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9B21B012

Identifying Industries through Financial Statement Analysis: Pakistan 2017

Imran Yousaf, Zhichuan (Frank) Li, and Aaqib Nawaz wrote this exercise 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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An accounting and finance student was provided with the financial data of eight major companies operating in Pakistan in 2017 and listed on the Pakistan Stock Exchange. The student was also given a list of eight of the country’s main industries. As an exercise, the student was then asked to identify which company operated within which industry. The exercise would test the student’s understanding of how a company’s financial data can be specific to a particular industry. Using only financial figures, could the student identify within which industry each company operated?

Company and Industry Characteristics

The student knew that companies could be categorized in many different ways: financial, non-financial, manufacturing, service, and others. Financial characteristics of companies could vary widely for various reasons. However, the most important differentiation for a company’s financial data was usually due to the industry within which it operated and the strategies the company adopted.

Each industry also had its own characteristics, some of which were obvious and could be easily identified. For example, a pharmaceutical firm would normally have much higher research and development costs than a consulting firm. Other characteristics could be identified based on industry experience. For example, companies in some industries carried high inventory, whereas companies in other industries had essentially no inventory. Therefore, it was feasible that a company could be identified through its financial statements or ratio analysis.

The Eight Companies

For the exercise, the student was provided with the balance sheets of all eight companies, labelled only as A to H (see Exhibit 1). Because each company was listed on the Pakistan Stock Exchange, its financial data was publicly available. The data was also taken from the income statements of each company and provided in a standardized format (see Exhibit 2). In addition, 13 relevant financial ratios were also provided to the student, which would be helpful information for the exercise (see Exhibit 3).

Companies that operated within the same industry could sometimes differ from each other based on their location, structure, or strategies. However, the eight companies in the student’s assignment were considered typical companies that reflected their respective industry. Each company could therefore be seen as an example of that industry’s norm.

The Eight Industries

The eight companies operated within eight different industry sectors in Pakistan. A brief description of each company and its industry was provided to help the student understand the characteristics of that particular industry:[[1]](#footnote-1)

* *Commercial bank*—Despite being a bank, this company represented the most comparable financial statements and ratio categories of a non-financial company. It was one of Pakistan’s largest banks for Internet banking, remittances, MCB (or Master Cell Bank) mobile, retail banking, and bank accounts. The company was established in 1947, the same year that Pakistan was established. Its customer base exceeded seven million, with over 1,400 branches in Pakistan and abroad.
* *Luxury hotel chain*—This company managed six luxury hotels in major cities with a total of 1,445 rooms and provided international standards in luxury hotel accommodation across South Asia.
* *Hospital*—This medical care centre was formed by a team of expatriate health care professionals in 1985. Its 550-bed quaternary health care facility offered international standards in major surgery to local and global patients.
* *Food and beverage company*—As a leading provider of quality foods and beverages in Pakistan with four major production facilities, this company aimed to enhance quality of life for its customers and to contribute to a healthier future for the country.
* *Oil and gas exploration service company*—This company started as a pioneer of the natural gas industry and became a leader in the energy sector in the 1950s, contributing 16 discoveries in exploration in just the previous five years. The company negotiates with owners of onshore and offshore acreage that is believed to contain oil and gas and secures leases and permission to drill.
* *Textile composite exporter*—This leading exporter of textile products had a composite unit that made everything from cotton to finished goods. It also had 40 retail stores across the country.
* *Pharmaceutical firm*—This science-led global health care company conducted research to develop and manufacture innovative pharmaceutical medicines, vaccines, and consumer health care products.
* *Fertilizer company*—As one of the biggest fertilizer companies operating in Pakistan since the 1950s, the primary segments of this company included fertilizers, crop science, and agricultural services that covered a complete range of agriculture products to empower farmers. The company mainly sold its products through distributors.

The student had all the information necessary for the exercise. The next step was to begin the process of analyzing the financial data provided for companies A to H (see Exhibits 1 to 3) and matching each one with the eight industries described above.

