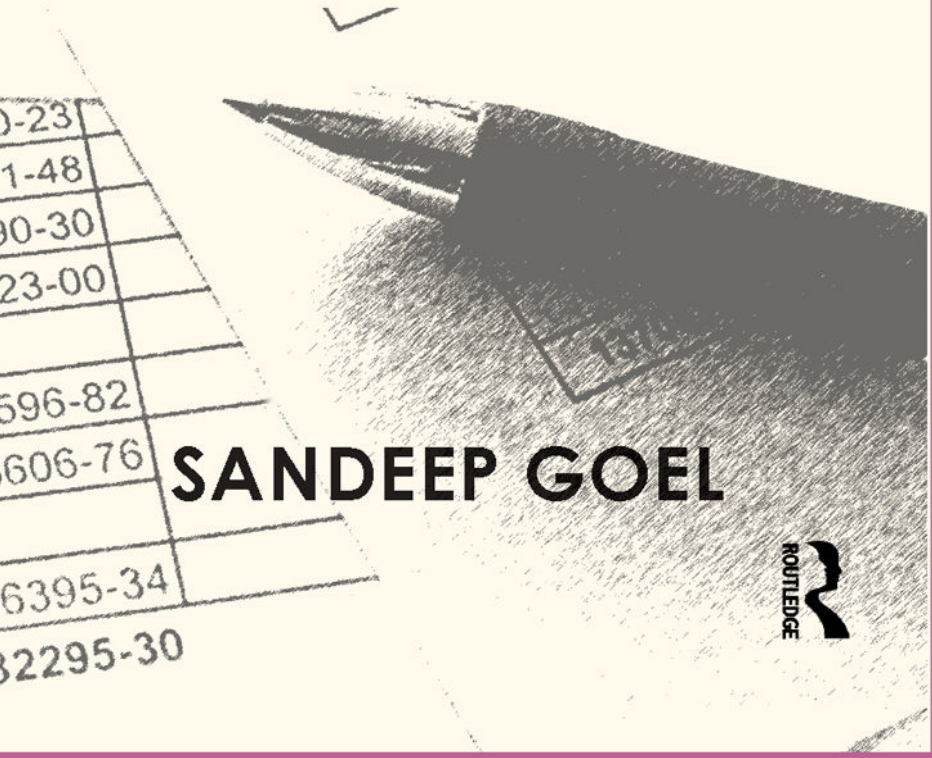
FINANCIAL STATEMENTS ANALYSIS



SANDEEP GOEL

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Financial Statements Analysis

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Cases from Corporate India

Sandeep Goel

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List of Abbreviations

2G	Second-Generation Wireless Telephone Technology
3G	Third-Generation Wireless Telephone Technology
ACC	Associated Cement Company Limited
BHEL	Bharat Heavy Electricals Limited
CAGR	Compound Annual Growth Rate
CASA	Current and Savings Account
CCIL	Cement Corporation of India Limited
CFF	Cash Flow from Financing Activities
CFI	Cash Flow from Investing activities
CFO	Cash Flow from Operating activities
COPR	Cash Operating Profit Ratio
DPS	Dividends per Share
DSL	Digital Subscriber Line
DTH	Direct to home
EBIT	Earnings Before Interest and Tax
EBT	Earnings BeforeTax
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortisation
EPS	Earnings per Share
FDI	Foreign Direct Investment
GAIL	Gas Authority of India Limited
GCF	Gross Capital Formation
GDP	Gross Domestic Product
HCC	Hindustan Construction Company
IFCI	Industrial Finance Corporation of India
L&T	Larsen & Toubro
NPM	Net Profit Margin
OFR	Operational and Financial Review
OPR	Operating Profit Ratio
PAT	Profit after Taxes
PPP	Public–Private Partnership
R&M	Repairs and Maintenance

SAIL	Steel Authority of India Limited
SEBI	Securities and Exchange Board of India
SEZ	Special Economic Zones
SFCs	State Financial Corporations
SIDBI	Small and Industrial Development Bank of India
SLM	Straight Line Method
WDV	Written Down Value

Preface

Understanding your organisation's financial health is a fundamental aspect of responding to today's increasingly stringent financial reporting requirements. To avoid risks, organisations must analyse financial performance trends in liabilities and assets, and evaluate and adjust planned and forecasted amounts. Financial analysis, therefore, is an integrated process that informs decision-making and should, if applied correctly, optimally support the viability of a business. It is an effective tool used for assessing the integrity of capital investment decisions and effective and efficient management of existing physical assets. It ensures that the 'best value for money' is achieved and that resources are allocated in a manner that reflects the business growth.

Financial analysis is defined as the process of identifying financial strengths and weaknesses of the firm by properly establishing the relationship between the items of the financial statements. Typically, financial analysis is used to appraise whether an entity is stable, solvent, liquid, or profitable enough to be invested in. When looking at a specific company, the financial analyst will often focus on the income statement, balance sheet and cash flow statement. In addition, one key area of financial analysis involves extrapolating a company's past performance into an estimate of the same company's future performance. Various methods or techniques are used in analysing financial statements, such as comparative statements, common size percentages, ratios analysis, and cash flow analysis.

In light of these issues, this book is an attempt to appraise and analyse the financial performance of corporate enterprises in India in various sectors. The book has been divided into two parts — Part I, 'Accounting Environment', discusses fundamental concepts of accounting and present various financial statements and ratios used for analysing the financial performance of business undertakings. Part II, 'Corporate Cases', discusses varied corporate case studies, across the different industrial sectors in the country. Eight sectors have been chosen for the present study — five are from manufacturing that is, construction, power, steel, automobile, and cement, while the remaining three are from the service sector, that is, telecom,

banking and the BPO industry — for an equal representation of all possible sectors and appreciation of their diverse financial issues. The companies have been selected within a sector on a comparative basis in order to better appreciate and understand the financial challenges of enterprises with varied nature and characteristics. A span of five years, 2005–06 to 2009–10, is the period of this study; this period was considered as it was a reasonably good time, economically, to analyse the financial performance of the selected companies and its impact on the shareholders' return.

Owing to its 'case-based' approach, the objective of the book is to develop an understanding of the concepts of finance as well as to help managers and corporate professionals to use it as an effective tool for communication, monitoring, analysis, and resource allocation. The book also attempts to provide direction to academicians, businessmen and policy-makers to effectively cope with the emerging financial issues and challenges of the current business world. It will also serve as a platform to answer key financial questions, such as:

(*a*) What is the aging distribution of Accounts Payable and Accounts Receivable?
(*b*) Are there any customers with payment problems; if so, who needs to be notified?
(*c*) What is the value of assets, liabilities and owners' equity on a given date?
(*d*) What is the breakdown of expenses by business units?
(*e*) Which business units are hitting their targets?
(*f*) What are the revenue trends by business units?
(*g*) What is the actual amount of profit margin by business unit or region? What are the associated trends?
(*h*) What is the change in cash position from period to period?

It is hoped that this book would create a fresh knowledge base on the subject matter as well as add value to the existing literature.

Acknowledgements

I must thank God Almighty for everything in life! The work would be incomplete if I do not acknowledge my parents' contribution. They have been a constant source of inspiration for me and have always stood by me through thick and thin. Anushree, my wife, deserves special mention and thanks for her unstinted encouragement and support in life. My little daughter, Maanya, is my soul whose smile always keeps me going. Last, but not the least, I am thankful to Routledge India, New Delhi, for their tremendous support and co-operation at all stages of publication of this book.

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Introduction

Business Organisations

Every individual comes into contact with business organisations, practically, at every turn in his or her daily life, directly or indirectly. The scale of such activities is vast and has an enormous impact on the life of the community. These activities include providing essential goods (such as clothes, automobiles and food items) and services (such as banking, insurance and advisory matters) of every type, modern and ultra-modern.

What is a Business Organisation?

Also known as business enterprise, business undertaking, business firm, or business concern, a business organisation is essentially engaged in some business or commercial activity. It may be owned by and controlled by a single individual or by a group of individuals. So, business organisation can be defined as, 'an enterprise which makes, distributes or provides any article or service which the other members of the community need and are able and willing to pay for'. Business organisations may be classified into the following three (broad) categories:

Private Enterprise

A private enterprise is owned, managed and controlled exclusively by private businessmen. The main motive of such an enterprise is to earn profit. There is no participation of the Central or State Governments in the establishment and ownership of a private enterprise.

Public Sector Enterprise

A public sector enterprise (PSU) is usually defined as a company or an organisation that may be (*a*) owned by the State; or (*b*) managed by the State; or (*c*) owned and managed by the State. According to Prof. A. H. Hanson (1959), 'Public enterprise means state ownership

and operation of industrial, agricultural, financial and commercial undertakings'. Their main objective is to serve the society.

Joint Sector Enterprises

Joint sector consists of those business undertakings wherein the ownership, management and control are shared jointly by the Government, private entrepreneurs and the public. Joint sector enterprises have been designed as an effective instrument for exercising social control over industry.

Forms of Private Enterprises

Various forms of private enterprises have been discussed in the following section:

Sole Proprietorship

In this form of business enterprise, one person provides the entire capital, bears all the risks and manages the business — that is, being a 'one-man army'. The proprietor is personally liable for all the debts of the firm. These businesses include computer repair services, catering and house-cleaning services, and home tutoring.

Joint Hindu Family Business

It may be defined as an organisation in which all the male members of a Hindu undivided ('joint') family carry on business under the management and control of the head of the family called the *Karta*.

Partnership

In this form of ownership, two or more persons enter into a contract to conduct lawful business (jointly) and share its profits. Section 4 of the Indian Partnership Act, 1932, defines partnership as 'the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all'.[1] Each partner is considered as an agent of the firm and of its partners, as the firm has no separate legal entity. Each partner is jointly and individually liable for the debts of the firm to an unlimited extent. Chartered accountancy and consulting forms are normally run as partnership firms.

Co-operative Organisation

A co-operative society is a voluntary association of persons who join forces to carry on a commercial activity. It is based on the principles of mutual trust, equality, democracy, and freedom. It has a distinct entity and the liability of its members is limited. But as an incorporated association of persons, it enjoys perpetual life. Amul, in Gujarat, is an example of an Indian dairy co-operative.

Joint Stock Company

It is an association of persons having a separate legal existence, perpetual succession and common seal, under the Companies Act, 1956.[2] Its capital is generally divided into shares which are transferable, subject to certain conditions. The Board of Directors, comprising elected representatives of the members, is responsible for its management and control. A joint stock company in the private sector could be either a private or a public company.

(*a*) *Private Company* — according to Section III of the Companies Act, 1956, a private company is identified with the following features:

i) minimum paid up capital is INR 1,00,000
ii) maximum number of members is 50
iii) it is prohibited from issue of shares to the public, and
iv) it is prohibited from transfer of shares

A private company must use the words 'Private Limited' in its name. For example: Competent Automobiles Co. (P) Ltd., Allied Motors Pvt. Ltd.

(*b*) *Public Company* — According to Section III of the Companies Act, 1956, a public company is identified with the following features.

i) minimum paid up capital is INR 5,00,000
ii) maximum number of members is unlimited
iii) it puts no restriction on the right of members to transfer their shares, and
iv) it is free to invite the public to subscribe to its shares and debentures

A public company must use the word 'Ltd'. For example: Reliance Industries Limited, Bajaj Auto Ltd. The following table provides the distinction between a private and a public company.

Table: Distinction between Private and Public Company

Nature	*Private Company*	*Public Company*
1. Meaning	Which by its article restricts: *i)* Numbers of members to 50 *ii)* Transfer of shares *iii)* Invitation of public to subscribe to its debenture, shares etc. *iv)* Acceptance of deposits from common public	Which is not private
2. Law	Companies Act, 1956	Companies Act, 1956; SEBI Act, 1992; and allied laws*
3. Minimum No. of Shareholders	2	7
4. Maximum No. of Shareholders	50	No limit
5. Minimum paid up capital	INR 1,00,000	INR 5,00,000
6. Minimum No. of Directors	2	3
7. Transferability of Shares	Restricted	No restriction, if company is listed in stock exchange
8. Whole Time Director (WTD)/ Managing Director (WTMD) Appointment	Appointment not compulsory and no restriction on appointment	Appointment Not compulsory, if paid up capital < INR 5 crore. Compulsory if paid up capital => INR 5 crore.

Source: All tables prepared by the author.

Note: * The Securities and Exchange Board of India Act, 1992, extends to the entire country and came into force on the 30 January 1992. It primarily aims at protecting the interests of investors in securities and regulating the securities market and is only applicable to listed companies. Available at http://www.sebi.gov.in/acts/act15ac.pdf (accessed on 25 July 2012).

Forms of Public Sector Enterprises

Public sector enterprises may be organised according to any of the following:

Departmental Undertakings

Departmental undertaking is the oldest and traditional form of organising public sector enterprises and is managed by government officials under the supervision of the concerned head of the department. It may be run either by the Central Government or by a State Government. The undertaking is under the overall and ultimate control of a minister who is responsible to the Parliament. Indian Railways, Post and Telegraphs, the Broadcasting Department,

Defence establishments, and Atomic Energy Projects are all examples of this form of public enterprise.

Statutory Corporations

A statutory or a public corporation is a body that is established under a special Act of the Parliament or State legislature. The statute or law that creates it also defines its objects, powers and functions. Examples of such corporations include the Life Insurance Corporation of India, Industrial Development Bank of India, Unit Trust of India, and Employees' State Insurance Corporation.

Government Companies

It is a company where the Central Government or one or more State Governments or the Central and State Governments (jointly) hold, at least, 51 per cent of the paid-up share capital. It is formed and registered under the Companies Act, 1956. These include Steel Authority of India Limited (SAIL), Gas Authority of India Limited (GAIL) and Bharat Heavy Electricals Limited (BHEL), among others.

Financial Problems in Business Organisations

A criticism on the financial front in business enterprises could be attributed to several deficiencies that are ignored and which actually impair the functioning of these enterprises. The following sections are a brief account of such anomalies.

Inadequate Mix of Funds

The enterprises fail to identify and maintain the desirable combination of funds sources. Most enterprises face a shortage of equity and depend too much on borrowed capital. This makes the financial structure inoptimal, that is, the utilisation of funds has not been optimum or effective. High debt and low equity is always a risky proposition for firms, especially in adverse periods, due to fixed payments of interest.

Lack of an Appropriate Combination of Assets

The enterprises fail to identify and maintain an appropriate combination of assets. They face under-investment or over-investment

in fixed assets, on one hand, and current assets, on the other hand. Furthermore, the utilisation of assets is not favourable either.

Improper Projection of Future Revenues and Costs

Some enterprises do not make or provide a proper projection of future revenues and costs which result in improper investment in inventories, receivables and additional plant capacity (to name a few). All these factors account for poor earnings of such enterprises.

No Stable Dividend Policy

The enterprises fail to pursue a definite and stable dividend policy. As a result, no adequate balance is maintained between payment of dividends and retention of earnings.

Types of Business Finance

Finance used in business can be any of the following:

Long-term Finance

Long-term finance refers to that category of funds where the repayment is generally more than the 10-years period. It is raised from shareholders, debenture-holders, financial institutions, and retained earnings. Long-term finance is used for meeting the permanent needs of business and is used for investments in fixed assets, such as land, buildings, plants, machinery, furniture, and fixtures. Such finance cannot be taken out of the business without closing down the firm or without reducing the scale of operations.

Medium-term Finance

Medium/intermediate-term finance is that category where repayment can be projected within the planning cycle of a reasonable length of time. It is raised for a period of more than one year but less than 10 years from debenture-holders, financial institutions, public deposits, and commercial banks. This type of finance is required for investment in permanent working capital and for repayment of assets.

Short-term Finance

Also known as working capital, short-term finance is employed by an enterprise for day-to-day operations. It is used for meeting obligations for a period of one year (or less) and is raised from trade

credit and commercial banks and, therefore, is represented by current liabilities and provisions. It is invested in current assets.

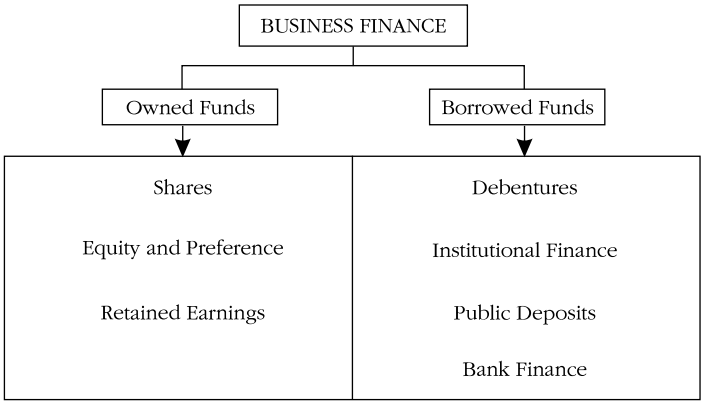
Instruments of Finance

A business form can raise funds from two main sources, as shown in the following figure.

(*a*) *Owned funds*, which are provided by the owners. In a proprietorship, the proprietor gives the owned funds from his personal resources. In a partnership, ownership funds are jointly contributed by all partners. In a joint stock company, owned funds are raised through the issue of shares and reinvestment of earnings.

(*b*) *Borrowed funds*, which refer to the borrowings of a business firm. In any company, borrowed funds consist of funds raised from debenture-holders, financial institutions and commercial banks.

Figure: Instruments of Finance



Source: All figures prepared by the author.

Shares

Issue of shares is the most important source of raising long-term finance. Share is one of the units into which the share capital of a company is divided. It indicates the interest of a shareholder in the assets and profits of a company. Shares can be issued in the following forms:

(*a*) *Equity (Ordinary) Shares* — Those shares which do not carry any special or preferential rights in the payment of annual dividend or repayment of capital. The rate of dividend on such shares is not fixed. Dividend is paid out of the residual profits after paying interest on debentures and dividend on preference shares. Similarly, equity shareholders are paid at the time of winding up of the company after all debts and preference shareholders have been paid. Therefore, equity shareholders are the real risk-bearers. But they enjoy full voting rights in the management affairs of the company.

(*b*) *Preference Shares* — They carry certain special or preferential rights in the payment of dividend and repayment of capital as compared to equity shareholders. Dividend is payable at a fixed rate on these shares. But preference shares do not carry voting rights.

Retained Earnings

Retained earnings refer to those profits that have not been distributed as dividends but are used for reinvestment in business. Retained profits are also known as reserves and surplus.

