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the game of financial ratios

Professors Pooja Gupta, Madhvi Sethi, and Rick Robertson wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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Priyankar Sarkar was a financial wizard who was adept at doing financial analysis. In late 2014, at a meeting of representatives from leading investment banks with the governor of the Reserve Bank of India, he encountered Rohit Jhunjhunwala. Jhunjhunwala and Sarkar had been rivals since they were contemporaries at a famous business school. They had both been high achievers in their school, and they had always competed against each other—whether in financial analysis quizzes or mergers and acquisitions projects. They had also competed for the same kind of jobs on campus, so it was no surprise to any of their classmates when they both got jobs in top, but rival, investment banks. Over the years, the rivalry between them had increased significantly.

In an arrogant tone, Jhunjhunwala said to Sarkar, “You are wrong about the forecast you made a couple of days back regarding the valuation of the information technology sector. I have done a similar analysis, and unlike you, I feel the sector is overvalued and due for a massive correction in the near future.” Sarkar replied, “Whatever you may feel, I stand by my analysis. Remember last month when you said that the banking sector was overvalued? You were wrong, as the sector has gone from strength to strength since then.”

Jhunjhunwala believed Sarkar was overconfident in his analytical abilities. He pointed out that Sarkar had downgraded the pharmaceutical sector in one of his recent reports, whereas Jhunjhunwala believed that any fresh graduate would have been able to see the growth potential in the sector.

Sudarshan R., a senior investment banker who carried great influence in financial circles, was passing by and commented: “My, my! You both are at it again! The whole financial community is sick and tired of your one-upmanship. Let us once and for all put this to rest and determine who is a better financial analyst.”

Sudarshan drafted a challenge for the two of them. “Why don’t you take up my challenge?” he asked. Neither Jhunjhunwala nor Sarkar could say no.

Sudarshan provided the two men with financial data for 10 anonymous companies (see Exhibit 1). He asked them to match the financial data with specific industries from a list (see Exhibit 2). The challenge was timed, and the winner would be determined on the basis of who came up with the right combinations first.

EXHIBIT 1: Financial Data from anonymous companies (in million INR, non-annualized)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **A** | **B** | **C** | **D** | **E** | **F** | **G** | **H** | **I** | **J** |
| **Year ended** | **Dec. 2013** | **Mar. 2014** | **Mar. 2014** | **Mar. 2014** | **Mar. 2014** | **Mar. 2014** | **Mar. 2014** | **Mar. 2014** | **Mar. 2013** | **Mar. 2014** |
| **Sales** | 123,756 | 410,575 | 499,185 | 94,821 | 271,935 | 19,295 | 443,410 | 17,246 | 865,789 | 1,536,362 |
| **Total expenses** | 118,541 | 394,746 | 443,101 | 85,295 | 255,929 | 26,137 | 367,420 | 16,234 | 719,517 | 1,457,915 |
| **Raw materials, stores, and spares (included in operating expenses)** | 20,028 | 176,382 |  | 23,442 | 184,276 |  | 210 | 3,976 | 41,961 |  |
| **Purchase of finished goods (included in operating expenses)** | 2,329 |  | 205 | 7,734 |  |  |  | 672 | 31 |  |
| **Total operating expenses** | 108,295 | 339,964 | 328,726 | 78,277 | 237,881 | 15,533 | 323,190 | 14,839 | 629,882 | 1,219,964 |
| **Reported profit after tax** | 10,930 | 34,608 | 66,002 | 13,883 | 21,091 | −5,898 | 101,941 | 1,258 | 209,257 | 108,912 |
| **Net fixed assets** | 55,040 | 46,929 | 398,782 | 35,242 | 22,433 | 16,974 | 57,320 | 5,288 | 799,242 | 77,165 |
| **Inventories** | 11,215 | 97,976 | 11 | 25,112 | 6,696 | 402 |  | 324 | 57,044 |  |
| **Sundry debtors and bills receivable** | 7,329 | 438,029 | 46,635 | 19,251 | 10,008 | 1,717 | 112,290 | 109 | 104,287 | 315,492 |
| **Cash and bank balances** | 5,034 | 118,729 | 4,953 | 464 | 1,175 | 444 | 250,770 | 232 | 132,186 | 1,325,496 |
| **Short-term loans and advances** | 12,262 | 113,321 | 293,563 | 23,023 | 21,318 | 16,224 | 26,570 | 1,299 | 683,164 | 12,217,092 |
| **Total assets** | 123,517 | 845,780 | 1,120,348 | 142,730 | 112,166 | 69,373 | 532,110 | 8,830 | 2,228,653 | 17,945,700 |
| **Current liabilities and provisions** | 37,463 | 487,495 | 323,624 | 29,538 | 53,277 | 12,828 | 108,160 | 2,571 | 770,541 | 935,751 |
| **Sundry creditors (included in current liabilities)** | 7,093 | 94,096 | 62,663 | 10,069 | 22,906 | 1,967 | 680 | 2,204 | 82,638 |  |
| **Shareholders’ funds** | 78,248 | 330,471 | 664,851 | 100,826 | 55,999 | 26,891 | 420,920 | 5,635 | 1,229,674 | 1,182,823 |
| **Borrowings** | 350 | 27,332 | 103,654 | 9,163 | 2,843 | 26,906 |  | 144 |  | 1,831,309 |

Note: INR = Indian rupee = ₹; all currency amounts are in ₹ unless otherwise specified; US$1.00 = ₹68.76 on November 24, 2016.

Source: Centre for Monitoring Indian Economy Pvt. Ltd. (CMIE), Prowess database, accessed on April, 14, 2014.

**Exhibit 2: List of Industries and their respective product lines**

|  |  |
| --- | --- |
| **Industry** | **Products/Services Offered** |
| Cement | clinker, grey cement, ready-mix concrete |
| Retail food | bakery products, beverages, desserts, dips |
| Oil and gas | crude oil, natural gas, liquefied petroleum gas, naphtha, kerosene |
| Hospitality | rooms, restaurants, other facilities |
| Automobile (two-wheeler) | motorcycles, scooters, spares |
| Telecommunications | mobile telephone services |
| Banking | financial services |
| Information technology | software development services |
| Pharmaceutical | chemicals, including malts, liquids, injections, tablets, capsules, and creams |
| Heavy engineering | thermal-, hydro-, and gas-based turnkey power projects; substation projects; rehabilitation projects; transformers; compressors; motors; valves and oil field equipment; electrostatic precipitators; photovoltaic equipment; insulators; heat exchangers; switchgears; castings and forgings |

Source: Capitaline Database, accessed on April 14, 2014.