INCOME :					
Revenue	2,821.3 1	5,814.0 6	6,751.3 7	6,573.7 3	5,750.3 1
EXPENDITURE :					
Raw Materials	2,184.9 8	4,722.2 6	5,263.6 0	5,473.5 9	5,056.8 9
Power & Fuel Cost	31.31	29.55	347.67	26.92	26.04
Employee Cost	45.95	57.55	135.77	129.04	121.89
Other Manufacturing Expenses	109.45	150.67	-62.23	217.3	206.42
Selling and Administration Expenses	80.68	123.02	316.18	110.66	138.55
Miscellaneous Expenses (See Note 1)	0.45	6.6	100.08	14.07	337.49
Depreciation	62.46	81.55	145.47	159.2	165.64
Total Expenditure	2515.2 8	5171.2	6246.5 4	6130.7 8	6052.9 2

Profit Before Interest and Taxes

Interest	88.39	82.46	369.87	367.1	318.2
Profit Before Taxes	217.64	560.4	134.96	75.85	-
Taxes	34.04	94.35	8.93	1.31	620.81
Fringe Benefit tax	0.1	0	0	0	17.36
Deferred Tax	39.99	56	41.98	22.7	0
Profit After Tax	143.51	410.05	84.05	51.84	-
Equity Dividend %	100	100	100	50	466.09

Note 1: Miscellaneous Expenses include

Loss on forex transactions	0	0	89.39	7.71	331.68
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Balance Sheet

	Sep 09	Sep 10	Mar 12	Mar 13	Mar 14
SOURCES OF FUNDS :					
Shareholders' Funds	1,262.5	1,769.5	1,780.5	1,792.9	1,335.6
	2	1	0	9	9
Debt	1,299.5	1,715.8	4,363.7	2,614.6	3,900.8
	2	6	6	9	8
Current Liabilities & Provisions	1030.0	2,122.9	1,397.7	3,575.7	1,420.5
	5	2	6	3	4
Total	3592.0	5608.2	7542.0	7983.4	6657.1
	9	9	2	1	1
APPLICATION OF FUNDS :					
Net Block	1,256.8	1,571.0	2,683.0	2,735.0	2,695.8
	6	5	6	9	4
Capital Work in Progress	242.31	410.46	120.48	27.04	24.37
Investments (See Note 2)	105.99	1,639.2	2,013.4	2,012.8	2,013.9
		8	9	9	6
Inventories	1,002.3	1,135.9	1,719.1	2,058.8	1,003.3
	2	5	6	4	9
Sundry Debtors	104.27	315.94	176.51	173.51	248.13
Cash and Bank	210.28	23.47	10.39	91.47	70.97
Loans and Advances	670.06	512.14	818.93	884.57	600.45
Total	3592.0	5608.2	7542.0	7983.4	6657.1
	9	9	2	1	1

Note 2: Investments are primarily in the equity shares of subsidiary and group companies

Most subsidiaries and group companies are not doing well, incur losses and in many cases

shareholders' fund turned negative.

Cash Flow Statement	Sep 09	Sep 10	Mar 12	Mar 13	Mar 14
Net Cash from Operating Activities	- 212.56	1306.5 7	- 675.81	2282.7 3	- 565.04
Net Cash Used in Investing Activities	- 311.11	- 2056.0 6	- 1247.7 8	- -68.05	- -16.94
Net Cash Used in Financing Activities	720.56	562.68	1910.5 1	- 2133.2 8	536.30

Case 5-3: FDC & Glenmark Pharmaceuticals

FDC and Glenmark are two Indian pharmaceutical companies manufacturing bulk drug and formulations. While FDC owns 'Electral' (Oral Rehydration Salts) brand, the leading brand of Glenmark is 'Candid'. The financial statements of two companies along with extracts of Directors report are provided.

Required

- Prepare DuPont Chart for FDC and Glenmark for two year period and analyse the financial performance of the company.
- Prepare DuPont Chart for FDC and Glenmark for the year ending March 2014 and perform inter-firm analysis.
- Based on your analysis, which of the two companies you would prefer to associate as (a) lender (b) supplier of goods and (c) investor.
- What advice you would like to give to the management of Glenmark for improving its performance?

FDC Ltd.

A young visionary, Anand Chandavarkar, in the backdrop of India's independence struggle, dreamed of building a world class company in 1936. His vision of freedom was to create, to build, and to industrialize, in order to make the nation self-reliant in healthcare. In 1940, this partnership firm was incorporated as a private limited company - Fairdeal Corporation (Private) Limited and in 1986 its name was changed to FDC Private Limited. Thereafter, FDC became a public limited company, and was listed on the Bombay and National Stock Exchanges of India in 1996. Today, FDC carries forward the flaming spirit of its first dream, achieving accreditations from the US-FDA, UK-MHRA, MCC-RSA, and the UAE, to cite a few. FDC is a forerunner in

manufacturing and marketing of Oral Rehydration Salts (ORS) and Ophthalmics. FDC has also set-up globally approved, multi-location manufacturing facilities for Active Pharmaceuticals Ingredients (APIs) as well as Finished Dosage Forms. These facilities are located at Roha, Waluj and Sinnar in Maharashtra, Verna in Goa and Baddi in Himachal Pradesh. FDC markets more than 300 products in India and exports many of these to over 50 countries.