Debentures

Debentures are known as creditorship securities because debentureholders are the creditors of a company. A debenture is a document or certificate issued by a company, under its seal, as an acknowledgement of its debt. It is also an undertaking to repay the specified sum with interest to its holder. Interest on debentures is paid at a fixed rate and is payable every year, irrespective of profits. Debentures carry no voting rights.

Institutional Finance

Both central and state-level financial institutions provide funds to business firms. They normally provide long-term and medium-term finance to business houses. Some of the prominent financial institutions in India are Industrial Finance Corporation of India (IFCI), Small and Industrial Development Bank of India (SIDBI) and State Financial Corporations (SFCs).

Public Deposits

These are deposits received by a company from the public as loan or debt. Companies prefer public deposits because these deposits are cheaper than bank loans.

Bank Finance

Bank finance refers to the finance raised from commercial banks — that are an important source of short-term and medium-term finance for business. These banks provide both unsecured and secured loans.

Conclusion

It is evident from these discussions that there are varied forms of business organisations in the world, from sole proprietorships to multinational corporate houses. The government sector which used to be considered a social sector at one point of time has changed tremendously towards commercialisation to survive in the global competition. It is equally true that every organisation faces its own share of financial problems and challenges in these changing times. Nevertheless, every business enterprise needs to be financially efficient for long-term growth and development.

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Part I
Accounting Environment

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1

Accounting

Nature and Scope

Information about the transactions and events of a business is recorded and presented in the form of reports that are used by various interested parties who are stakeholders, such as shareholders, investors, creditors, and lenders. This is the most common concept of accounting. It is also known as the 'language of the business' as it communicates the result of business operations to various stakeholders, that is, the proprietor, creditors, investors, regulators, government, and other agencies.

Meaning of Accounting

The term 'accounting' refers to the processes that accountants carry out — of aggregating and shaping information into financial reports that are meaningful to users of those reports. According to the American Institute of Certified Public Accountant (1941), 'accounting is the art of recording, classifying and summarizing in significant manner and in terms of money, transactions and events which are, in part, at least of a financial character and interpreting the results thereof'. If we look at accounting in the narrow perspective of only recording business transactions, then it is known as 'bookkeeping'.

Every user uses this information for various purposes. Managers need accounting information to make sound leadership decisions. Investors use it for making profits. Creditors are always concerned about the entity's ability to repay its obligations. Governmental units need information for tax and regulation purpose. Analysts use accounting data to recommend investment strategies. Employees need the information for evaluating the company's growth for their own well being.

Functions of Accounting

(*a*) *Recording* — This is the basic function of accounting. It is essentially concerned with ensuring that all business transactions (of a financial character) are recorded in an orderly manner, in the book or journal. This book may be further sub-divided into various subsidiary books, such as Cash Journal (for recording cash transactions), Purchases Journal (for recording credit purchase of goods), and Sales Journal (for recording credit sales of goods). The number of subsidiary books to be maintained depends on the nature and size of the business.

(*b*) *Classifying* — It is concerned with analysing recorded data, and grouping transactions or entries of similar nature at one place, in a 'ledger'. This book contains individual account heads, under which all financial transactions of similar nature are placed for calculating and finding out the total balance. For example: there may be separate account heads for Office Expenses and/or Sales.

(*c*) *Summarising* — This involves presenting the classified data in a manner which is understandable and useful to the end users of accounting information. This process leads to the preparation of the following statements:

(*i*) Trial Balance, (*ii*) Income Statement and (*iii*) Balance Sheet.

(*d*) *Analysing and Interpreting* — The recorded financial data is analysed and interpreted in a manner that helps the users make a meaningful judgment about the profitability and financial health of the business.

(*e*) *Communicating* — The accounting information in the end has to be communicated in a proper form to all end users. This is done by preparing and distributing various accounting reports.

Branches of Accounting

The diversity of interested parties and their needs results in various forms of accounting, mentioned in the following section.

Financial Accounting

It is the original form of accounting and is mainly concerned with the preparation of financial statements of Profit and Loss Accounts

and Balance Sheets for various stakeholders, which include shareholders, debenture holders, creditors, banks and financial institutions. These reports are prepared under the relevant accounting principles and standards set by the respective standard-setting bodies. Financial accounting is external in nature.

Management Accounting

Management accounting provides necessary information to the management for taking various decisions, such as expansion of a business, buyouts or takeovers. All these decisions require additional information — what are business resources? What are financial strengths and what is the present standing? Management accounting helps the management by providing this information and facilitates decision-making. It covers various areas including cost and human resource. Therefore, cost accounting and human resource accounting are a part of management accounting. Managerial accounting information is intended to serve the specific needs of the management, such as budgets, product costing data and other details, which are generally not reported on an external basis.

Objectives of Accounting

(*a*) Accounting is done to keep a systematic record of financial transactions, easing the jobs of humans.

(*b*) It helps to ascertain the net profit earned or loss suffered on account of business operations. This is accomplished by keeping a proper record of revenues and expenses, of a particular period, in the form of Profit and Loss Account.

(*c*) To ascertain the financial position of business, using Balance Sheets or Position Statements. A balance sheet is a statement of the assets and liabilities of the business on a particular date. It serves as a barometer for determining the financial strength of the business.

(*d*) Finally, accounting helps to facilitate managerial decision-making by providing access to accounting records, analyses and reports information, at various points of time, to the required levels of authority.

Limitations of Accounting

(*a*) A considerable amount of judgment and estimation is involved in maintaining and presenting the accounting information.

For example, should the sale be recorded on despatch or receipt of goods? Therefore, to present the information in a timely manner, one has to make certain subjective judgments while preparing financial reports.

(*b*) Accounting is historical in nature as it records and presents information which has happened in the past. These records do not help for future planning and other managerial decisions.

(*c*) Accounting information is recorded on historical cost basis, instead of current or fair value. For example: land is typically recorded in accounting records at the price at the time of purchase. This undermines the value of the business.

(*d*) Financial accounting provides information as a whole, in terms of income, expenses, assets, and liabilities. It does not provide the details of the costs incurred by departments, processes, products, services, or other unit within the organisation.

Accounting Elements

The entire accounting cycle comprises the following elements:
Assets — they are used for generating returns. They are owned by a business that has a commercial value.

(*a*) Fixed Assets — they are long-term resources (for more than a year), used for the growth and expansion of a business, such as land and buildings, plant and machinery, furniture and fixtures, motor vehicles, and others.

(*b*) Current Assets — these are meant for current use (usually for less than a year) and for day-to-day operations, such as inventory, debtors, cash, and bank.

Liability — a debt or outstanding balance owed to another party requiring a future cash flow for payment.

(*a*) Long-term Liability — these are for more than a year and include term loans and debentures.

(*b*) Current Liability — these are for less than a year and include creditors and bank overdraft.

Capital — it is the money contributed by the owners/shareholders in a business.
Revenue — it is the money that comes in through sale of goods or rendering of services.
Expenses — they are daily costs incurred to run and maintain a business.

Double Entry System of Accounting

Double entry system is the basis of accounting for business and other organisations to record financial transactions. The system is called 'double entry' because every transaction is considered to have two effects and recorded in two accounts. Each transaction results in at least one account being debited and at least one account being credited, so that the total debits of the transaction equal to the total credits. For example: if there is a purchase of machinery in cash, then the Machinery Account will be debited while the Cash Account is credited. The most common expression of this system is the accounting equation, discussed in the following section.

Accounting Equation

The accounting formula, also called the 'balance sheet equation', represents the relationship between the assets, liabilities, and the owner's equity of a business. It shows that the resources owned by a firm (its assets) are always equal to its obligations (its liabilities and capital), that is

Assets = Liabilities + Owner's Capital

This is a balancing equation because everything the firm owns (assets) has to be purchased with either a liability or the owner's capital.

(*a*) *Assets* are the economic resources of the entity and includes items such as cash, stock, land and buildings, and

even intangible assets like patents and copyrights. Assets are used to generate returns for business.

(*b*) *Liabilities* are amounts owed to outsiders in the form of loans, and credit. It is an 'existing' obligation to pay.

(*c*) *Owner's equity* is the owner's 'interest' in the business. In case of a sole proprietorship, the equity consists of a single owner's capital account. Conversely, partnership equity consists of separate capital accounts for each partner. Finally, in corporate equity, ownership interest is represented by shares of stock. The total owners' (stockholders) equity of a firm consists of the shareholders' initial capital and reserves and surplus. Figure 1.1 explains the accounting equation mechanism.

Figure 1.1: The Accounting Equation Mechanism

1. Ram & Bros. start-up is a small business of readymade garments with INR 10,000 of capital.

   Assets = Liabilities + Capital
   INR 10,000 = 0 + INR 10,000

It increases Assets in the form of cash and capital thereof.

2. They spend INR 1,500 on office consumables. Therefore:

   Assets = Liabilities + Capital
   INR 8,500 = 0 + INR 8,500

It will reduce cash as an asset and expenses decrease the owner's equity. Consequently, the accounting equation stays balanced, in all cases.

Basis of Accounting

Cash accounting is the more popular method of recording and reporting small business income and expenses. In this method, income and expenses are recorded only when funds are received or disbursed (see Figure 1.2).

In accrual accounting, income is recorded when a sale is made, irrespective of whether the payment is received or not. Expenses are recorded when they are incurred, without being paid (see Figure 1.2).

Figure 1.2: Cash vs Accrual Basis of Accounting

Question

During 2007–08, A Ltd. had cash sales of INR 3,90,000 and credit sales of INR 1,60,000. Their expenses for the year were INR 2,70,000, out of which INR 80,000 is still to be paid. Commission received in the current year (due of last year) INR 5,000. Income due on investments for the year, INR 10,000.

Find out their profit/loss for 2007–08 as per:

(a) cash basis of accounting
(b) accrual basis of accounting

Solution

1. Profit/loss as per cash basis

Revenue (cash inflow or cash sales)	INR 3,90,000
Commission received, due of last year	+INR 5,000
	3,95,000
Less: expenses (cash outflow) (INR 2,70,000 – INR 80,000)	1,90,000
Profit	**INR 2,05,000**

2. Profit/loss as per accrual basis

Revenue (total sales)	INR 5,50,000
Interest due on investments	+INR 10,000
	5,60,000
Less: Total expenses for the year	2,70,000
Profit	**INR 2,90,000**

2

Financial Statements

Financial accounting provides information to various stakeholders, at regular intervals, through published reports, which contain information about the business performance in the form of financial statements. They include the balance sheet, the income statement, the statement of retained earnings, and the statement of cash flows. Many rules govern the form and content of each financial statement. At the same time, these rules are not so rigid as to preclude variations in the exact structure or layout. For example, both horizontal and vertical forms of financial statements are allowed. Additional supplemental disclosures provide insight about related areas of business.[1] One can gain this information by reviewing corporate websites' filings with regulators and financial journals and magazines, among other such sources.

Profit and Loss Account

Profit and Loss Account or Income Statement is a summary of an entity's results of operation for a specified period of time (for example: year, quarter, month). It provides information about revenues generated and expenses incurred during that period. The difference between the revenues and expenses is identified as the net income or loss. Income statement is a flow concept[2] as it reveals the operational performance of a business for the entire period (see Figure 2.1).

Simply put, the income statement measures all revenue sources against business expenses for a given time period. To understand the major components of an income statement, let us take the example of a yarn manufacturer.

(*a*) Sales — the gross revenue generated from the sale of yarn, less the returns and allowances, in the form of discounts given to customers.

Figure 2.1: Profit and Loss Account for the Year-end 31 March 2008

(INR in million)

	2007–08	**2006–07**
INCOME		
Turnover		
Less: Excise Duty		
Net Turnover		
Other Income		
EXPENDITURE		
Manufacturing Expenses		
Office and Selling Expenses		
Depreciation		
Interest and Finance Charges		
Profit Before Tax		
Provision for Current Tax		
Profit after Tax		
Amount available for appropriation		
Dividend		
Reserves		
Balance carried forward		

(*b*) Cost of goods sold (COGS) — the direct cost associated with the manufacturing of yarn. These costs include the materials used and direct labour, along with freight and other costs associated with operating a plant.

(*c*) Gross profit — this represents the amount of direct profit associated with the actual manufacturing of yarn. It is calculated as sales less the COGS.

(*d*) Operating expenses — selling, general and administrative expenses that are necessary to run the business. Examples include office salaries, insurance, advertising, sales commissions, and rent.

(*e*) Depreciation expense is usually included in operating expenses and/or cost of goods sold. Depreciation is a non-cash expense.

(*f*) Operating profit or earnings before interest and tax (EBIT) — the amount of profit earned during the normal course of operations. It is computed by subtracting operating expenses from the gross profit.

(*g*) Other income and expenses are those items that do not occur during the normal course of business operation. For example, a yarn manufacturer does not normally earn any income from sale of assets or interest on investments; therefore, these income sources are accounted for separately. Interest expense on debt is also included in this category. A net figure is computed by subtracting other expenses from other income.

(*h*) Profit or earnings before tax (EBT) — this figure represents the amount of income earned by the business before paying taxes. It is computed by adding other income (or subtracting if expenses exceed other income) to the operating profit.

(*i*) Income taxes — the total amount of income taxes paid.

(*j*) Profit after taxes (PAT) — this is the 'bottom line' of the business, which is calculated by subtracting the taxes paid from the net income before taxes.

Balance Sheet

The balance sheet is based on the accounting equation (discussed in the previous chapter) and depicts the economic resources owned by an entity and the claims against those resources (liabilities and owner's equity). The balance sheet is prepared on a specific date (see Figure 2.2) and is, therefore, considered as stock concept. It presents the financial position of a company.

Assets in the Balance Sheet

(*a*) Fixed assets comprise the following.

- (*i*) Land
- (*ii*) Building
- (*iii*) Plant and Machinery
- (*iv*) Furniture and Fixture
- (*v*) Vehicles

Figure 2.2: Balance Sheet as on 31 March 2008

(INR in million)

	2008	2007
SOURCES OF FUNDS		
Shareholders' Funds		
Share Capital		
Reserves and Surplus		
Loan Funds		
Secured Loans		
Unsecured Loans		
TOTAL		
APPLICATION OF FUNDS		
Fixed Assets		
Gross Block		
Less: Depreciation		
Net Block		
Capital Work-in-Progress		
Investments		
Current Assets		
Current Assets		
Inventories		
Sundry Debtors		
Cash and Bank Balances		
Other Current Assets		
Less: Current Liabilities and Provisions		
Current Liabilities		
Provisions		
Net Current Assets		
TOTAL		

Intangible assets are also included in fixed assets. These include:

(*i*) Goodwill
(*ii*) Patents
(*iii*) Trade marks

(*b*) Investment is a financial asset. It is done for getting interest or dividend earning and will be shown on cost or market value which is less. For example:
  (*i*) Investment in government securities.
  ii) Investment in shares, debentures or bonds
(*c*) Current assets, loans and advances are shown under a separate head and include the following components.
  (*i*) Raw material
  (*ii*) Work in progress
  (*iii*) Finished stock
  (*iv*) Stores and spares
  (*v*) Sundry debtors; less provision for doubtful debts
  (*vi*) Cash in hand
  (*vii*) Bank balance

Liabilities in the Balance Sheet

(*a*) Share Capital — In the share capital of a company, authorised capital, issued capital, subscribed capital, called up capital and paid up capital is given.
  (*i*) Authorised capital is the maximum amount of capital which a company is permitted to raise through shares from the general public. For example: A company is registered with 100 shares of INR 10 per share, so the total authorised amount of the company is INR 1000. It is the registered capital of the company.
  (*ii*) Issued capital is that part of the authorised capital which is actually issued to the general public. For example: A company has issued 80 shares of INR 10 each. Therefore, the issued capital is INR 800.
  (*iii*) Subscribed capital is that part of the issued capital which is actually subscribed by the general public. That is, if a company has issued 80 shares and the general public buys 50 shares, then the subscribed capital is INR 500.
  (*iv*) Called up capital is that part of the subscribed capital which is actually called up by the company. For example: if a company has asked its shareholders to pay INR 5 per share, then the price of 50 shares will be INR 250 — this is the called up capital.
  (*v*) Paid up capital is that part of the called up capital which is paid by the shareholders. For example: out of the 50

shares which were subscribed, 30 shareholders have paid their call money, that is, INR 150 (30 x 5).

(*vi*) Unpaid amount is known as Calls in Arrears.

(*b*) Reserves and Surplus — Following reserves will be shown in liabilities side of balance sheet of company.

(*i*) Capital reserves
(*ii*) Share premium account
(*iii*) Other reserves
(*iv*) Surplus balance in profit and loss account after providing dividend

(*c*) Secured Loan — If a loan is taken by the company after keeping any asset as security, then it will be shown under the secured loan head. It includes:

(*i*) Debentures
(*ii*) Loan and advances from subsidiaries
(*iii*) Other loan and advances

(*d*) Unsecured Loan — These include:

(*i*) Fixed deposits of public
(*ii*) Short term loans and advances
(*iii*) Other loan

(*e*) Current Liabilities — All liabilities, which are payable within one year, will be included under the current liabilities head, including:

(*i*) Acceptance or bill payables
(*ii*) Sundry creditors
(*iii*) Interest payable other than on loan
(*iv*) Outstanding expenditures

(*f*) Provision — It is a charge against profits, which is created for a specific expense in future. For example: provision for depreciation.

(*i*) Provision for taxation
(*ii*) Proposed dividend
(*iii*) Other provisions

Cash Flow Statement

The statement of cash flows (see Figure 2.3) describes the enterprise's cash flows. It tells how cash is generated and expended during a specific period of time and also tracks the effects of changes

Figure 2.3: Cash Flow Statement for the Year-end 31 March 2008

	2007–08	2006–07
CASH FLOW FROM OPERATING ACTIVITIES		
Net Income before tax		
Adjustments:		
Add: Depreciation		
Loss on Sale of Fixed Assets		
Less: Interest Income		
Operating Profit before Working Capital Changes		
Add: Decrease in Current Assets & Increase in Current Liabilities		
Less: Increase in Current Assets & Decrease in Current Liabilities		
Cash Generated from Operations		
Taxes Paid		
Net Cash from Operating Activities		
CASH FLOW FROM INVESTING ACTIVITIES		
Sale of Land		
Sale of Equipment		
Less: Purchase of Equipment		
Net Cash used in Investing Activities		
CASH FLOW FROM FINANCING ACTIVITIES		
Issue of equity Share Capital		
Less: Dividends Paid		
Net Cash used in Financing Activities		
Net Decrease/Increase in cash and cash equivalents		
Cash and cash equivalents at the beginning of the period		
Cash and cash equivalents at the end of the period		

in balance sheet accounts. It consists of three parts of inflows and outflows, resulting from (*a*) operating activities, (*b*) investing activities and (*c*) financing activities.