Exhibit 1: Balance Sheet of Companies A to H

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Financial Item** | **A** | **B** | **C** | **D** | **E** | **F** | **G** | **H** |
| **A. Non-Current Assets** |  |  |  |  |  |  |  |  |
| 1. Capital work in progress | 4.89% | 2.11% | 11.86% | 6.21% | 14.29% | 6.96% | 2.90% | 0.00% |
| 2. Operating fixed assets | 73.61% | 68.45% | 28.66% | 36.76% | 28.66% | 49.25% | 56.01% | 3.37% |
| 3. Intangible assets | 0.00% | 0.14% | 4.75% | 0.23% | 0.12% | 0.04% | 3.83% | 0.10% |
| 4. Long-term investments | 3.32% | 0.00% | 0.00% | 0.00% | 8.53% | 0.00% | 0.00% | 54.79% |
| 5. Other non-current assets | 3.24% | 0.59% | 0.52% | 0.63% | 0.45% | 0.69% | 0.12% | 0.00% |
| **B. Current Assets** |  |  |  |  |  |  |  |  |
| 1. Cash and bank balance | 0.77% | 8.31% | 8.32% | 0.77% | 1.88% | 2.29% | 1.54% | 6.98% |
| 2. Inventories | 0.20% | 4.91% | 27.81% | 34.02% | 0.00% | 26.32% | 10.95% | 0.00% |
| 3. Trade debt and accounts receivables | 1.48% | 5.82% | 10.80% | 9.78% | 30.62% | 1.34% | 4.63% | 2.48% |
| 4. Short-term loans and advances | 0.25% | 4.39% | 2.07% | 1.86% | 1.23% | 0.76% | 0.99% | 28.96% |
| 5. Short-term investments | 0.07% | 2.45% | 1.59% | 0.00% | 11.43% | 0.00% | 7.00% | 0.00% |
| 6. Other current assets | 12.19% | 2.83% | 3.61% | 9.73% | 2.78% | 12.35% | 12.04% | 3.32% |
| Total Current and Non-Current Assets (A + B) | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% |
| **C. Shareholders’ Equity** |  |  |  |  |  |  |  |  |
| 1. Issued, subscribed, and paid-up capital | 0.77% | 7.05% | 14.56% | 9.58% | 6.08% | 0.78% | 11.41% | 0.67% |
| 2. Reserves | 18.81% | 46.35% | 46.98% | 20.50% | 60.55% | 7.17% | 24.89% | 8.01% |
| 3. Surplus on revaluation of fixed assets | 56.10% | 9.39% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 1.52% |
| **D. Non-Current Liabilities** |  |  |  |  |  |  |  |  |
| 1. Long-term borrowings | 16.11% | 2.17% | 0.00% | 19.20% | 0.04% | 15.93% | 19.48% | 0.00% |
| 2. Employees benefit obligations | 1.15% | 0.00% | 1.34% | 0.08% | 0.73% | 2.85% | 0.15% | 0.00% |
| 3. Other non-current liabilities | 0.87% | 5.35% | 2.45% | 0.85% | 16.01% | 4.27% | 8.08% | 5.21% |
| **E. Current Liabilities** |  |  |  |  |  |  |  |  |
| 1. Trade credit and other accounts payables | 3.96% | 25.34% | 30.30% | 15.51% | 14.99% | 44.96% | 18.78% | 73.43% |
| 2. Short-term borrowings | 0.80% | 0.00% | 0.00% | 32.07% | 0.00% | 21.18% | 4.50% | 9.76% |
| 3. Current portion of non-current liabilities | 1.19% | 4.34% | 0.00% | 1.82% | 0.03% | 0.20% | 4.42% | 0.00% |
| 4. Other current liabilities | 0.25% | 0.01% | 4.36% | 0.38% | 1.56% | 2.67% | 8.29% | 1.40% |
| Equity and Liabilities (C + D + E) | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% |

Source: State Bank of Pakistan, Statistica & DWH Department, *Financial Statements Analysis of Companies (Non-Financial) Listed at Pakistan Stock Exchange (2014–2019)*, accessed May 27, 2021, https://www.sbp.org.pk/departments/stats/FSA(Non).pdf.