FDC is a pioneer in the manufacture of specialized formulations, and the world's leading manufacturer of ORS (Oral Rehydration Salts) since 1972. It is a fully-integrated Pharmaceutical Company, with US-FDA and UK-MHRA approved API and formulations manufacturing facilities. FDC was the first in South East Asia to offer ophthalmic formulations, using Blow-Fill-Seal (BFS) technology. It has its presence in numerous therapeutic segments: anti-infectives, gastrointestinal, ophthalmologicals, vitamins/ minerals/ dietary supplements, cardiac, anti-diabetes, respiratory, gynaecology, dermatology, analgesics and others. FDC's Zifi, Electral, Enerzal, Vitcofol, Pyrimon, Zocon, Zoxan, Zathrin, Zipod, Zefu, Cotaryl and

Glenmark Pharmaceuticals Ltd.

Glenmark Pharmaceuticals Ltd was incorporated in the year 1977. In the year 1979, the company entered dermatology market with the launch of 'Candid Cream'. The company engaged in discovery of new molecules both new chemical entities (NCEs) and new biological entities (NBEs). The company operates in five geographical areas: India, United States, Latin America, Europe and Rest of the World. They operate in three segments: specialty, generics and out-licensing. **Specialty segment** includes manufacture and distribution of branded products of Glenmark. Specialty business is focused on range of therapeutic segments, such as dermatology, internal medicine, respiratory, pediatrics, diabetes, gynecology, oncology. **Generics segment** consists of finished pharmaceutical products ready for consumption by the patient, marketed under as generic finished dosages with therapeutic equivalence to branded formulations (generics). **Out-licensing segment** includes the discovery of new chemical entities for subsequent commercialization and out-licensing, as well as contract research services.

Financial Statements of Glenmark and FDC

	Glenmark Pharma		FDC	
	Mar-13	Mar-14	Mar-13	Mar-14
Income Statement				
INCOME				
Revenue	2,145.30	2,466.22	804.69	878.31
EXPENDITURE				
Raw Materials	544.93	615.36	296.53	323.26

Power & Fuel Cost	20.26	19.97	16.83	18.42
Employee Cost	303.02	395.35	106.43	120.74
Other Manufacturing Expenses	90.71	100.00	23.40	29.59
Selling and Administration Expenses	567.26	563.52	90.23	94.09
Miscellaneous Expenses	170.43	208.92	41.19	47.66
Depreciation	25.04	30.20	27.51	24.54
Total Expenditure	1,721.65	1,933.32	602.12	658.30
Profit Before Interest and Taxes	423.65	532.90	202.57	220.01
Interest	43.69	30.98	1.51	3.01
Profit Before Taxes	379.96	501.92	201.06	216.99
Tax	-10.93	60.27	41.09	82.50
Deferred Tax	4.78	7.84	1.63	0.07
Profit After Tax	386.11	433.82	158.33	134.42
Equity Dividend %	200.00	200.00	225.00	225.00

Balance Sheet	Mar-13	Mar-14	Mar-13	Mar-14
SOURCES OF FUNDS				
Shareholders' Funds	2,523.18	2,906.02	779.70	840.49
Debt	665.60	405.20	1.45	1.25
Current Liabilities and Deferred Tax	696.77	918.37	177.44	206.01
Total	3,885.55	4,229.59	958.59	1,047.75
APPLICATION OF FUNDS				
Fixed Assets	275.66	448.52	276.56	272.14
Capital Work in Progress	172.42	83.31	7.22	18.10
Investments	1,294.33	1,409.24	422.45	423.22
Inventories	190.15	210.43	97.45	100.59
Sundry Debtors	556.73	1,136.04	44.76	58.62
Cash and Bank	167.79	108.46	34.90	20.02
Loans and Advances	1,228.47	833.59	75.25	155.08
Total Assets	3,885.55	4,229.59	958.59	1,047.77

Cash Flow Statement	Mar-13	Mar-14	Mar-13	Mar-14
Net Cash from Operating Activities	253.02	114.24	149.05	147.58
Net Cash Used in Investing Activities	-119.30	210.75	-105.07	-61.95
Net Cash Used in Financing	-13.77	-384.67	-62.28	-74.93

Extracts from the Directors' Report of FDC Ltd.**PHARMA INDUSTRY- OVERVIEW & OUTLOOK**

The global pharmaceutical market is dominated by USA, which accounts for about 28 percent of global sales followed by the European Union, accounting for nearly 15 percent, and Japan for 12 percent. Together, these three markets represent nearly 55 percent of the global market. The global pharmaceutical market is expected to grow at a Compounded Annual Growth Rate of 6.5% throughout the year 2014. The Indian Pharmaceutical Market grew by 6.2% to touch the market size of Rs.75,727 crores, during the year ended March 31, 2014. Around 1,603 products were introduced during the year (Source: AIOCD Pharmasofttech AWACS Private Limited- Moving Annual Total Turnover-March 2014).