The cash flow statement is one of the most useful financial management tools for business operations. It is divided into the following three categories:

(*a*) Net cash flow from operating activities (CFO) — these are the core activities of a business that either require cash or

generate it. They include cash collections from customers, cash paid to suppliers and employees, and cash paid for operating expenses.

(*b*) Net cash flow from investing activities (CFI), which are discretionary investments made by management. These primarily consist of the purchase (or sale) of equipment.

(*c*) Net cash flow from financing activities (CFF) — these are fund-related activities (either sources or uses of cash) that affect cash flow. These include issue of shares, raising of loans and dividends paid.

The sum of CFF, CFI and CFO is net cash flow. It is a very important performance measure as it decides the company's growth plan.

Other Disclosures in the Annual Report

An annual report, especially of a listed company, is a very substantial document. It is not just about financial statements but also contains significant information about the company in the form of additional disclosures (examples of which are excerpts of annual reports of companies. These have been included in the following chapters, wherever applicable).

(*a*) Chairman's report — is given by listed companies and other public interest entities.

(*b*) Operational and financial review (OFR) — this is recommended for listed and other public interest companies.

(*c*) Report on corporate governance — is required for listed companies as per SEBI guidelines.

(*d*) Directors' report — is a legal requirement, though the contents are not standardised.

(*e*) Auditors' report — is an opinion from the auditor as required by the Companies Act, 1956.

(*f*) Statement of accounting policies —in this section, the company describes the accounting policies it has used to prepare its accounts.

(*g*) Notes to the accounts — these explain what is in the Profit and Loss Account, the balance sheet and the cash flow statement. In addition, there are notes dealing with matters such as related party transactions.

3

Financial Ratios

Financial analysis or appraisal is the process of analysing the information in financial statements, at a specific level, and interpreting the meaning of those numbers with the help of financial tools. Financial techniques, which are generally used to assign meaning to these numbers, include comparative analysis, common-size analysis, trend analysis, and ratio analysis. The latter, however, is the most relevant and widely used technique for financial appraisal.

What are Financial Ratios?

It is a relationship between two financial expressions. It measures business performance and financial situation on a given parameter, such as the ratio between the company's current assets and its current liabilities or between its debtors and its turnover. The basic source of these ratios is the company's Profit and Loss Account and balance sheet that contain all the financial details and other information about that company. The ratios bring these details to light and identify the financial strengths and weaknesses of the company.

When assessing ratios, it is important that the results are not taken in isolation and are compared with other companies in the same industry. It is quite plausible that what seems like a poor ratio (at the first glance) is normal for a particular industry and vice versa, that is, what seems like a standalone good ratio, could very well be below average for that industry.

The following sections discuss various types of financial ratios:

Profitability Ratios

These ratios are used to analyse the profitability of a company in total and the return generated for shareholders.

Profit Margin: PAT/Sales × 100

It measures the margin of profitability on sales throughout the year and is the main indicator for measuring the efficiency of the

operation as well as gauging the business's ability to face various pressures.

Profit/Capital Employed (Return on Capital Employed):

$$\frac{\text{Profit before Tax}}{\text{Capital employed}} \times 100$$

This ratio measures whether or not a company is generating adequate profits in relation to the funds invested and is a key indicator of investment performance. In manufacturing, we would expect to see figures exceeding 10 per cent, rising to over 25 per cent at the top. In retail, lower figures would be experienced, ranging between 5 and 15 per cent. Construction figures show an average of about 7 per cent, increasing to over 35 per cent for the top performers. These figures are industry averages of analysis.

Return on Shareholders' Funds:

$$\frac{\text{PAT}}{\text{Shareholders' funds}} \times 100$$

It indicates whether or not a company is generating adequate profits for shareholders.

Operating Efficiency Ratios

They are computed to find out the efficiency of the management in utilisation of resources, both long-term and short-term.

Proprietors' Ratio:

$$\frac{\text{Shareholders' funds}}{\text{Total Assets}} \times 100$$

This ratio determines if the total liabilities of a business (both secured and unsecured) are too high, indicating a possible over-dependency on outside sources for long-term financial support. By comparing shareholders' funds with total assets, we can produce a confidence factor for unsecured creditors to the business. As a general rule, the higher the result the better it is.

Collection Period:

$$\frac{\text{Debtors}}{\text{Turnover}} \quad 365 \text{ (days)}$$

It measures the length of time a company takes to collect its debts, in days. In general terms, the figure indicates the effectiveness of the company's credit control department in collecting the outstanding money.

Creditor Days:

$$\frac{\text{Creditors}}{\text{Purchases}} \quad 365 \text{ (days)}$$

This ratio measures the length of time (in days) it takes a company to pay its creditors.

Stock Turnover Ratio:

Turnover/Stock

It determines the number of times a company converts its stock into sales during the year. While examining this ratio, it should be kept in mind that different companies will have varying levels of stock turnover depending on the industry they operate in. Low figures are generally poor as they indicate excessively poor moving stocks.

Asset Turnover Ratio:

Turnover/Assets

It indicates how effectively a company utilises its investment in assets and is also a measure of how efficient the company has been generating sales from the assets at its disposal. A low figure suggests either poor trading performance (which can be evaluated by the profit margin sales per employee data) or an over-investment in costly fixed assets.

Liquidity Ratios

They are oriented towards evaluating the short-term viability of the company.

Current Ratio:

Current Assets/Current Liabilities

It reflects the working capital situation and indicates the ability of a company to pay its short-term creditors from the realisation of its current assets. An ideal figure is 2:1, which indicates that there are sufficient assets available to pay liabilities. In retail and manufacturing, we would expect figures between 1.1 to 1.6; in wholesale and construction, 1.1 to 1.5 and motor vehicles 1.2 to 1.6. Usually, where credit terms are liberal and stocks are larger in volume, one has to make huge investments in current assets for working capital. This

leads to a higher current ratio. For example, a retail business where cash sales are the norm.

Liquid Ratio:

$$\frac{\text{Current Assets} - \text{Stock}}{\text{Current Liabilities}}$$

It is generally considered to be a more accurate assessment of a company's financial health (than the current ratio) as it excludes stock; thus, it reduces the risk of relying on a ratio that may include slow moving or redundant stock. An ideal ratio is 1. In manufacturing, figures between 0.7 and 1.1 are seen as acceptable, and for wholesalers, 0.7 to 1.0. Construction should operate at between 0.6 and 1.0.

Solvency Ratios

These ratios are used to find out the long-term stability of company.

Debt-Equity Ratio

The D/E ratio indicates relative proportions of debt and equity in financing the assets of a firm and the extent to which it depends upon debt capital for its existence. In other words, it reveals whether the firm is highly leveraged or not, that is, whether it has the benefit of trading on equity. It also indicates the margin of safety to the creditors — the amount of risk that creditors face in getting back their due money. The higher the ratio, the greater will be the risk to the creditors; therefore, this indicates too much dependence of the firm on debt capital. The ideal ratio is taken as 2:1.

Market Ratios

These are used to determine the financial market performance of a company.

P/E Ratio:

Market Price per Share/Earning Per Share

Since it judges the market reaction to the earning potential of a company, it should be on the higher side.

All the ratios, discussed in this chapter, have been used in analysing the financial statements of companies under study for the period 2005–06 to 2009–10 in the Part II of this book. For this purpose, the data has been obtained from the Annual Reports of the evaluated companies.

Part II
Corporate Cases

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4

Construction Sector

Hindustan Construction Company vs Larsen & Toubro

The construction sector comprises the infrastructure and real estate sectors. In this chapter, we present the analyses of the financial statements of two companies from the infrastructure sector, Larsen & Toubro Ltd (L&T), a multinational conglomerate and one of the largest companies in India's private sector, and the Hindustan Construction Company (HCC), a leading Indian company in the infrastructure industry.

After successfully tiding over the recession, the Indian economy has been progressing exponentially, with the growth expected to touch the double digit mark in the next few years. This will result in rapidly increasing infrastructure spending, expected to cross INR 22,00,000 crore (US$ 400 billion). But the infrastructure sector should grow at the Compound Annual Growth Rate (CAGR)[1] of 15 per cent if it has to meet the requirements of the other sectors. For sustained economic development, the growth of this sector is imperative; yet, in our country, millions still lack the access to basic infrastructure facilities, such as transport, communication, electricity and clean drinking water. This gap has to be bridged if India wants to feature into the next league among developed nations. The 11th Five Year Plan (2007–12) had planned to increase the Gross Domestic Product (GDP),[2] in infrastructure, from around 5 per cent to 9 per cent by 2012. The 12th Five Year Plan (2012–17) has also envisaged a spending of INR 55,00,000 crore (US$ 1 trillion) in the infrastructure sector.

The main areas of focus in the infrastructure sector will be on roads and bridges, railways, seaports, airports, inland waterways, power, urban transport, solid waste management, water supply, and setting up of Special Economic Zones (SEZ).[3] One hundred per cent foreign direct investment (FDI)[4] is permitted in infrastructure services while

services under the aviation sector are permitted 49–100 per cent. The government has also introduced the Public–Private Partnership (PPP)[5] in the infrastructure sector to combine the best practices of both sectors. The company awarded the contract will be selected by a transparent and open bidding process.

In the coming years, the Government of India has envisaged maximum investment in the power sector, followed by railways and highways. This provides a great opportunity for the private infrastructure companies to expand their operations and be a part of this exponential growth.

A Brief Introduction to the Companies

Hindustan Construction Company (HCC),[6] founded in 1926, is an infrastructure company based in Mumbai, India. Part of the Walchand–Gulabchand Group, it is headed by Ajit Gulabchand, the Chairman and Managing Director. A company with a market cap of INR 36,240 million (US$ 659 million approx.), HCC has projects that span across diverse segments such as transportation, power, marine projects, oil and gas pipeline constructions, irrigation and water supply, and utilities and urban infrastructure. The company specialises in large-scale civil engineering and developing construction technologies and, for over eight decades, they have been a part of prestigious projects across various verticals, building everything from roads and bridges to dams and barrages, nuclear power generators and tunnels and metros. Some of their major projects include:

(*a*) Bandra–Worli Sea Link, Mumbai
(*b*) Ennore Breakwaters, Tamil Nadu
(*c*) Godavari Rail Bridge, Andhra Pradesh
(*d*) Nathpa Jhakri Hydro-electric Project — Construction of head race tunnel and surge shaft, with Impregilo SPA
(*e*) Naini — Allahabad Bridge: One of the first cable-stayed bridges across the River Yamuna, India, with Hyundai Engineering and Construction
(*f*) Delhi Metro Project — Underground Metro Corridor with Kumagaigumi Co. Limited, Japan, Skanska AB, Sweden, and Itochu Corporation, Japan
(*g*) East-West Road Corridor Project in Rajasthan, with M/s. Continental Engineering Corporation, Taiwan
(*h*) Lavasa Hill City, Pune

Larsen & Toubro (L&T)[7] was founded in 1938 in Mumbai, by Henning Holck-Larsen and Soren Kristian Toubro. Currently headed by A.M. Naik, Chairman, and K. Venkataramanan, Chief Executive Officer and Managing Director, L&T specialises in the implementation of turnkey projects in core infrastructure sectors in India. Their various divisions include:

(*a*) Engineering & Construction Projects (E&C)
(*b*) Construction
(*c*) Heavy Engineering (HED)
(*d*) Power
(*e*) Electrical & Electronics (EBG)
(*f*) Machinery & Industrial Products (MIPD)
(*g*) Railway Projects

It also has subsidiaries in Information Technology and Finance.

The company has a market cap of INR 111,0641 million and has been involved in several projects including:

(*a*) Hydrocarbon projects executed in India, the Middle East and South East Asia
(*b*) Power projects in India, the Gulf and Sri Lanka.
(*c*) The world's largest coal gasifier, made in India and exported to China
(*d*) The world's biggest ethylene oxide (EO) reactor for a petrochemical complex in the Gulf
(*e*) The world's largest fluid catalytic cracking (FCC) regenerator for a refinery
(*f*) Asia's highest viaduct
(*g*) The world's longest limestone conveyor

L&T also played a critical role in building India's first nuclear-powered submarine as well as the country's maiden moon mission.

Comparison of HCC and L&T

Profitability

For comparing the profitability of these companies (see Table 4.1), the parameters to be looked (in the infrastructure industry) are:

(*a*) Cash Operating Profit Ratio (COPR) — the ratio of EBITDA to net sales of a firm. It denotes the cash operating profit capacity of a firm.
(*b*) Operating Profit Ratio (OPR) — the ratio of EBIT to net sales of a firm. It signifies the core profit capacity of a firm.
(*c*) Net Profit Margin (NPM) — the ratio of PAT to net sales of a firm. It indicates the total profit earning capacity of a firm.
(*d*) Operating Ratio (OR) — the ratio of Operating expenses to net sales of a firm. It indicates the efficiency of a firm in regard to operating expenses coverage.

(*Note*: They all are expressed in percentage.)

Table 4.1: Profitability Analysis

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
(*i*) Cash Operating Profit Ratio						
HCC	13.05	15.79	13.68	12.35	12.48	11.48
L&T	19.01	16.14	14.10	13.08	11.27	11.37
Industry	13.07	13.11	15.16	13.61	12.08	12.62
(*ii*) Operating Profit Ratio						
HCC	9.93	12.32	10.55	8.98	9.83	8.45
L&T	17.97	15.30	13.32	12.17	10.54	10.72
Industry	10.18	10.25	12.04	10.7	8.95	10.03
(*iii*) Net Profit Margin						
HCC	2.23	3.78	3.52	1.55	6.28	5.04
L&T	11.81	10.27	8.7	7.97	6.86	7.4
Industry	2.5	2.52	4.04	3.83	2.20	6.28
(*iv*) Operating Ratio						
HCC	90.06	87.68	89.44	91.01	90.16	91.56
L&T	82.02	84.70	86.68	87.83	89.45	89.28
Industry	89.82	89.75	87.95	89.30	91.05	89.96

Analysis:

(*a*) The OPR margin and net profit margin for HCC is below the industry average, which is a cause of concern.

(*b*) L&T has high COPR, OPR as well as NPR. Thus, L&T is a high profit making company as compared to its peers, including HCC.

HCC's OPR is higher than the industry's, which is not a good sign as operating margin indicates the efficiency in terms of expenses coverage. It should be on the lower side, whereas PAT margin should be as high as possible. But HCC has a lower NPM as compared to industry. L&T excels here in higher profitability as well as lower expenses, vis-à-vis the industry and HCC. Therefore, it has shown a better performance.

Return on investments (ROI) and Return on equity (ROE) are discussed in Tables 4.2 and 4.3. Du-Pont Analysis has been given in Tables 4.4 and 4.5, while a graphical representation of the same is shown in Figures 4.1 and 4.2, respectively.

Table 4.2: Return on Investment (ROI)

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
HCC	9.84	11.17	12.27	9.33	10.46	18.42
L&T	23.85	26.89	31.82	30.92	24.16	22.12
Industry	13.91	13.23	13.87	12.76	14.16	15.99

Analysis:

(*a*) L&T is the clear winner in terms of ROI, which has been consistently above the industry average for the last six years.

(*b*) However, HCC's ROI has been lower than the industry average for the last five years — indicating a poor use of the capital employed. A detailed study of efficiency of operations, demand for products and utilisation of resources is required to improve sales, reduce costs and improve overall profitability.

Table 4.3: Return on Equity (ROE/RONW)

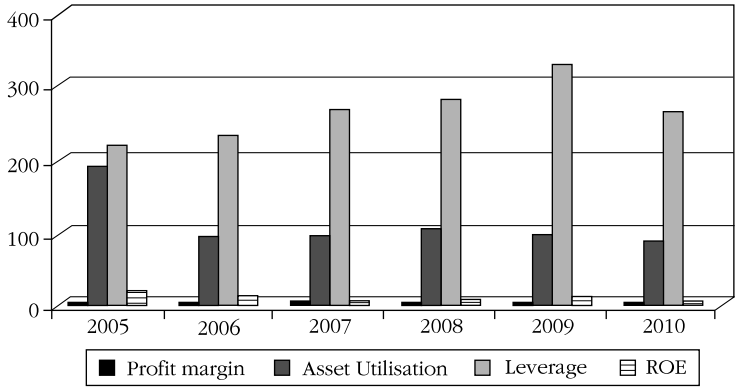
	2010	*2009*	*2008*	*2007*	*2006*	*2005*
HCC	5.36	12.47	10.83	4.06	14.03	21.25
L&T	23.89	27.94	22.75	24.32	21.81	29.20
Industry	14.52	13.3	14.4	11.55	16.81	17.23

Table 4.4: Du-Pont Analysis of HCC

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
1) PAT/Sales (%)	2.23	3.78	3.52	1.56	6.28	5.04
2) Sales/Total Assets (%)	90.39	99.61	108.2	96.02	95.27	191.01
3) Total Assets/Shareholders' equity (%)	265.74	331.06	283.74	271.56	234.39	220.59
1 × 2 × 3 (%)	5.37	12.47	10.83	4.06	14.03	21.25

Note: Du-Pont analysis:
ROE = Profit after taxes (PAT)/Shareholders' equity = PAT/Sales × Sales/Total Assets × Total Assets/Shareholders' equity

Figure 4.1: Du-Pont Analysis of HCC



Analysis:

(*a*) The ROE has decreased in the last six years. This is quite negative signal to equity shareholders as this affects the outlook towards the company in a big way. The reasons for this decrease are given in the Du-Pont analysis. ROE is an indicator of the shareholders' wealth maximisation. Any decrease indicates a decline of the shareholders' wealth in the company.

(*b*) Decrease in asset utilisation is the main reason for the fall in ROE. From 191 per cent in 2005, the sales/total assets ratio reduced to 90 per cent in 2010 (almost half of what it was in 2005).