Exhibit 2: Income Statements of Companies A to H

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Financial Item** | **A** | **B** | **C** | **D** | **E** | **F** | **G** | **H** |
| 1. Sales | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| 2. Cost of sales | 55.98% | 0.00% | 73.52% | 81.83% | 44.88% | 63.38% | 69.90% |  |
| 3. Gross profit (loss) | 44.02% | 100.00% | 26.48% | 18.17% | 55.12% | 36.62% | 30.10% | 100.00% |
| 4. General, administrative, and other expenses | 27.13% | 91.43% | 14.34% | 15.17% | 17.64% | 18.81% | 12.67% | 29.25% |
| - Selling and distribution expenses | 0.92% | 0.42% | 10.00% | 8.65% | 0.05% | 15.06% | 9.39% |  |
| - Administrative and other expenses | 26.21% | 91.01% | 4.34% | 6.52% | 17.64% | 3.75% | 3.28% |  |
| 5. Other income (loss) | 2.53% | 1.47% | 3.16% | 1.20% | 4.11% | 0.26% | 7.61% | 0.20% |
| 6. Earnings before interest and tax | 19.42% | 10.04% | 15.30% | 4.20% | 41.53% | 18.07% | 25.04% | 70.95% |
| 7. Financial expenses | 4.16% | 0.72% | 0.27% | 2.15% | 0.39% | 0.90% | 3.43% | 41.13% |
| - Interest expenses | 3.35% | 0.55% | 0.00% | 1.77% | 0.39% | 0.87% | 3.37% |  |
| 8. Profit (loss) before taxation | 15.26% | 9.32% | 15.03% | 2.05% | 41.14% | 17.17% | 21.61% | 29.83% |
| 9. Tax expenses | 5.40% | 2.79% | 5.79% | 0.01% | 10.64% | 5.19% | 7.14% | 20.81% |
| 10. Profit (loss) after tax | 9.86% | 6.53% | 9.24% | 2.03% | 30.50% | 11.98% | 14.46% | 9.01% |

Source: State Bank of Pakistan, Statistica & DWH Department, *Financial Statements Analysis of Companies (Non-Financial) Listed at Pakistan Stock Exchange (2014–2019)*, accessed May 27, 2021, https://www.sbp.org.pk/departments/stats/FSA(Non).pdf.

Exhibit 3: Financial Ratios of Companies A to H

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Financial Ratio** | **A** | **B** | **C** | **D** | **E** | **F** | **G** | **H** |
| Asset turnover | 0.25 | 1.24 | 1.52 | 1.17 | 0.39 | 2.24 | 0.72 | 5.00 |
| Return on assets | 2.47 | 8.11 | 14.07 | 2.37 | 11.96 | 26.83 | 10.40 | 4.00 |
| Return on equity | 3.07 | 13.05 | 22.42 | 8.23 | 17.46 | 217.78 | 26.52 | 38.00 |
| Current ratio | 2.41 | 0.97 | 1.56 | 1.13 | 2.89 | 0.62 | 1.03 | 0.49 |
| Days of inventory | 5.47 | — | 92.13 | 138.36 | 0.00 | 72.37 | 86.70 | 0.00 |
| Days of payables | 110.18 | — | 100.39 | 63.09 | 337.87 | 123.61 | 148.72 | 18257.13 |
| Days of receivables | 23.04 | 17.74 | 26.31 | 32.55 | 309.77 | 2.33 | 25.64 | 2,106.04 |
| Debt to total capitalization | 0.18 | 0.03 | 0.00 | 0.63 | 0.00 | 0.82 | 0.40 | 0.49 |
| Financial leverage | 1.32 | 1.59 | 1.62 | 3.32 | 1.50 | 12.59 | 2.75 | 9.80 |
| Gross margin | 44.02% | — | 26.48% | 18.17% | 55.12% | 36.62% | 30.10% | — |
| Interest coverage | 5.80 | 18.34 | — | 2.37 | 105. | 20.87 | 7.42 | 1.73 |
| Inventory turnover | 66.78 | — | 3.96 | 2.64 | — | 5.04 | 4.21 | 0.00 |
| Return on sales | 0.10 | 0.07 | 0.09 | 0.02 | 0.30 | 0.12 | 0.14 | 0.09 |

Source: State Bank of Pakistan, Statistica & DWH Department, *Financial Statements Analysis of Companies (Non-Financial) Listed at Pakistan Stock Exchange (2014–2019)*, accessed May 27, 2021, https://www.sbp.org.pk/departments/stats/FSA(Non).pdf.

1. The eight company industries in this list are not necessarily arranged in the same order as the companies in Exhibits 1 to 3. [↑](#footnote-ref-1)