OPPORTUNITIES, THREATS, RISKS & CONCERNS

Your Company has launched two new divisions namely Pixel and Dil Se. The Pixel division will exclusively cater to Ophthalmologist with premium range of Ophthalmics. Your Company, being pioneers in Ophthalmological, Pixel is an initiative to regain the Company's leadership position in Ophthalmology in India. The Dil Se division will primarily cater to the growing Cardio-diabetic segment with an aim of putting patients at ease. Their major brands being Zivast, Zilos and Ziglim. Your Company expects that the changes made in the business model will improve our ability to act vigorously and cohesively as an organisation and attract the right talent and address the needs of our markets.

The Indian Pharmaceutical Industry has witnessed a lot of turmoil in the past year in terms of pricing regulations, cloud on irrational combinations, trade related issues & other regulatory issues. The rate at which, new introductions were being launched a couple of years back has also slowed down. In spite of all these hurdles, the Indian Pharmaceutical Industry is still growing at a Compounded Annual Growth Rate of 12%. The new drug price control regime enacted vide Drug Price Control Order (DPCO), 2013 has become law from May' 2013. The new DPCO is based on average market pricing of top 99% formulators as against cost based pricing under old DPCO 1995. The number of formulations of our Company covered under price control has doubled under new DPCO whereas percentage of formulations covered under price control has increased over six fold under new DPCO 2013. The impact of new DPCO on

pricing of various companies in the industry would differ from company to company depending upon their basket of formulations.

Extracts from Directors' Report of Glenmark Pharmaceuticals Ltd.

Global Pharma Scenario

The world pharmaceutical market is estimated to have grown by around 2.5% in 2013. While average revenue growth in developed markets was only 0.36%; in emerging markets the growth was about 10.7%. The outlook for the global pharmaceutical market is marked by greater cost pressures and a higher bar for product innovation that reflects an increased demand for value from both regulators and consumers. Weak growth in developed markets, the continued rise of emerging markets and a shift to specialty medicines are predicted to be significant outcomes over the next five years. The Global Pharma scenario remains dynamic and challenging. We are witnessing various new developments that make one believe that the ensuing years for pharma companies will be challenging.

The pharmaceutical industry is facing the 'Innovation Challenge' characterized by the drastic decrease in productivity in its R&D and marketing of new molecules. The decrease in innovation capacity of Big Pharmaceutical companies threatens their short and long term economic performance. Another important trend that is being witnessed is the regulatory environment in developed and developing countries. While developed countries are constantly raising the bar, the developing countries are rapidly changing guidelines to bring them on par with the developed countries' regulatory framework. The increased scrutiny from regulators will continue to enforce renewed commitment to quality from the industry. Some of the other movements that are being witnessed are the continuous shift of share of healthcare spends from treatment of disease to prevention and diagnosis. Further, the disease burden shift towards chronic diseases is rapidly happening. The patients are becoming increasingly empowered and going ahead, will be responsible for an increased portion of healthcare costs due to ever increasing pressure on governments. The value of patent expiries will increase, but the composition of value will shift from small molecule to biologics.

India Formulations

The India formulations business performed well during the year under review registering revenue of Rs. 15,104.89 Mn (USD 249.96 Mn) as compared to Rs. 13,095.79 Mn (USD 240.07 Mn) in the previous corresponding year, recording

growth of 15.34% in Rs. term. As per IMS MAT Mar 2014, Glenmark gained 1 rank from 20th to 19th compared to MAT Mar 2013 with increase in market share to 0.13% exhibiting value growth of 17.65% vis-a-vis Indian Pharmaceutical Market (IPM) growth of 10.07%. The growth has been driven by strong performance of leading brands resulting in market share improvement across therapeutic areas.

Outlook

Glenmark's short-term and long-term outlook is encouraging for several reasons. On the discovery front, the pipeline is progressing well with 6 molecules in clinics. The company will also continue with its approach of out-licensing its molecules. On the generics front, with high value patented drugs going off patent in the coming years, there is huge potential for the generics business. Glenmark is actively increasing its base in major generics markets of US and Western Europe. At same time, the specialty business will continue to build differentiated pipelines in rest of the world markets, notably the 'Pharmerging' markets. Focus will be on building size and scale organically. The company has also put multiple systems and processes in place to manage its complex operations and instil efficiencies across the value chain. Glenmark will also continue to build capabilities and nurture a talent pool with diverse skills sets to deliver continuous results.