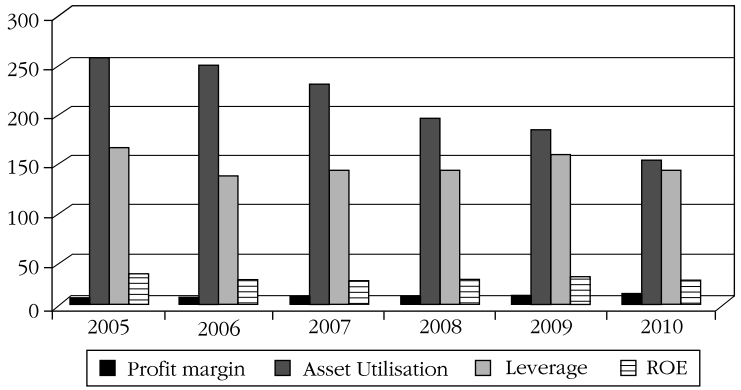
(*c*) Similarly, the net profit margin also reduced from over 5 per cent in 2005 to just over 2 per cent in 2010 — calling for a review of the efficiency of operations by the company.

(*d*) HCC has a high financial leverage ratio. Its fixed assets are more than double the total shareholders' equity. This indicates that it relies extensively on debts to finance its activities — all the more reason to improve profitability and efficiency as debt is a risky and costly fund.

Table 4.5: Du-Pont Analysis of L&T

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
i) PAT/Sales (%)	11.82	10.27	8.7	7.8	6.87	7.48
ii) Sales/Total Assets (%)	147.39	178.32	190.12	224.32	241.9	251.46
iii) Total Assets/Shareholders' equity (%)	137.14	152.62	137.5	136.02	131.33	155.18
1 × 2 × 3 (%)	23.90	27.94	22.75	24.32	21.81	29.20

Figure 4.2: Du-Pont Analysis of L&T



Analysis:

(*a*) L&T has a very healthy ROE even though it has decreased from 29 per cent in 2005 to nearly 23.9 per cent in 2010. In spite of this decrease, L&T remains a high returns' company for equity shareholders. The breakup of ROE by the Du-Pont analysis helps us understand the driving factors behind the changes in ROE.

(*b*) The Asset Utilisation Ratio has decreased from 251 per cent in 2005 to nearly 150 per cent in 2010. This can be attributed to two factors — decrease in efficiency of operations or reduction in orders due to slump in demand.

(*c*) From the order to book ratio, we know that orders decreased during the period of 2007–09. Thus, the decrease in asset utilisation could be because of a lack of projects to complete. Nonetheless, L&T should concentrate on better efficiency in asset utilisation as well as getting more orders to improve order to book ratio.

(*d*) The leverage ratio is at 137 per cent, which means that debt financing is at acceptable levels. Also, if the need arises, it can raise further debts.

(*e*) The Net Profit Margin has increased to around 11 per cent, much above the industry average of 2.5 per cent. Thus, in terms of profitability and ROE, the outlook on L&T is very positive.

Asset Utilisation and Working Capital Efficiency

Fixed Assets Efficiency

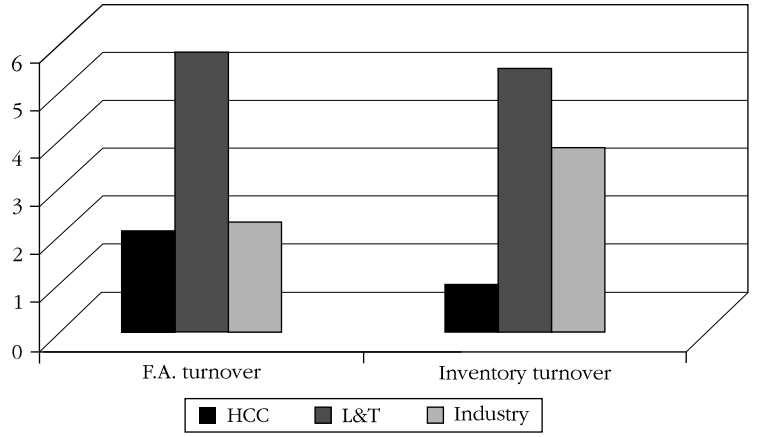
(*a*) Fixed Asset Turnover Ratio
(*b*) Inventory Turnover Ratio
(*c*) Inventory Holding Period

The fixed assets' utilisation and their efficiency of select companies are given in Table 4.6 and Figure 4.3.

Table 4.6: Fixed Assets' Utilisation

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
(*i*) Fixed Asset Turnover Ratio						
HCC	2.08	2.14	2.46	2.52	2.85	2.54
L&T	5.82	7.04	7.2	7.01	6.9	6.54
Industry	2.28	2.8	3.07	2.95	2.64	2.2
(*ii*) Inventory Turnover Ratio						
HCC	1	1.15	1.41	1.51	2.12	2.54
L&T	5.52	6.78	6.93	6.88	6.71	6.56
Industry	3.86	3.09	2.9	3.01	4.56	5.09
(*iii*) Average Inventory Holding Period						
HCC	365	317	258	241	172	161
L&T	66	54	53	53	54	55
Industry	95	118	126	121	123	72

Figure 4.3: Fixed Assets' Utilisation



Analysis:

(*a*) In terms of fixed asset utilisation as well as inventory turnover, L&T is ahead of both HCC and the industry average.
(*b*) HCC has to improve its efficiency of utilising its assets to gain maximum productivity from them. Furthermore, HCC needs to look into its inventory management system and restructure the purchase and utilisation of inventory. Its inventory holding period is much higher than the industry average of 95 days. This increases losses due to obsolescence and increases costs on storage.
(*c*) L&T not only has a holding period of 66 days, which is lower than industry average, but it also has a sufficient margin period to purchase inventory in a situation of sudden shortage.

Debtors Management

(*a*) Debtors Turnover Ratio
(*b*) Average Collection Period (Days)
(*c*) Average Payment Period (Days)

Debtors' efficiency of select companies is given in Table 4.7 and Figures 4.4 and 4.5, respectively.

Table 4.7: Debtors' Management

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
(*i*) DTR						
HCC	990.27	723.23	1235.58	673.55	680.7	742.41
L&T	3.54	3.97	3.93	3.48	3.39	3.64
Industry	5.25	5.24	5.86	5.83	5.80	5.64
(*ii*) Average Collection Period						
HCC	0	0	0	0	0	0
L&T	103	91	81	78	74	71
Industry	70	70	62	62	63	65
(*iii*) Average Payment Period						
HCC	128	113	108	103	92	82
L&T	126	117	101	92	88	83
Industry (NA)						

Figure 4.4: Debtors' Turnover

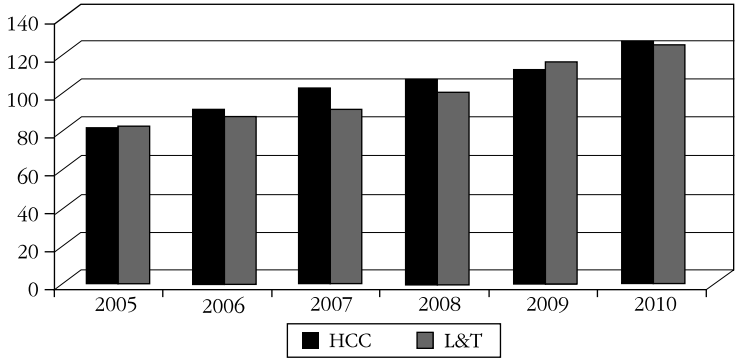
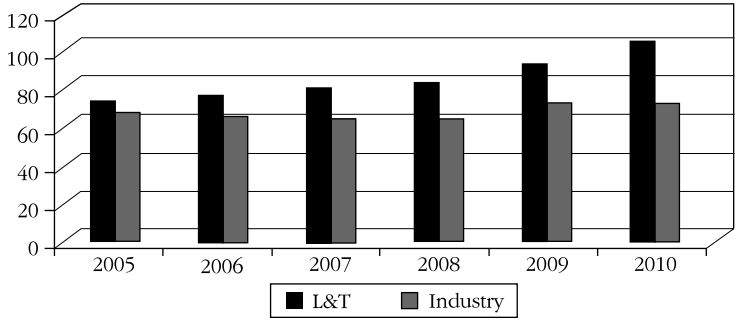


Figure 4.5: Average Payment Period



Analysis:

(*a*) The comparison of the average collection period for HCC and L&T is not relevant here because both companies have entirely different styles of functioning in sales. HCC has almost a zero collection period due to a high debtors' turnover ratio.

(*b*) L&T, on the other hand, is a very large company which has big customers and massive projects, and allows its customers flexibility to make payments. However, its average collection period is much higher than the industry average, which is a cause of concern. Average collection period should be as low as possible as it determines the efficiency of a company to collect its payments from customers. But L&T's higher collection period (in terms of days) indicates a lack of efficiency. This has a direct impact on the liquidity of the company. Therefore, L&T should put more emphasis towards a faster realisation of payments from customers.

(*c*) The average payment period of L&T is higher than its collection period, which is good, but it is still lower than HCC — which has a negligible collection period and a high payment period.

(*d*) Thus, as far as collections and payments are concerned, HCC is ahead of L&T. But, this is largely negated by its inefficient use of resources.

Liquidity and Solvency

The liquidity and solvency of the companies (see Table 4.8 and Figure 4.6) can be determined by the following parameters:

(*a*) Current Ratio (CR)
(*b*) Long-term Debt-Equity Ratio (D/E)
(*c*) Interest Coverage Ratio (ICR)
(*d*) Debt-Service Coverage Ratio (DSCR)

Table 4.8: Liquidity Trend

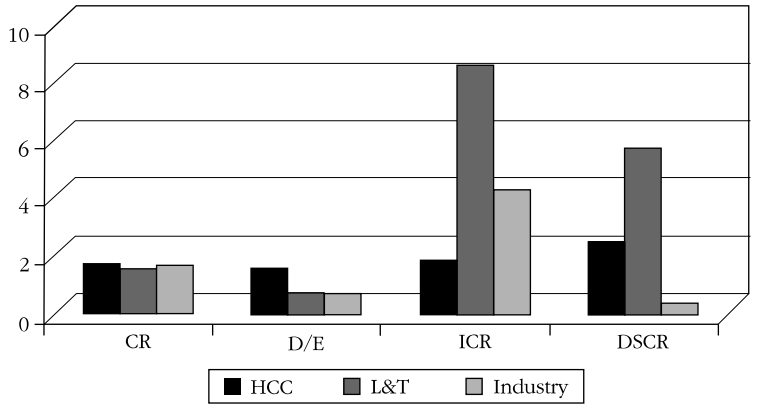
	2010	*2009*	*2008*	*2007*	*2006*	*2005*
(*i*) CR						
HCC	1.38	1.38	1.38	1.49	1.4	1.05
L&T	1.22	1.16	1.14	1.23	1.35	1.35
Industry	1.3	1.25	1.24	1.31	1.36	1.35

Table 4.8: (*Continued*)

Table 4.8: (*Continued*)

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
(*ii*) D/E						
HCC	1.25	1.38	1.08	0.95	0.85	1.17
L&T	0.37	0.37	0.26	0.25	0.31	0.35
Industry	0.38	0.35	0.25	0.24	0.30	0.31
(*iii*) ICR						
HCC	1.51	1.42	1.92	2.26	2.62	2.49
L&T	8.24	9.03	19.17	15.56	7.85	8
Industry	3.91	7.09	11.86	11.12	7.2	7.65
(*iv*) DSCR						
HCC	2.15	0.72	0	0	0	38.6
L&T	5.4	5.19	27.04	3.99	5.22	0.11
Industry (NA)						

Figure 4.6: Liquidity Trend



Analysis:

(*a*) L&T had a good D/E ratio, more or less similar to the industry average. However, HCC had a very high D/E ratio (over both L&T and the industry), that is, they depend too much on external funding for their financing requirements. Also, most of its cash inflows are from financing activities and its cash from operations is not sufficient to cover its liabilities. Thus, HCC needs to focus on increasing its profitability by scaling in operations as well as improving operational efficiency.

(*b*) HCC outdid L&T and the industry average, by a small margin, in liquidity ratios. L&T's low liquidity ratio is due to the fact that its average collection period is very high when compared to HCC.

(*c*) In terms of covering its interests and capital borrowed, L&T was ahead of both HCC and the industry average by a large margin, because of its high Interest ICR and DSCR. This can be attributed to the high profitability of L&T. Thus, a banker would like to lend capital to L&T rather than any other company.

Cash Flow Position

The cash flow analysis of the companies is discussed in Tables 4.9 and 4.10, respectively. Their trend is depicted in Figure 4.7.

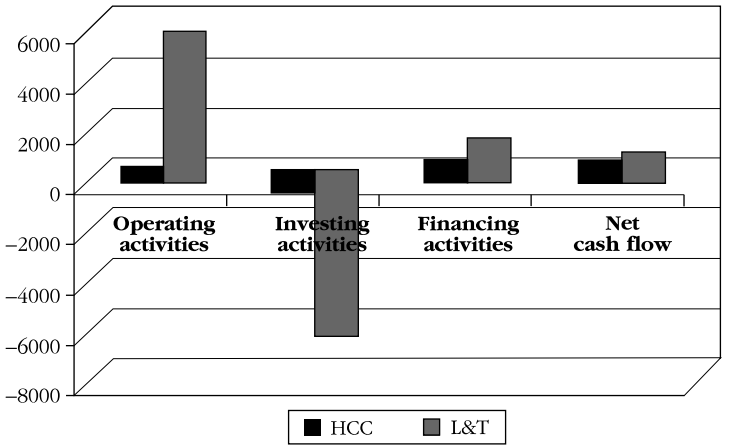
Table 4.9: Cash Flow Analysis of HCC (INR in million)

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
Cash & Cash equivalents at the beginning of period	1534	2643	2083	10060	874	408
Cash flow from operating activities	568	1046	1821	–5674	–1030	2169
Cash flow from investing activities	–4144	–3082	–2879	–4872	–1190	–2491
Cash flows from financing activities	3921	932	–1608	2599	11408	789
Net cash flow	344	–1104	549	–7949	9185	488
Cash & Cash equivalents at the end of period	1883	1539	2633	2111	10060	874

Table 4.10: Cash Flow Analysis of L&T (INR in million)

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
Cash & Cash equivalents at the beginning of period	7752	9644	10944	5832	8280	3752
Cash flow from operating activities	54828	14786	19452	21304	13692	1120
Cash flow from investing activities	–60718	–33086	–52419	–15881	–13263	2362
Cash flows from financing activities	12456	16408	31667	–310	–2878	1044
Net cash flow	6565	–1891	–1279	5112	–2449	4528
Cash & Cash equivalents at the end of period	14319	7752	9644	10944	5832	8280

Figure 4.7: Cash Flow Trend



Analysis:

(*a*) L&T generates most of the cash from operating activities. This is a very healthy cash flow because cash from operations usually takes care of investing activities, leading to future benefits. The proportion of financial inflow of cash to total inflow is low, which is a good sign as the major financing is done by operations while only a part is dependent on external finance.

(*b*) HCC generates most of its cash inflow from financing activities. Its operational inflows are not sufficient to cover its investing activities. Thus, HCC does not have a healthy cash flow.

Market Performance

The market performance of the companies (on various parameters) is discussed in Tables 4.11, 4.12, 4.13 and 4.14, respectively. The trend is given in Figure 4.8.

Table 4.11: Earnings Per Share (EPS)

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
HCC	2.55	4.75	4.11	1.31	4.77	31.43
L&T	70.83	57.11	71.73	47.65	70.58	71.94

Table 4.12: Price/Earnings Ratio

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
HCC	52.55	8.25	32.12	68.28	36.3	15.23
L&T	22.96	11.68	42.17	33.98	34.47	13.83

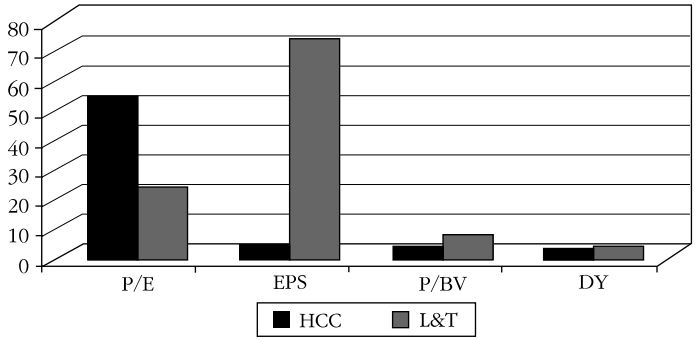
Table 4.13: Price/Book Value

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
HCC	2.68	1.05	3.42	2.54	4.99	3.11
L&T	5.36	3.17	9.28	7.99	7.25	3.87

Table 4.14: Dividend Yield (DY)

	2010	*2009*	*2008*	*2007*	*2006*	*2005*
HCC	1.19	4.08	1.21	1.68	0.81	25.06
L&T	0.77	1.56	1.12	1.61	3.62	11.05

Figure 4.8: Market Trend



Analysis:

(*a*) Earnings per share of L&T has been very good (compared to HCC's) and has increased in the 2010 financial year ending while HCC's has reduced considerably, which points to some significant problems in terms of profit generation. EPS indicates the profit available to a shareholder. HCC's earnings had reduced at alarmingly (nearly 90 per cent) from INR 31.43 to INR 2.55 per share, signifying a decline in the potential of the company.

(*b*) The Price to Earnings ratio is very high in the case of HCC, as compared to L&T, throughout the five-year period. In the last year, due to a dip in Earnings, the valuation of HCC seems to be very high.

(*c*) However, the Price to Book Value and Dividend Yield tell a different story. HCC seems to be a bit undervalued in comparison with L&T. But, the EPS and the P/E show that both in the short- and long-term, L&T is a better bet, as investors from a long-term perspective look at growth and returns, not dividends. Furthermore, for short-term investors, HCC's volatility is a deterrent.

Expansion Plans: Gross Block

The gross block of any construction company is indicative of that company's expansion plans for the future. It is discussed with the help of Table 4.15 and Figure 4.9.

Table 4.15: Gross Block Picture (INR in million)

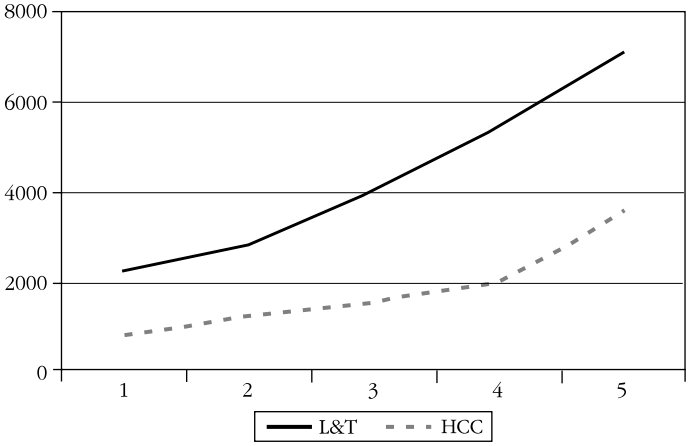
	2006	*2007*	*2008*	*2009*	*2010*
Expansion in terms of Gross Block					
L&T	22729	28408	40969	54341	70931
HCC	8057	12398	15799	20126	35714

We can see that both L&T and HCC have substantially increased their respective gross blocks, as both companies are focusing on future growth. However, the expansion must come at the right time along with an increase in operating revenue and profits. L&T scores high in this case. They had been building there gross block over the years; fixed assets' investment (on a continuous basis) signals expansion and growth plans of a company. But, HCC's expansion has been fairly risky, using huge debt and tremendously under utilising its assets.

Conclusion

In terms of efficiency of operations and profit margins (Operating and Net), HCC scores low, while L&T is far ahead of the industry average.

Figure 4.9: Expansion of Gross Block



(*a*) Asset utilisation is one of the major concerns for HCC. Its gross block has increased substantially, yet its asset utilisation has decreased, indicating speculative buying of assets in lieu of future business. This is not an issue otherwise, but in the case of HCC, it has raised a large amount of debt leading to a high leverage ratio, which is worrying.

(*b*) L&T has also declined in terms of asset utilisation due to an increase in assets but a decrease in the rate of order inflows and a smaller order to book ratio.

(*c*) In terms of solvency, L&T is more than capable of repaying its interest and debt capital.

(*d*) Liquidity ratio indicates that HCC is a head of L&T. This is due to L&T's long collection periods, which are higher than the industry average. This is a risk that L&T should avoid.

(*e*) HCC's inventory holding period is much higher than the industry average, which has to be reduced to improve efficiency.

(*f*) Investors' outlook:

L&T — High EPS, ROE and ROI indicate a positive outlook from the investing point of view. A high P/E and P/BV ratio is indicative of overpricing. Furthermore, due to a low BETA[8] and a high EPS, L&T looks like a good investment option in the short-term as well as in the long-term.

HCC — Low EPS, ROE, and ROI is a cause of concern for current as well as future investors. High P/E ratio due to decrease in earnings is indicative of a highly overpriced market rate per share. A high BETA shows uncertainty and volatility. Thus, investors will shy away from investing in HCC. The company has to improve on all these fronts because it needs equity more than L&T to improve its leverage ratio, D/E ratio & solvency. Also, L&T is already an established company and market leader while HCC is a smaller company which has big expansion and growth plans. Hence, HCC's requirement to raise new funds is much higher than L&T.

(*g*) In the larger perspective, HCC, L&T and the construction sector in general have strong growth potential, as India moves towards developing world-class infrastructure.

(*h*) The country's core sector, comprising six key infrastructure industries, is growing rapidly, accelerating by 5.1 per cent. Therefore, there is a huge opportunity for both companies to expand.

(*i*) While HCC's debt has been growing, their sales have not, at the same pace. It should increase its FA turnover by taking up projects that can be executed quickly.

(*j*) L&T should continue with its current strategy as that seems to be paying dividends. However, the company should consider a few strategic acquisitions as it has sizeable reserves.

Annexure 4.1

Significant Accounting Policies

HCC

Basis of Accounting

The company maintains its accounts on accrual basis. Management makes estimates and technical and other assumptions regarding the amounts of income and expenses in accordance with the Generally Accepted Accounting Principles (GAAP) in its preparation of financial statements. Difference between the actual results and estimates are recognised in the period in which they are determined.

Fixed Assets

Fixed assets are stated at cost of acquisition including attributable interest and financial costs till the date of acquisition/installation of the assets and improvement thereon less accumulated depreciation/amortisation. Intangible assets comprise license fees, other implementation cost for software (ERP) and other application software acquired for in-house use.

Investments

Investments are classified as long-term and current investments. Long-term investments are shown at cost or written down value (in case of other than temporary diminution) and current investments are shown at cost or market value, whichever is lower.

Accounting of Construction Contracts

The company follows the percentage completion method. Based on the stage of completion of the balance sheet date taking into account, the contractual price and revision thereto, by estimating total revenue and total cost till completion of the contract and the profit so determined, has been accounted for, proportionate to the percentage of the actual work done.

Revenue Recognition

(*a*) In case of item rate contracts, revenue is recognised on the basis of physical measurement of work actually completed at the balance sheet date.

(*b*) In case of lump sum contracts, revenue is recognised on the completion of milestones as specified in the contract or as identified by the management.

(*c*) Foreseeable losses are accounted for as and when they are determined except to the extent they are expected to be recovered through claims presented or to be presented to the customer or in arbitration.

(*d*) Claims are accounted as income in the year of receipt of arbitration award or acceptance by client or evidence of acceptance received.

Taxation

The tax expense comprises current tax and deferred tax charged or credited to the profit and loss account for the year. Current tax is calculated in accordance with the tax laws applicable to the current financial year. The deferred tax charge or credit is recognised using the tax rates and tax laws that have been enacted by the balance sheet date. Where there are unabsorbed depreciation or carry forward losses, deferred tax assets are recognised only if there is virtual certainty of realisation of such assets.

Other deferred tax assets are recognised only to the extent there is reasonable certainty of realisation in future. At each balance sheet date, recognised and unrecognised deferred tax assets are reviewed.

L&T

Basis of Accounting

The company maintains its accounts on accrual basis following the historical cost convention in accordance with generally accepted accounting principles (GAAP) except for the revaluation of certain fixed assets.

Revenue Recognition

Revenue is recognised based on nature of activity when consideration can be reasonably measured and there exists reasonable certainty of its recovery.

Research and Development

Revenue expenditure on research and development is charged under respective heads of account in the year in which it is incurred. Capital expenditure on research and development is included as part of fixed assets and depreciated on the same basis as other fixed assets.

Fixed Assets

Fixed assets are stated at original cost minus accumulated depreciation and those revalued on 1 October 1984. Assets acquired on hire purchase basis are stated at their cash values. Administrative and other general overhead expenses, which are specifically attributable to construction or acquisition of fixed assets or bringing the fixed assets to working condition, are allocated and capitalised as a part of the cost of the fixed assets.

Investments

Long-term investments including interests in incorporated jointly controlled entities, are carried at cost, after providing for any diminution in value, if such diminution is of permanent nature. Current investments are carried at lower of cost or market value. The determination of carrying amount of such investments is done on the basis of specific identification. Investments in integrated joint ventures are carried at cost net of adjustments for the company's share in profits or losses as recognised.

Taxation

The tax expense comprises current tax and deferred tax charged or credited to the profit and loss account for the year. Current tax is calculated in

accordance with the tax laws applicable to the current financial year. The deferred tax charge or credit is recognised using the tax rates and tax laws that have been enacted by the balance sheet date. Where there are unabsorbed depreciation or carry forward losses, deferred tax assets are recognised only if there is virtual certainty of realisation of such assets. Other deferred tax assets are recognised only to the extent there is reasonable certainty of realisation in future. At each balance sheet date, recognised and unrecognised deferred tax assets are reviewed.

5

Power Sector

NTPC Limited vs TATA Power

India is the world's sixth largest energy consumer, accounting for 3.4 per cent of global energy consumption. The Government of India is working hard on its ambitious mission of 'Power for All' by 2012; with expected bottlenecks. It had an installed generation capacity of at least 200,000 MW and double to 400,000 MW by 2020. With rising population, the need for a fast-paced development in power generation is increasingly becoming important. Energy is one of the major contributors to the economic development of a country and the demand for electricity is growing exponentially. And, herein are the opportunities for investors to capitalise, in both public and private sector companies. This chapter analyses two companies in the power sector — NTPC Limited and TATA Power.

A Brief Introduction to the Companies

NTPC Limited

NTPC Limited (henceforth NTPC) is the largest state-owned, power-generating company in India, listed on the Bombay Stock Exchange (as public sector) although, at present, the Government of India holds 84.5 per cent (after divestment on 19 October 2009) of its equity.

NTPC's core business is engineering, construction and operation of power-generating plants and providing consultancy to power utilities in India and abroad. Among the biggest and best-performing power generation companies in the world, NTPC has already set up a 32,194 MW capacity. By 2032, it plans to have total capacity of 1,28,000 MW. While the company has 20 per cent market share of installed capacity in India through its higher capacity utilisation levels, compared to those of other power-generating companies, it produces 30 per cent of India's total electricity generation.

With a market cap of over INR 16,00,000 million, the company has remained among the top five Indian companies (in terms of market

capitalisation), which underlines its high-value market position. The company has been investing in technology and innovation, focusing on efficiency, environment and economical generation of power. It has been accorded the status of 'Maharatna'[1] by the Government of India, a recognition of its globally comparable stature, strength and potential, with enhanced powers to expand its operations in both domestic and global markets.

TATA Power

TATA Power Company Limited (TPC), India's largest integrated Electric Power Utility (EPU) in the private sector with a reputation for reliability, incorporated in the year 1919 at Mumbai. TPC pioneered the generation of electricity in India nine decades ago. Their core business is to generate, transmit and distribute electricity; the power business is a mix of thermal, hydro-power and wind power. The company (through its subsidiaries) is engaged in the generation, transmission–distribution and sale of electricity in the states of Maharashtra, Jharkhand and Karnataka in India. It holds the generation capacity of 2,986 MW and after the completion of on-going projects it will increase to 8,411 MW by year 2013. TPC supplies power to bulk consumers, such as Central and Western Railways, Mumbai port, refineries, textile mills, fertiliser factories, Bhabha Atomic Research Centre (BARC), municipal corporation water pumping plants, and other continuous processes industries requiring uninterrupted power supply.

Analysis of Financial Statements

Profit and Loss Account Analysis

NTPC Limited and TATA Power's profitability picture is given in Tables 5.1 and 5.2, respectively.

Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA)

EBITDA is an indicator of a company's financial performance. EBITDA is essentially net income with interest, taxes, depreciation, and amortisation and can be used to analyse and compare profitability between companies and industries because it eliminates the effects of financing and accounting decisions. A common misconception is that EBITDA represents cash earnings but it is simply a good metric to evaluate profitability, but not cash flow. EBITDA also

Table 5.1: Profitability Statement — NTPC Limited

Year	*Total Income from Operations*	*Total Cost of Production*	*EBITDA*	*EBIT*	*Profit before Tax*	*Profit after Tax*	*Operating Ratio*
2009–10	4,63,778	3,39,906	1,53,446	1,26,944	1,08,856	87,399	73.29
2008–09	4,19,752	3,15,941	1,37,202	1,13,558	93,596	82,214	75.26
2007–08	3,70,910	2,58,658	1,43,170	1,21,786	1,02,549	74,233	69.74
2006–07	3,26,318	2,25,683	1,29,649	1,08,896	89,074	68,719	69.16

Note: 1. All figures are in INR million except Operating Ratio.
2. Operating Ratio is in number of times.

Table 5.2: Profitability Statement — TATA Power

Year	*Total Income from Operations*	*Total Cost of Production*	*EBITDA*	*EBIT*	*Profit before Tax*	*Profit after Tax*	*Operating Ratio*
2009–10	70,982	52,197	21,601	17,372	12,681	9,477	70.72
2008–09	72,577	61,279	17,807	14,549	11,376	9,222	77.47
2007–08	59,098	49,751	14,514	12,797	10,162	8,699	77.41
2006–07	49,187	42,084	10,776	8,904	7,669	6,969	79.62

Notes: 1. All figures are in INR million except Operating Ratio.
2. Operating Ratio is in number of times.

leaves out the cash required to fund working capital and the replacement of old equipment, which can be significant. It is a major yardstick for any firm's operating profit, realised in cash. Therefore, higher EBITDA is an indication of a firm's efficiency and prosperity regarding cash surplus for both capital investment and working capital operations. Consequently, EBITDA is often used as an accounting tool to 'dress up' a company's earnings.

The EBITDA of NTPC had increased by 15.5 per cent for the year 2009–10 and was approximated to be equal to INR 1,53,446 million. There was a decrease in the EBITDA for the year 2008–09, primarily due to the increase in the cost of production. However, NTPC was able to decrease the cost of production in the following year. The EBITDA of TPC, on the other hand, had been increasing continuously through the period of 2005–06 to 2009–10, 23 per cent during the latter period. An increase was noticed in the cost of production for both the companies during the year 2008–09, due to an increase in the cost of raw materials. However TPC outperformed NTPC, during the year, with a greater percentage increase in revenue; hence, the EBITDA did not decrease during the year. The ratio of administration costs to the revenue is also less in the case of TATA power — which means that there is greater managerial efficiency in TATA Power.

Earnings before Interest and Taxes (EBIT)

EBIT is an indicator of a company's profitability. It is calculated as revenue minus expenses, excluding tax and interest. An important factor contributing to the widespread use of EBIT is the way in which it nulls the effects of the different capital structures and tax rates, used by various companies. By excluding both taxes and interest expenses, the figure hones in on the company's ability to profit and, thus, makes for easier cross-company comparisons. EBIT was the precursor to EBITDA, which takes the process further by removing two non-cash items (depreciation and amortisation) from the equation.

The EBIT of NTPC increased from INR 1,13,558 million in 2008–09 to INR 1,26,944 million in the year 2009–10. There was an approximately 15 per cent increase in EBIT. However, there was a decrease in EBIT during the year 2008–09. As mentioned earlier, this was due to the increase in the price of raw materials. The depreciation charged by NTPC during the period 2005–08 was more or less constant but there was an increase in the depreciation charged during

the financial year 2009–10, due to an increase in the gross block. The depreciation amounts to INR 26,501 million for the year 2009–10.

The EBIT for TATA Power had been increasing continuously during the period 2005–10, from INR 14,549 million, in 2008–09, to INR 17,372 million, in 2009–10 — an increase of about 20.63 per cent in the latter period. There has also been a constant increase in the amount of depreciation for TATA Power during the period 2005–10, due to the expansion that has taken place and because of the increase in gross block. The depreciation amounts to INR 4,779 million for the year 2009–10.

Profit after Tax (PAT)

There has been a steady increase in PAT of NTPC during the period 2005–10. The PAT for the year 2009–10 amounted to INR 87,399 million. While the company witnessed a greater increase in PAT in the previous years, there was an increase of 6.08 per cent in the value of PAT for the same year.

There has also been a constant increase in PAT of TATA Power during the period 2005–10. the amount for the year 2009–10 was INR 9,477 million and there was an increase of 2.63 per cent in the PAT value. The company witnessed very high growth during the year 2007–08, approximately equal to 25 per cent. Since then, there has been little increase in the PAT in the following years.

Balance Sheet Analysis

NTPC's and TATA Power's balance sheet figures are given in Table 5.3 and 5.4.

NTPC

The net equity of NTPC has remained the same during the period of 2005–06 to 2009–10. There has been no preference share been allotted by the NTPC. There has also been a constant increase in the reserves, which is because the company has been making continuous profit during the period 2005–10. The net worth of the company has been increasing continuously in the same period in accordance to the profit earned. The company has been declaring dividends at a constant percentage of PAT and, hence, the same percentage has been added to the reserves each year. The net worth of the company increased to INR 7,32,910 million in 2012 from INR 4,49,486 million in 2005.

The company has not issued any debenture and the only debt the company has taken is in the form of loans. The total debt of the company increased between 2005 to 2010, primarily because the company kept expanding during this period. The company has been taking debt in accordance to the net worth since the debt to equity ratio has remained the same (approximately) during the years.

The long-term assets or the Gross Block (GB) of the company has been increasing at a constant rate, ratifying the company's expansion. The net block (that is gross block minus accumulated depreciation) has increased to INR 3,47,613 million in 2010 from INR 2,29,676 million in 2005. The inventory (of the company) has been increasing but the percentage increase is in accordance with the operating revenue.

Sundry debtors have also been increasing at a rate that corresponds with the net sales. However, these debtors increased considerably for the period 2009–10, from INR 8,679 million in 2005 to INR 66,514 million in 2010. But there have been no changes in the net sales and so the company has to check the amount of credit given to the customers.

Table 5.3: Position Statement — NTPC Limited

	March 2010	*March 2009*	*March 2008*	*March 2007*
Shareholders funds	624374.20	573701.00	526386.00	485966.00
Total Debts	394689.10	371660.00	288194.00	251411.00
Total Liabilities	**1019063.30**	**945361.00**	**814580.00**	**737379.00**
Gross Block	668500.70	623530.00	533680.00	507273.00
Less: Accumulated Depreciation	320887.80	294153.00	272743.00	250792.00
Net Block	347612.90	329377.00	260937.00	256481.00
Other fixed assets	469114.00	403884.00	377455.00	329335.00
Current assets, loans and advances	378615.50	343987.00	305278.00	258931.00
Less: Current Liabilities and Provisions	178039.10	141620.00	129089.00	107367.00
Net Current Assets	200576.40	202367.00	176189.00	151564.00
Others	1760.00	9733.00	–1.00	–1.00
Total Assets	**1019063.30**	**945361.00**	**814580.00**	**737379.00**

TATA Power

The Equity Share Capital of TATA Power increased from INR 1,979 million in 2006 to INR 2,373 million in the year 2010. The company had issued shares in the years 2007–08 and 2009–10 but had not allotted any preference shares. Their reserves increased from INR 53,159 million in 2005 to INR 1, 03,864 million in 2010. The percentage increase was higher in the year 2009–10, due to the fewer dividends distributed. The company also had a good increase in profit in the same year. Their reserves had doubled period — showing that they have been performing outstandingly well during this period.

The net worth of the company also increased from INR 54,567 million in 2007 to INR 1,06,412 million in 2011.

The total debt taken by the company was only in the form of loans and it increased from INR 27,969 million to INR 58,720 million in the year 2010. However, the increase in net worth has been higher than the increase in its debt, which is a good sign for the investors. The GB had almost doubled during the period 2005–10, from INR 30,030 million in 2005 to INR 57,528 million in 2010. This shows that the company has been expanding at an outstanding pace and has been allocating a lot of funds towards expansion — indicating long-term, secured plans. Their increased investments also show optimum capital utilisation. The company has also been ensuring that the ratio of debtors to revenue does not change during the years. The amount given to debtors increased from INR 10,582 million in 2005 to INR 19,763 million in 2010.

Table 5.4: Position Statement — TATA Power

	March 2010	*March 2009*	*March 2008*	*March 2007*
Shareholder's Funds	106237.70	86923.60	80989.10	60331.10
Total Debts	58720.10	51982.00	30372.70	36333.60
Total Liabilities	**164957.80**	**138905.60**	**111361.80**	**96664.70**
Gross Block	100108.00	89858.60	64822.50	62297.10
Less: Accumulated Depreciation	42580.60	37953.20	34767.60	31994.00
Net Block	57527.40	51905.40	30054.90	30303.10
Other fixed assets	71648.30	62046.30	61117.40	43512.00
Current assets, loans and advances	59542.60	46811.40	38755.10	40423.30
Less: Current Liabilities and Provisions	21682.70	20713.20	18393.10	17578.40
Net Current Assets	37859.90	26098.20	20362.00	22844.90
Others	–2077.80	–1144.30	–172.50	4.70
Total Assets	**164957.80**	**138905.60**	**111361.80**	**96664.70**

Cash Flow Statement Analysis

The cash flow picture of NTPC and TATA Power is given in Tables 5.5 to 5.8.

Table 5.5: Cash Position of NTPC

	2006	*2007*	*2008*	*2009*	*2010*
Net Profit Before Tax	62,712	88,966	1,05,294	94,679	1,08,077
Net Cash From Operating Activities	62,064	80,653	1,01,711	96,881	1,05,942
Net Cash from Investing Activities	–27,137	–31,459	–62,039	–75,004	–1,04,978
Net Cash from Financing Activities	–10,998	–763	–23,488	–8,493	–19,087
Net (decrease)/increase In Cash	23,931	48,432	16,187	13,384	–18,121
Opening Cash & Cash Equivalents	60,783	84,714	1,33,147	1,49,332	1,62,717
Closing Cash & Cash Equivalents	84,714	1,33,147	1,49,332	1,62,717	1,44,596

Note: All figures are in INR million.

The given cash flow statement shows that the cash generated from operating activities is sufficient to fund NTPC's investing and financing activities. Hence, the company has an excellent cash position, leaving it with excess cash at the end of every year to maintain a consistently growing cash balance. At the end of the year 2009–10, the company had a closing cash balance of INR 1,44,596 million.

Table 5.6: Cash Position of TATA Power

	2006	*2007*	*2008*	*2009*	*2010*
Net Profit Before Tax	7,474	5,860	9,701	11,167	12,592
Net Cash From Operating Activities	2,969	4,368	11,262	6,487	13,529
Net Cash (used in)/from Investing Activities	1,444	–9,466	–25,411	–22,206	–18,732
Net Cash (used in)/from Financing Activities	–4,538	5,386	4,409	15,888	17,939
Net (decrease)/increase In Cash and Cash Equivalents	–124	287	–9,740	169	12,734
Opening Cash & Cash Equivalents	9,864	974.05	10,028	288	456
Closing Cash & Cash Equivalents	9,740	10,028	288	456	13,189

Note: All figures are in INR million.

The given cash flow statement shows that the cash generated from operating activities is sufficient to fund TATA Power's investing and financing activities. However, for the year 2008–09, there was been a decrease in the cash reserves of the company with the closing cash balance falling to just INR 288 million, indicating major cash expenditures in the year. Nevertheless, the company showed a major recovery in its cash position in the year 2009–10 with a closing cash balance of INR 13,189 million.

Table 5.7: Cash Flow Indicators of NTPC

	2006	*2007*	*2008*	*2009*	*2010*
Dividend Payout Ratio	45.23	44.11	45.53	42.31	41.94
Dividend Cash Profit Ratio	33.45	33.83	35.33	32.83	32.17
Earning Retention Ratio	46.91	54.23	54.17	51.75	54.95
Cash Earning Retention Ratio	62.44	65.20	64.49	63.70	66.03
Adjusted Cash Flow (times)	2.95	2.89	2.86	3.62	3.51

Table 5.8: Cash Flow Indicators of TATA Power

	2006	*2007*	*2008*	*2009*	*2010*
Dividend Payout Ratio	31.41	31.60	30.84	31.20	34.12
Dividend Cash Profit Ratio	21.34	22.05	23.02	22.90	22.68
Earning Retention Ratio	56.37	54.01	43.09	40.16	65.56
Cash Earning Retention Ratio	73.65	71.79	65.02	64.68	77.18
Adjusted Cash Flow (times)	3.84	4.71	4.02	6.44	4.14

Dividend Payout Ratio

The payout ratio gives an idea of how well earnings support the dividend payments. More mature companies tend to have a higher payout ratio. It is calculated as:

Dividends/(Net Income)

The dividend payout ratios for both NTPC and TATA Power have been consistent. However, NTPC's higher dividend payout ratios show that they have a higher level of shareholder satisfaction as compared to TATA Power.

Earning Retention Ratio

Earning Retention Ratio is the per cent of earnings credited to retained earnings, that is, it is the proportion of net income that is not paid out as dividends. It is calculated as:

(Net Income – Dividends)/(Net Income)

The retention ratio is the opposite of the dividend payout ratio. In fact, it can also be calculated as 'one minus the dividend payout ratio'. Retained earnings are used to fund company growth. Since TATA Power requires more funds to invest in developmental activities, they have a higher earnings retention ratio as compared to NTPC.

Dividend Cash Profit Ratio

It is the ratio of dividends paid as a ratio of cash profits. It is calculated as:

Dividend/Cash Profit

For NTPC, it is in the range of 32 to 35 while for TATA Power it is in the range of 21 to 23. Hence, it is almost consistent for both companies.

Cash Earning Retention Ratio

It is opposite to the dividend payout to ratio cash profit as it is a measure of what percentage of profit is retained (and not paid as dividends). It is calculated as:

(Cash Profit – Dividend)/(Cash Profit)

Cash earnings retention ratio is higher for TATA Power as compared to NTPC, which shows that the former company has more requirements of cash retained earnings.

Analysis of Financial Ratios

Profitability ratios are discussed with the help of Tables 5.9 and 5.10.

Table 5.9: Profitability Ratios — NTPC

	2005–06	*2006–07*	*2007–08*	*2008–09*	*2009–10*
Gross Profit Margin (%)	32.62	33.28	25.32	19.48	21.01
Cash Profit Margin (%)	27.30	25.25	23.74	21.10	21.87
Operating Profit Margin (%)	28.40	31.13	31.07	25.11	26.73
Net Profit Margin (%)	20.20	19.39	18.51	18.11	17.72
Return on Capital Employed (%)	12.26	14.69	15.15	12.27	12.58
Return on Net Worth (%)	12.95	14.13	13.66	13.90	14.06
Return on Assets (%)	7.84	8.13	65.81	71.55	75.26
Return on Long Term Funds (%)	12.26	14.69	15.15	12.27	12.58

Gross profit Margin and Net Profit Margin

Gross profit is the difference between Sales and Cost of Sales, which is the purchase price of the goods to be sold together with the cost of getting them ready for sale. Net profit remains after all expenses except for profit tax have been charged to the gross profit. These may include staff salaries, rent, rates, motor expenses, and auditors' remuneration, among others. The Gross Profit Margin is obtained

Table 5.10: Profitability Ratios — TATA Power

	2005–06	*2006–07*	*2007–08*	*2008–09*	*2009–10*
Gross Profit Margin (%)	18.25	16.27	16.64	15.96	19.73
Cash Profit Margin (%)	18.81	18.81	12.65	10.88	19.99
Operating Profit Margin (%)	18.46	14.26	15.56	15.49	26.46
Net Profit Margin (%)	12.92	13.26	14.35	12.32	12.84
Return on Capital Employed (%)	8.69	7.61	6.96	7.32	10.19
Return on Net Worth (%)	11.07	11.63	10.88	10.66	8.92
Return on Assets (%)	6.31	6.06	362.04	390.36	447.68
Return on Long Term Funds (%)	8.72	7.62	7.18	7.67	10.19

by dividing Gross Profit by Total Revenues while the Net Profit is obtained by dividing Net Profit by the Total Revenues. The gross and the net profit margins vary depending upon the type of the industry. By comparing these margins, we can gain a good impression of their non-production and non-direct costs, such as administration, marketing and finance costs. The Gross Profit Margins and Net Profit Margins of both NTPC and TATA Power are shown in Tables 5.9 and 5.10. The Gross Profit Margins of TATA Power were consistent until 2009; in the year 2009–10, there was a remarkable increase in the gross profit. However, the Net Profit of TATA Power remained consistent for the period of 2005–10. Until 2009, the company was spending a good amount on non-operating expenses. However, for the year 2010, the company managed to increase the total profit by not increasing the non-operating expenses by a great margin — that is, the company had increased its efficiency during the financial year 2009–10.

On the other hand, NTPC's gross profit and net profit margin decreased considerably (in 2010) when compared to what it was in 2005 and 2006. However, over the last three years, the gross profit margin has remained consistent. Even the net profit margin remained nearly the same during the period 2009–10. The gross profit percentage and the net profit percentage of NTPC is higher than that of TATA Power, which can be attributed to NTPC's higher production capacity and market share. Nevertheless, TATA Power's Gross Profit Margin has been on the rise.

Operating Profit Margin

It is a ratio used to measure a company's pricing strategy and operating efficiency, calculated as:

$$\text{Operating Profit Margin} = \frac{\text{Operating Income}}{\text{Net Sales}}$$

Operating margin is a measurement of what proportion of a company's revenue is left over after paying for variable costs of production, such as wages and raw materials. A healthy operating margin is required so that a company is able to pay its fixed costs, such as interest on debt. Operating margin gives analysts an idea of how much a company makes (before interest and taxes) on each rupee of sale. For example, if a company has an operating profit margin of 12 per cent, this means that it makes 0.12 per cent (before interest and taxes) for every rupee of sales.

After analysing the data in Tables 5.9 and 5.10, we understand that the operating margin of TATA Power has been more or less consistent until the year 2008–09. However for the 2009–10, the operating margin increased from around 15 per cent to 26 per cent, which shows that the company has been trying hard to improve its operational efficiency. NTPC's operating efficiency had been consistent throughout 2005–10, with a slight increase or decrease in the operating margin. Until the year 2009, the operating margin of NTPC was higher than that of TATA Power by a huge margin but in 2010, the operating margin was almost the same for both companies. An operating margin of more than 20 per cent is considered to be good and both companies seem to be performing well, in spite of the various regulations that are imposed by the government.

Return on Capital Employed (ROCE)

It is the ratio which indicates the efficiency and profitability of a company's capital investments and is calculated as:

$$\frac{\text{EBIT}}{\text{Total Assets} - \text{Current Liabilities}}$$

Returns on Capital Employed (ROCE) should always be higher than the rate at which the company borrows; otherwise, any increase in borrowing will reduce shareholders' earnings. The ROCE is also

the ratio between the EBIT and the Capital employed. The Capital employed is given by the Net worth + preference Share Capital + Long Term Loans which is also equal to the Net Block + Working Capital.

For TATA Power, ROCE remained consistent during the period 2005–09. However, there had been a slight increase for the year 2009–10. Nonetheless, the ROCE is considerably less and has to be improved by using better management of resources. The company has been trying to increase the ROCE which is evident from their results for the year 2009–10. The ROCE, in case of NTPC, had slightly decreased over the years when compared to 2005. The high returns show that the company had been using its resources in an optimal manner. But the company should try and retain the 2005 margins. Therefore, a shareholder would want to invest in NTPC because of their size and better utilisation of capital.

Return on Equity (ROE)

The amount of net income returned as a percentage of shareholders' equity. It measures a corporation's profitability by revealing how much profit a company generates with the money that shareholders have invested. ROE is expressed as a percentage and calculated as:

ROE = Net Income/Shareholders' Equity

Net income is for the full fiscal year (before dividends paid to common stockholders but after dividends to preferred stock). Shareholders' equity does not include preferred shares. ROE is useful for comparing the profitability of a company to that of other firms in the same industry. The return on equity/net worth have been more or less consistent for TATA Power. However, it has shown a slight declining trend from 12 per cent in 2005–06 to 8 per cent in 2009–10. This shows that there has not been optimal utilisation of shareholders' equity. Compared to TATA Power, NTPC has shown better return on net worth, in the range of 13 per cent to 14 per cent from 2005–06 to 2009–10. In recent times, it has increased to 14 per cent after a period of decline. Hence, it has improved on utilisation of shareholders' wealth but further improvement is still necessary.

Liquidity, Efficiency and Solvency Ratios

Liquidity and solvency ratios are given in Tables 5.11 and 5.12, respectively.

Table 5.11: Liquidity, Efficiency and Solvency Ratios — NTPC

	2005	*2006*	*2007*	*2008*	*2009*
Current Ratio	2.11	2.42	2.36	2.89	2.44
Quick Ratio	1.84	2.18	2.16	2.59	2.17
Debt–Equity Ratio	0.46	0.52	0.50	0.49	0.51
Long-term Debt–Equity Ratio	0.46	0.52	0.50	0.49	0.51
Interest Coverage ratio	11.59	9.49	10.28	11.91	6.97

Table 5.12: Liquidity, Efficiency and Solvency Ratios — TATA Power

	2005	*2006*	*2007*	*2008*	*2009*
Current Ratio	2.18	2.22	1.78	1.64	2.51
Quick Ratio	1.85	2.00	1.75	1.77	2.26
Debt–Equity Ratio	0.51	0.61	0.39	0.61	0.55
Long-term Debt–Equity Ratio	0.50	0.60	0.34	0.53	0.55
Interest Coverage Ratio	4.86	4.03	4.63	3.33	3.98

Current Ratio

It is a liquidity ratio that measures a company's ability to pay short-term obligations (debt and payables) with its short-term assets (such as cash, inventory and receivables). The formula is:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Higher the current ratio, more capable is the company of paying its obligations. A ratio under 1 suggests that the company would be unable to pay off its obligations if they came due at that point. While this shows the company is not in good financial health, it does not necessarily mean that it will go bankrupt — as there are many ways to access financing. The current ratio can give a sense of the efficiency of a company's operating cycle or its ability to turn its product into cash. Companies that have trouble getting paid on their receivables or have a long inventory turnover can run into liquidity problems because they are unable to alleviate their obligations. Since business operations differ in each industry, it is always more useful to compare companies within the same industry.

This ratio is similar to the acid-test ratio except that the acid-test ratio does not include inventory and prepaid assets that can be liquidated. The components of current ratio (current assets and current liabilities) can be used to derive working capital (difference

between current assets and current liabilities) — which is frequently used to derive the working capital ratio that is working capital as a ratio of sales. NTPC has a current ratio that is greater than 1, actually, it has s always been greater than 2, which shows consistency. Hence, it can be concluded that the company has the ability to pay off its current liabilities, when required.

TATA Power has a current ratio greater than 1 which shows that it also has enough assets to pay off its current liabilities. The ratio for TATA Power had shown a declining trend but has increased to a value greater than 2 for the year 2009–10. This shows that the company had increased its net assets or decreased its liabilities considerably. Both companies have a good current ratio and it should not be a problem for them to raise further debt, if and when required.

Quick Ratio

It is an indicator of a company's short-term liquidity. The quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets. Higher the quick ratio, better is the position of the company. It is calculated as:

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}}$$

The quick ratio is more conservative than the current ratio because it excludes inventory from current assets. Inventory is excluded because some companies have difficulty turning their inventory into cash. In the event that short-term obligations need to be paid off immediately, there are situations in which the current ratio would overestimate a company's short-term financial strength.

Both NTPC and TATA Power have a quick ratio of greater than 1, which means that both companies have enough assets to pay off their current liabilities. NTPC's quick ratio has always been greater than 2, which means that the company is not dependent on their inventory to pay off debt. The ratio for TATA Power had shown a declining trend but has increased to a value greater than 2 for the year 2009–10, which means that the company had increased its net assets or decreased its liabilities considerably. Like NTPC, TATA Power also does not depend on its inventories to pay off the liabilities.

NTPC and TATA Power have always maintained a good quick ratio, in spite of the heavy costs are incurred by them while building new plants or increasing capacities of existing plants. The companies

have good credibility among their suppliers and would not have any kind of problem in raising loans for future investments.

Inventory Turnover Ratio

The inventory turnover ratio indicates the number of days it takes to convert raw material into finished goods, which are ready to be sold. A higher inventory turnover ratio leads to the danger that the inventory may turn obsolete while a lower inventory turnover ratio leads scarcity. Hence, an optimum level of inventory turnover (that is dependent on the sector) should be maintained.

The inventory turnover ratio of NTPC is in the range of 13–14 and was consistent over the period 2005–10. The inventory turnover ratio for TATA Power is in the range of 11.5–13.5 and has been decreasing from the year 2008. Nonetheless, the inventory ratio of both companies is optimum.

Debtors Turnover Ratio

The debtors turnover ratio indicates the velocity of debt collection of a firm. In simple words, it indicates the number of times average debtors (receivable) are turned over during a year. Higher the value of debtors turnover, more efficient is the management of debtors or more liquid the debtors are. Similarly, low debtors turnover ratio implies inefficient management of debtors or less liquid debtors. It is a reliable measure of the time of cash flow from credit sales. There is no rule of thumb which may be used as a norm to interpret the ratio as it may be differ across firms.

NTPC's debtors turnover ratio of is very high, which indicates that they are liberal towards their customers and have a good credit policy. However, there is always a credit risk involved due to defaulting by customers. As a result, steps should be taken to minimise credit sales. TATA Power, on the other hand, has a poor credit policy and, therefore, their debt turnover ratio is usually consistent.

Debt-Equity Ratio

It indicates what proportion of equity and debt the company uses to finance its assets. It is a measure of a company's financial leverage, which is calculated as:

$$\frac{\text{Loans}}{\text{Shareholders Equity}}$$

A high debt-equity ratio generally means that a company has been aggressive in financing its growth with debt. This can result in volatile earnings as a result of the additional interest expense.

If a lot of debt is used to finance increased operations (high debt to equity), the company could potentially generate more earnings than it would have without this external financing. If this were to increase earnings by a greater amount than the debt cost (interest) then the shareholders benefit from it, as more earnings are being spread among the same amount of shareholders. However, the cost of this debt financing may outweigh the return that the company generates on the debt through investment and business activities and become too much for it to handle. This can lead to bankruptcy, which would leave shareholders with nothing.

The debt-equity ratio also depends on the industry in which the company operates. For example: capital-intensive industries, such as auto manufacturing, tend to have a debt–equity ratio above 2, while personal computer companies have a debt–equity ratio of under 0.5.

The debt-equity ratio of NTPC has been constant throughout the period 2005–09, in the range of 0.45–0.5. It has been noticed that the company maintains a constant debt-equity ratio. Table 5.9 shows that whenever there has been an increase in the total debt, the company has also increased their share of equity. Moreover, the profits of the company have been on the rise and they are able to generate more funds from the debt than the interest, which is being paid towards it. Hence, the increase in debt works in favour of the shareholders. A similar trend has been observed with TATA Power where the debt-equity ratio has been in the range of 0.55–0.61 except for the year 2007. It has also been noticed that the percentage contribution of debt has been more in the case of TATA Power in comparison with NTPC.

Interest Coverage Ratio

Interest coverage is a financial ratio that provides a quick picture of a company's ability to pay the interest charges on its debt. The 'coverage' aspect of the ratio indicates how many times the interest could be paid from available earnings, thereby providing a sense of the

safety margin a company has for paying its interest for any period. A company that sustains earnings well above its interest requirements is in an excellent position to weather possible financial storms. The Interest Coverage Ratio is calculated as:

$$\frac{\text{Earnings before Interest and Taxes (EBIT)}}{\text{Interest Expense}}$$

Since interest coverage is a highly variable measure, not only between companies within an industry but between different industries, it is worthwhile to establish some guidelines for setting acceptable levels of interest coverage in particular industries. Obviously, an interest coverage ratio below 1 is an immediate indication that the company, regardless of its industry, is not generating sufficient cash to cover its interest payments. That said, an interest-coverage ratio of 1.5 is generally considered the bare minimum level of comfort for any company, in any industry. NTPC's interest coverage ratio is very high, in the range of 9–11. However, the ratio had decreased for the year 2009. Lenders need to be assured that they are lending to a creditworthy company. Shareholders also stand to benefit as the revenue generated from operations are greater than interest being paid to debt holders.

TATA Power's interest coverage ratio is quite good as well but is much lower than NTPC. The ratio proves that the company is credit worthy but they should try to increase the interest coverage ratio for their own profit.

Valuation Ratios

Valuation ratios are given in Tables 5.13 and 5.14.

Table 5.13: Valuation Ratios — NTPC

	2009–10	*2008–09*	*2007–08*	*2006–07*	*2005–06*
Price Earning (P/E)	20.8	19.29	23.45	19.08	20.09
Price to Book Value (P/BV)	2.73	2.59	3.09	2.54	2.46
Reported Net Profit	17.69	18.1	18.45	19.32	19.61
Earnings Per Share (EPS)	9.95	9.34	8.4	7.85	6.67

Note: Beta Value — 0.6164.

Table 5.14: Valuation Ratios — TATA Power

	2009–10	*2008–09*	*2007–08*	*2006–07*	*2005–06*
Price–Earnings (P/E)	36.17	19.03	30.69	15.17	19.54
Price to Book Value (P/BV)	3.1	2	3.33	1.75	2.16
Reported Net Profit	12.63	11.65	13.48	13.7	12.34
Earnings Per Share (EPS)	37.95	40.21	38.19	33.59	29.66

Note: Beta Value — 0.7107.

Price–Earnings Ratio

Price–earnings ratio is a valuation ratio of a company's current share price compared to its per share earnings. The price–earnings ratio is calculated as:

$$\frac{\text{Market Value per Share}}{\text{Earnings per Share (EPS)}}$$

EPS is usually from the last four quarters (trailing P/E), but sometimes it can be taken from the estimates of earnings expected in the next four quarters (projected or forward P/E). A third variation uses the sum of the last two actual quarters and the estimates of the next two quarters.

In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E. However, it is also useful to compare the P/E ratios of one company with another in the same industry, to the market in general or against the company's past P/E, as it would be a futile exercise to compare the P/E of a technology company (high P/E) to a utility company (low P/E), since each industry's different growth prospects. Furthermore, it is important that investors note a key problem that arises with the P/E measure, to avoid basing a decision on this measure alone. The denominator (earnings) is based on an accounting measure of earnings that is susceptible to forms of manipulation, making the quality of the P/E only as good as the quality of the underlying earnings number.

NTPC's price–earnings ratio was more or less consistent during the period 2005–09, in a range between 19 and 23. The value suggests that the stock is not too overvalued and the share traders should invest in NTPC as there is a scope for the company to attain a higher

share price. However, the P/E ratio is not the only way in which one can determine if it is worth investing in the company. Nevertheless, taking into consideration the other ratios, NTPC undoubtedly has a good stock for the long run.

Unlike NTPC, the P/E ratio of TATA Power is not so consistent and its value has continuously been changing from a low of 15.17 in 2006–07 to a high of 36.17 in 2009–10. The P/E ratio suggests that the stock is a little overvalued and it might not be wise for a shareholder to invest in the company, if he is a short-term investor. However, since the other ratios of the company are good and also because the company had expanded in 2010, it may prove to be a wise decision to invest in their stocks, if one is looking for long-term profits. Looking at the price–earnings ratios of both companies, it is obvious then that one would invest in NTPC.

Price-to-Book Ratio

Price-to-book (P/B) or 'price–equity' ratio is used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share.

$$\text{P/B Ratio} = \frac{\text{Stock Price}}{\text{Total Assets} - \text{Intangible Assets and Liabilities}}$$

The P/B ratio, is a financial ratio used to compare a company's book value to its current market price. Book value is an accounting term denoting the portion of the company held by the shareholders; in other words, the company's total tangible assets minus its total liabilities. The calculation can be performed in two ways but the result has to be the same either way. In the first method, the company's market capitalisation can be divided by the company's total book value from its balance sheet. The second method, using per-share values, divides the company's current share price by the book value per share (that is, its book value divided by the number of outstanding shares).

As with most ratios, it varies a fair amount by industry. Industries that require more infrastructure capital (for each dollar of profit) will usually trade at P/B ratios much lower than consulting firms, for example. P/B ratios are commonly used to compare banks, because most assets and liabilities of banks are constantly valued at market

values. A higher P/B ratio implies that investors expect management to create more value from a given set of assets, all else equal (and/or that the market value of the firm's assets is significantly higher than their accounting value). P/B ratios do not, however, directly provide any information on the ability of the firm to generate profits or cash for shareholders.

This ratio also gives some idea of whether an investor is paying too much for what would be left if the company went bankrupt immediately. For companies in distress, the book value is usually calculated without the intangible assets that would have no resale value. In such cases, P/B should also be calculated on a 'diluted' basis, because stock options may well rest on sale of the company or change of control or firing of management.

NTPC's price-to-book value has been consistent during the period 2005–10, the value in the range of 2.5 and 3. From this figure, we understand that the stock is undervalued and the investors can expect the price of the stock to increase in both the long- and short-run. Since the P/E ratio of NTPC is also small, the stock for sale is bound to increase in the near future. However, the P/E and P/B ratios are not the only things to consider before investing in stock.

TATA Power's price-to-book value has also been consistent during the period 2006–09, the value varying between 1.75 and 3. This might indicate that the stock is undervalued; however, since the P/E ratio of the stock is high, an investor should think twice before investing in TATA Power in the short run.

Comparing the P/B ratio of both companies, it is again obvious that an investor should invest in NTPC because their P/B and P/E ratios are lower and also they have shown good results, over the past few years.

Depreciation Accounting and Inventory Valuation

Depreciation accounting is the process of providing deprecation for the replacement of assets. Deprecation is a provision which is charged out of profits every year for he expected life of the asset so as to have enough funds for replacing the worn out assets. All assets are assumed to depreciate, except land which is assumed to appreciate.

Depreciable cost includes all costs necessary to acquire an asset and make it ready for use minus the asset's expected salvage value, which is the asset's worth at the end of its service life, usually the amount of time the asset is expected to be used in the business. There are various methods of calculating depreciation, most commonly used are straight line method and written down value method.

For example, if a machine costs INR 10,000, has an expected salvage value of 1,000, and has an estimated service life of 5 years, then INR 9,000 is allocated to expense at a rate of INR 1,800 each year (INR 9,000 ÷ 5 = INR 1,800). This method of calculating depreciation expense is called as straight-line depreciation. It is the easiest and most widely used method of depreciation.

In case of written down, depreciation amount will not be uniform every year; rather it will keep on decreasing every year. The depreciation is calculated on the reducing balance of the asset every year. Taking the same example, if the rate of depreciation is 20 per cent p.a. then the deprecation amount for the first year will be INR 1,800, which is similar to straight line method. Afterwards, it will be calculated on INR 7,200 (9,000 – 1,800) and it will be INR 1,440. Every year it will keep on decreasing as it is calculated on the net value of the asset every year. It is a more realistic approach to depreciation.

NTPC

Advance against depreciation considered as deferred revenue in earlier years is included in sales to the extent that the depreciation recovered in tariff during the year is lower than the corresponding depreciation charged.

Exchange differences on account of translation of foreign currency borrowings recoverable from or payable to the beneficiaries in subsequent periods as per Central Electricity Regulatory Commission (CERC) Tariff Regulations are accounted as Deferred Foreign Currency Fluctuation Asset/Liability. The increase or decrease in depreciation or interest and finance charges for the year due to the accounting of such exchange differences is adjusted in sales. Accounting policy is internal, mentioned in the financial statements of the company; hence, it is not really relevant.

(*a*) Depreciation on additions to/deductions from fixed assets during the year is charged on pro-rata basis from/up to the month in which the asset is available for use/disposal. Assets

costing up to INR 5,000 are fully depreciated in the year of acquisition.

(*b*) Cost of software recognised as intangible asset is amortised on straight line method over a period of legal right to use or three years, whichever is earlier. Intangible assets/others are amortised on straight line method over the period of legal right to use.

(*c*) Where the cost of depreciable assets has undergone a change during the year due to increase/decrease in long-term liabilities on account of exchange fluctuation, price adjustment, change in duties or similar factors, the unamortised balance of such asset is charged prospectively over the residual life.

(*d*) Where the life and/or efficiency of an asset is increased due to renovation and modernisation, the expenditure thereon alongwith its unamortised depreciable amount is charged prospectively over the revised useful life, determined by technical assessment.

(*e*) Machinery spares, which can be used only in connection with an item of plant and machinery (and their use is expected to be irregular), are capitalised and fully depreciated over the residual useful life of the related plant and machinery.

(*f*) Capital expenditure on assets not owned by the company is amortised over a period of four years from the year in which the first unit of project concerned comes into commercial operation and thereafter from the year in which the relevant asset becomes available for use. However, such expenditure for community development in case of stations under operation is charged off to revenue.

(*g*) Leasehold lands, other than acquired on perpetual leases, are amortised over the lease period. Leasehold buildings are amortised over the lease period or 30 years, whichever is lower. Leasehold land and buildings whose lease periods are yet to be finalised are amortised over a period of 30 years.

(*h*) Expenses on ex-gratia payments under voluntary retirement scheme, training and recruitment and research and development are charged to revenue in the year incurred.

(*i*) Preliminary expenses on account of new projects incurred prior to approval of feasibility report/techno economic clearance are charged to revenue.

(*j*) Actuarial gains/losses with respect to Employee Benefit Plans are recognised in the statement of Profit and Loss Account.
(*k*) Net pre-commissioning income/expenditure is adjusted directly in the cost of related assets and systems.
(*l*) Prepaid expenses and prior period expenses/income of items of INR 1,00,000 and below are charged to natural heads of accounts.

Carpet coal is charged off to coal consumption. However, during pre-commissioning period, carpet coal is retained in inventories and charged off to consumption in the first year of commercial operation. Transit and handling losses of coal as per norms are included in cost of coal.

The depreciation provided is adequate enough for replacement of assets. The method followed to account for depreciation in financial statements and income tax statements is straight line method; hence, there is no provision for deferred tax assets. Therefore, there is no variation in accounting income and taxable income as consistency has been maintained. Also, there has been a constant increase in depreciation charged over the period and, hence, it has not affected the financial position of the company significantly.

Inventory Valuation

Inventories are valued at the lower of cost, determined on weighted average basis, and net realisable value. The diminution in the value of obsolete, unserviceable and surplus stores and spares is ascertained on review and provided for.

TATA Power

(*a*) Depreciation for the year with respect to assets relating to the electricity business of the company as Licensee/other than a Licensee, has been provided on straight line method, in terms of the repealed Electricity (Supply) Act, 1948 on the basis of Central Government Notification No. S.0.265 (E)/266 (E) dated 27 March 1994/29 March 1994, except that computers acquired on or after 1 April 1998 are depreciated at the rate of 33.40 per cent p.a. on the basis of approval obtained from the state government (Annual Report 2011–12).[2]
(*b*) In respect of assets relating to other business of the company, depreciation has been provided for on written-down value

basis at the rates and in the manner prescribed in Schedule XIV[3] to the Companies Act, 1956, except in the case of technical know how, which is written off on a straight line basis over a period of six years.

(*c*) Assets costing less than INR 5,000 are depreciated at the rate of 100 per cent.

(*d*) Leasehold land is amortised over the period of the lease.

(*e*) Depreciation on additions/deletions of assets is provided on pro-rata basis.

(*f*) Depreciation rates used for various classes of assets are:

- (*i*) Hydraulic Works — 1.95 per cent to 3.40 per cent
- (*ii*) Buildings — 3.02 per cent to 33.40 per cent
- (*iii*) Railway Sidings, Roads, Crossings, etc. — 3.02 per cent to 5.00 per cent
- (*iv*) Plant and Machinery — 1.80 per cent to 45.00
- (*v*) Transmission Lines, Cable Network, etc. — 3.02 per cent to 13.91 per cent
- (*vi*) Furniture, Fixtures and Office Equipment — 12.77 per cent to 18.10 per cent
- (*vii*) Mobile Phones — 100 per cent
- (*viii*) Motor Vehicles, Launches, Barges, etc. — –25.89 per cent to 33.40 per cent
- (*ix*) Helicopters — 9.00 per cent to 33.40 per cent

Depreciation so provided has been determined as being not less than the depreciation which would have been recognised in the Profit and Loss Account, had the rates and the manner prescribed under Schedule XIV to the Companies Act, 1956, been applied. Like NTPC, the depreciation provided is adequate enough for replacement of assets. The method followed to account for depreciation in financial statements and income tax statements is straight line method; hence, there is no provision for deferred tax assets. Therefore, there is no variation in accounting income and taxable income as consistency has been maintained. Also, there has been a constant increase in depreciation charged over the period and, hence, it has not affected the financial position of the company significantly.

Inventory Valuation

Inventories of stores, spare parts, fuel, and loose tools are valued at or below cost. Cost is ascertained on weighted average basis.

Work-in-progress and property under development are valued at lower of cost and net realisable value. Cost includes cost of land, material, labour, manufacturing, and other overheads.

Inventory for both companies is valued at lower of cost method. Inventory valuation method is constant. There is no significant effect of this method on financial position or profitability of the company. Cost of inventory is ascertained on weighted average basis for both companies. Hence, it does not lead to any effect on profitability of company.

Strategic View of the Companies

NTPC

It is one of the largest players in India's power sector. As a public sector undertaking, it enjoys the status of 'Mahanavratna'. The total sales of company have increased almost 100 per cent in five years. In the meantime, they have been able to keep control over their selling and distribution expenses, which have risen by just 34 per cent. This shows that company is managing its operations efficiently.

(*a*) Their reserve and surpluses stand at almost INR 5,20,000 million. As discussed earlier, the company is a safe bet for long-term lenders. Therefore, the company should go in for aggressive expansion in its generation capacity to increase its revenues and profits. Construction of a power generation plant, especially larger capacity plants, is a time-consuming activity; therefore the strategic step of expanding should be taken right now.

(*b*) The power and fuel consumption of company have increased by 246 per cent, for a sales increase of 100 per cent. Consequently, the company's administration should look for more efficient fuel consumption technologies to improve their productivity. It will also help in earning carbon credits.

(*c*) The company should set annual targets for reduction in line and distribution losses to further improve the efficiency of operations.

(*d*) Also, since the company has the capability to raise enough capital, they should look into alternate sources of energy, such as wind and solar energy for power generation, to reduce their and the country's dependence on fossil fuels.

(*e*) Finally, the company should also look into the possibility of acquiring coal mines to reduce the cost of raw material procurement as well as have better stability in terms of supply of raw material.

TATA Power

It belongs to the prestigious and powerful TATA group of companies. It is part of demand-driven sector, which all players together are not able to meet. Thus, the expansion of generation capacity is a natural and sensible course of action.

(*a*) The company has stable debt to equity ratio and asset turnover ratio of 0.75. The credit rating of TATA Power is LAA,[4] making them an attractive proposition for long-term lenders. Also, their reserves stand at a reasonable amount of INR 1,00,000 million. Therefore, the company should begin the process of raising capital to start their expansion on generation capacity.

(*b*) The sales of the company have risen by 79 per cent in five years but its selling and distribution expenses have grown by 354 per cent, which is a matter of concern from an operating point of view. The fixed assets of the company have increased by more than 90 per cent, indicating that company has already started expansion activities. All current on-going projects should be completed in time to generate enough money for investment in larger capacity plants (which have a capacity greater than 4000 MW).

(*c*) The company has already started to build hydel, wind and geothermal power stations, which should be continued.

(*d*) They have also done a commendable job by controlling their line and distribution losses to 18 per cent. Nonetheless, the management should work further to bring it down to less than 10 per cent.

(*e*) The power and fuel consumption of the company have increased by almost 150 per cent, for a sales increase of 79 per cent. Therefore, like NTPC, the administration should look for more efficient fuel consumption technologies to improve the productivity — which also help in earning carbon credits.

Conclusion

The power sector in India is a demand-driven sector. It is a capital intensive sector as the cost of setting up generation plants and distribution infrastructure runs into thousands of millions. The starting cost is the reason that the number of companies (in this sector) is limited and the most dominant company of the sector is a public sector undertaking.

Both companies have shown very optimistic financial results over the last five years. Their sales, net profits, assets, and reserves/surpluses are showing a strong increasing trend. Their current assets are far greater than current liabilities and they are working on increasing their returns environment. Therefore, it is time they started their expansions to cater to the increasing demand.

The comparison of TATA Power with NTPC Limited seems like the corporate version of the story of David with Goliath. NTPC is a safer and risk-free bet for both investors and money-lenders due to its large size while the power deficient Indian economy ensures that whatever amount of power they generate, it will be consumed. For investors who are willing to take high risks, TATA Power can definitely give larger returns on short-term investments. Consequently, for investors and money-lenders (both short- and long-term,) NTPC seems to be a better option than TATA Power.

6

Steel Sector

TATA Steel vs Steel Authority of India Limited

The Indian steel industry has shown great promise over the past few years. According to the Annual Report (2009–10) by the Ministry of Steel (MoS), India has emerged as the fifth largest producer of steel in the world and is likely to become the second largest producer of crude steel by 2015–16. The production of steel in India rose by 4.2 per cent in 2009–10 to reach 60 million tonne (MT) and is expected to increase further with several greenfield (new projects) and brownfield (capacity expansion of existing plants) projects underway. According to the recent data released by MoS, India, 222 Memorandum of Understanding (MoU) have already been signed with various states for a planned capacity expansion of around 276 MT. The majority of these investments will be centred around Orissa, Jharkhand, Chhattisgarh, West Bengal, Karnataka, Gujarat, and Maharashtra.

India's steel consumption, along with production, is also on the rise. The year end for March 2010 recorded a growth of around 8 per cent — over the same period a year ago — on account of improved demand from sectors such as automobile, infrastructure and housing.

(*a*) Investments: Indian investment policy stipulates 100 per cent foreign direct investment (FDI) in the Indian steel sector. Keeping in mind the huge requirement in the sector, companies under study have also geared up for the upcoming challenge. SAIL planned to set up a 12 MT plant in Jharkhand. TATA Steel entered into a joint venture (JV) with Japan's Nippon Steel. The JV is expected to invest US $ 400 million for its new establishment in India.

(*b*) Government Initiatives: As per the Press Information Bureau, during 2009, the Government of India had taken several initiatives to promote the development of the steel sector in India, which included:

(*i*) Reduction in Central Value Added Tax (CENVAT) on steel items — reduced from 14 per cent to 10 per cent, w.e.f. February 2009.
(*ii*) Increased allocation of funds to the infrastructure sector, which would indirectly assist in the growth of the steel sector.

This chapter analyses the financial performance of two of the major steel players in the country, TATA Steel and Steel Authority of India Limited (SAIL). These two companies are essentially of diverse natures. While TATA Steel is a private sector enterprise, SAIL is a public sector undertaking.

About the Companies

TATA Steel

The TATA Steel Group has a balanced global presence in over 50 developed European and fast-growing Asian countries, with manufacturing operations in 26 countries and various on-going projects in different parts of the world.

It is the first integrated steel plant in Asia and the world's second most geographically diversified steel producer. Through its investments in Corus, Millennium Steel (now TATA Steel, Thailand) and Nat Steel Holdings, Singapore, TATA Steel has created a manufacturing and marketing network in Europe, South-east Asia and the pacific-rim countries. Corus, which manufactured over 20 MTPA of steel in 2008, has operations in the UK, the Netherlands, Germany, France, Norway, and Belgium.

Existing Capacity and Expansion Plans

(*a*) TATA Steel's Jamshedpur Works, in India, has a crude steel production capacity of 6.8 MTPA, which was slated to increase to 10 MTPA by 2011.
(*b*) The company also has proposed three greenfield steel projects in the states of Jharkhand, Orissa and Chhattisgarh in

India, with additional capacity of 23 MTPA and a greenfield project in Vietnam.

Product Portfolio

(*a*) TATA Steel's Jamshedpur Works produces hot and cold rolled coils and sheets, galvanised sheets, tubes, wire rods, construction rebars, and bearings.

(*b*) The company has also introduced brands such as TATA Steelium (the world's first branded cold rolled steel), TATA Shaktee (galvanised corrugated sheets), TATA Tiscon (re-bars), TATA Bearings, TATA Agrico (hand tools and implements), TATA Wiron (galvanised wire products), TATA Pipes (pipes for construction), and TATA Structura (contemporary construction material).

Steel Authority of India Limited

Steel Authority of India Limited (SAIL) is one of the leading steel-making companies in India and is a fully integrated iron- and steel-maker. They produce both basic and special steels for different utilities including domestic construction, engineering, power, railway, automotive and defense industries, and for sale in export markets.

They have been ranked amongst the top ten public sector companies in India in terms of turnover. SAIL has a wide chain of plants under its belt and produces iron and steel at five integrated plants and three special steel plants. They are also India's second largest producer of iron ore and have the country's second major mines network.

Major Units

Integrated Steel Plants

(*a*) Bhilai Steel Plant (BSP) in Chhattisgarh
(*b*) Durgapur Steel Plant (DSP) in West Bengal
(*c*) Rourkela Steel Plant (RSP) in Orissa
(*d*) Bokaro Steel Plant (BSL) in Jharkhand
(*e*) IISCO Steel Plant (ISP) in West Bengal

Special Steel Plants

(*a*) Alloy Steels Plants (ASP) in West Bengal

(*b*) Salem Steel Plant (SSP) in Tamil Nadu
(*c*) Visvesvaraya Iron and Steel Plant (VISL) in Karnataka

In their four decades of successful operations, SAIL has gained immensely in terms of technical and managerial expertise in steel-making. The company has a well-equipped Research and Development Centre for Iron and Steel (RDCIS) at Ranchi which is engaged in developing new technologies for iron- and steel-making. They also has their own (in-house) Centre for Engineering and Technology (CET), Management Training Institute (MTI) and Safety Organisation at Ranchi.

Financial Analysis

Profitability

Using the data given in Tables 6.1 and 6.2, we have compared the profitability ratios of TATA Steel and SAIL. Their profitability trend is given in Figures 6.1 and 6.2. However, the recession of 2008–09 adversely impacted the steel industry and demand for steel declined. Due to this, we observe that Profit after Tax (PAT) had declined in 2008–09, when compared to the previous year.

PAT is the accumulation of operating and non-operating incomes; the fact that it has not increased in proportion to operating profit shows that income from non-operating sources has decreased. On the other hand, it also shows that the company has concentrated more on its core competencies and, hence managed to increase operating profits significantly, indicating greater resilience in times of recession.

TATA Steel

Table 6.1: Profitability Ratios of TATA Steel

	2008–09 (%)	*2007–08 (%)*
Gross Profit Margin	44.16	47.25
Cash Operating Profit Margin-EBITDA	34.00	35.40
Operating Profit	30.37	31.67
PBT	27.25	31.84
Net Profit Margin	19.37	21.12
Operating Ratio	69.63	68.33

There is a major difference between the values of Earnings before Income, Tax, Depreciation and Amortisation (EBITDA) and

operating profit, which indicates that a considerable sum has been spent on indirect expenses (around 4 per cent every year).

The significant decline in the Net Profit Margin with respect to Profit Before Taxes (PBT) indicates that taxes have been taking away a major chunk of the profit margins. Even though this has decreased from around 10.5 per cent in 2007–08 to 8 per cent in 2008–09, there is still scope for improvement. The reason for this decline is the reduction in the percentage of tax levied, as a part of the initiative taken by the government to maintain a sustained level of production in a recession-hit economy.

SAIL

Their decreasing PAT in 2008–09 (when compared to the previous year) illustrates the prevailing market condition and demand crunch in steel markets. While calculating EBITDA, indirect operating expenses are subtracted from gross profit. In this case (see Figure 6.1) we subtracted pre-operative expenses capitalised from expenses. Since pre-operative expense capitalised has a very high value, it resulted in the inflation of EBITDA and, hence, Net Profit.

The operating efficiency of SAIL is less than PBT. This implies that non-operating income is high and is the major component of revenues. Therefore, it is advisable that SAIL should concentrate more on them.

Figure 6.1: Profitability Trend of TATA Steel

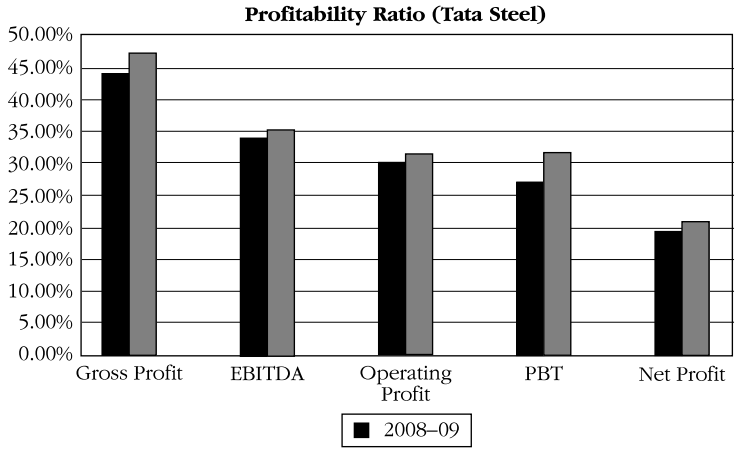
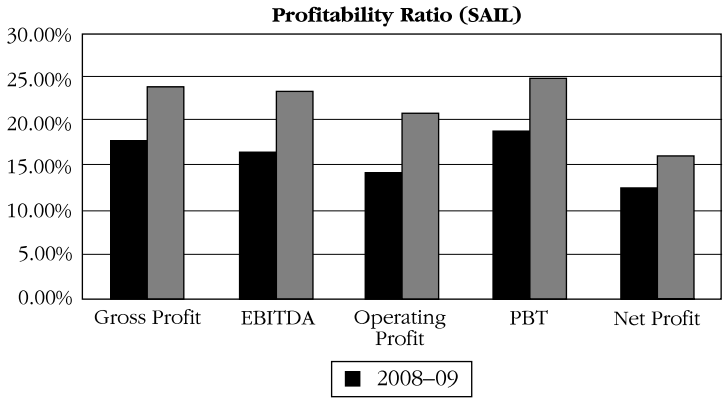


Table 6.2: Profitability Ratios of SAIL

	2008–09 (%)	*2007–08 (%)*
Gross Profit Margin	18.26	24.22
Cash Operating Profit Margin-EBIDTA	17.04	23.91
Operating Profit	14.43	21.22
PBT	19.10	24.94
Net Profit Margin	12.65	16.46
Operating Ratio	85.57	78.78

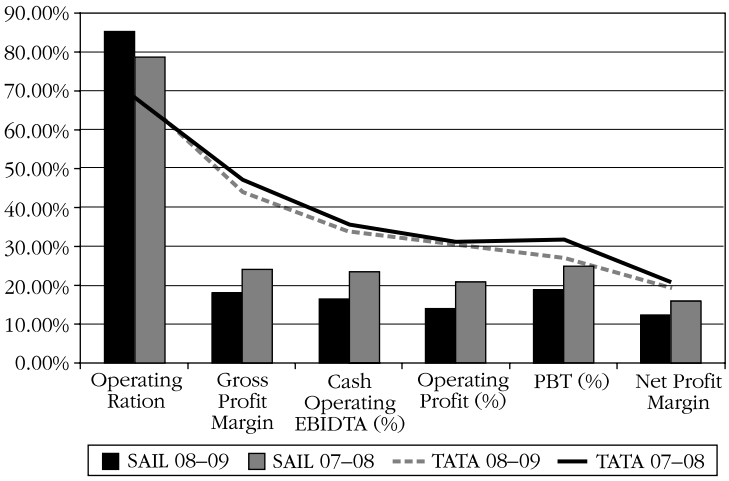
It has been a common phenomenon for most companies (manufacturing, in particular) to have declining profits because of the fall in demand due to there cession. However, a fall in the percentage of profit or profitability ratios is a matter of concern (see Figure 6.2). The fall in the gross profitability ratio has led to a fall in all subsequent ratios. This means that the operating margin has decreased, which may be due to an increase in the price of raw materials, but the sales price of steel has not increased by the same proportion. The comparative profitability analysis of both companies is explained in Figure 6.3.

Figure 6.2: Profitability Trend of SAIL



From the comparative profitability ratios (and Figure 6.3), we can conclude that TATA Steel has better profit margins and operating efficiency as compared to SAIL. Operating Ratio (OR) depicts how efficiently a company has utilised its resources. Since TATA Steel has a lower value, it shows that their operating efficiency has been better than SAIL's. In fact, TATA Steel is rated as the most efficient

Figure 6.3: Comparative Profitability of TATA Steel and SAIL



global producer of steel. Nonetheless, it is still a matter of concern as the OR has increased by nearly 1.5 per cent during the period under study (2007–08 to 2008–09). This indicates a loss of operating efficiency, which may be attributed to the increase in the cost of raw materials.

The PBT of SAIL is higher than the Operating Profit for both years that implies that the PBT or PAT may be a misnomer as the profit from core competency is less. A higher percentage of PBT could be attributed to high returns on income from other sources, which are taking the PAT margin higher; whereas, in the case of TATA, the returns from steel-making are quite high. Therefore, TATA Steel is a better company from the perspective of shareholders.

Return Earned and Distributed

The following ratios are used in the present section:

(*a*) Return on Investment (ROI) or Return on Capital Employed (ROCE) = [EBIT/Capital Employed]
(*b*) Return on Net Worth (RONW) = [PAT-Preference Dividend-DDT]/Net Worth
(*c*) Earnings per Share (EPS) = [PAT-Preference Dividend-DDT]/Number of Equity Shares

(*d*) Dividend Per Share (DPS) = Dividend paid to equity shareholders/No. of Equity Shares

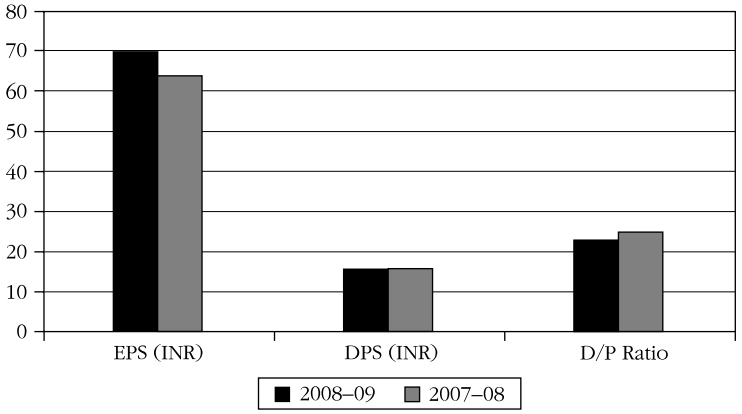
The return picture of the units is given in Tables 6.3 and 6.4. Their graphical representation is shown in Figures 6.4 and 6.5.

TATA Steel

Table 6.3: EPS, DPS and D/P Ratio of TATA Steel

	2008–09	*2007–08*
ROI	14.27%	15.51%
RONW	20.61%	21.37%
EPS (INR)	69.68	63.83
DPS (INR)	16.00	16.00
D/P Ratio	22.96%	25.06%

Figure 6.4: EPS, DPS and D/P Trend of TATA Steel



From the given description, it can be inferred that EPS has increased in proportion with PAT. Dividend payout ratio is where the company shares their earnings with shareholders. Here, the DPS ratio is 25 per cent, that is, it is creating wealth for shareholders as there are not many expansion plans lined up for the company.

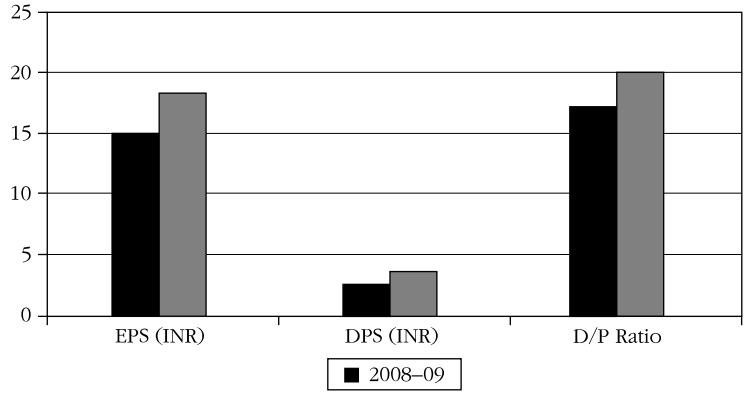
SAIL

The dividend payout ratio of TATA Steel is more than that of SAIL. But earnings distribution in the form of dividends is not the main

Table 6.4: EPS, DPS and D/P Ratio of SAIL

	2008–09	*2007–08*
ROI	20.01%	37.39%
RONW	22.25%	32.82%
EPS (INR)	15.08	18.33
DPS (INR)	2.60	3.70
D/P Ratio	17.25%	20.19%

Figure 6.5: EPS, DPS and D/P Trend of SAIL



parameter for an investor. An investor will look for wealth maximisation in the form of capital gains and not on dividend. In case of SAIL, the dividend payout ratio is lesser but the RONW are more than that of TATA Steel, which is more important; TATA Steel's RONW has increased by a smaller amount. SAIL also has a higher ROCE and RONW, which are increasing at a higher rate compared to TATA Steel. Therefore, SAIL is a better investment when compared to TATA Steel.

Assets Utilisation

Efficiency in terms of assets utilisation of the units has been discussed in Tables 6.5 and 6.6. Their trend is given in Figures 6.6 and 6.7.

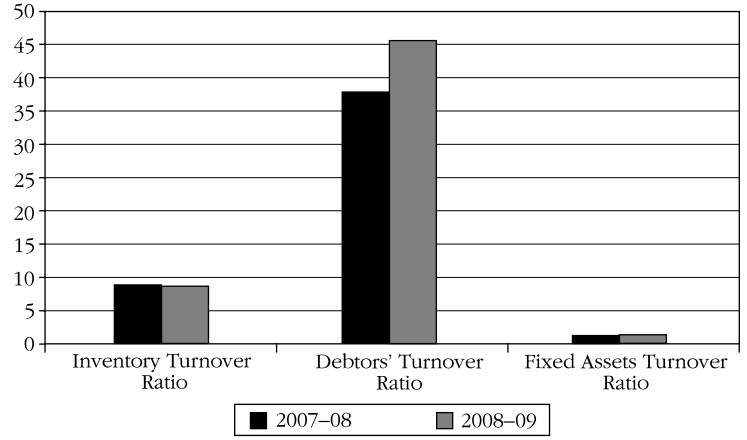
TATA Steel

Inventory turnover ratio has marginally decreased due to the increase in the inventory period, which does not affect the company much as

Table 6.5: Turnover Ratios of TATA Steel

	2007–08	*2008–09*
Inventory Turnover Ratio	8.94	8.82
Debtors' Turnover Ratio	37.77	45.52
Fixed Assets Turnover Ratio	1.37	1.47

Figure 6.6: Turnover Performance of TATA Steel



it is only a marginal increase. Debtors' turnover ratio has increased because of the decrease in the average collection period. Despite recession, TATA Steel was able to decrease its average collection period, which is a very good sign for the company. Fixed asset turnover ratio has been increasing implying that the sales generated by a single unit of fixed asset are on the rise. It has resulted in the increase of return to shareholders. All turnover ratios of TATA Steel have been increasing, even in the recessionary period.

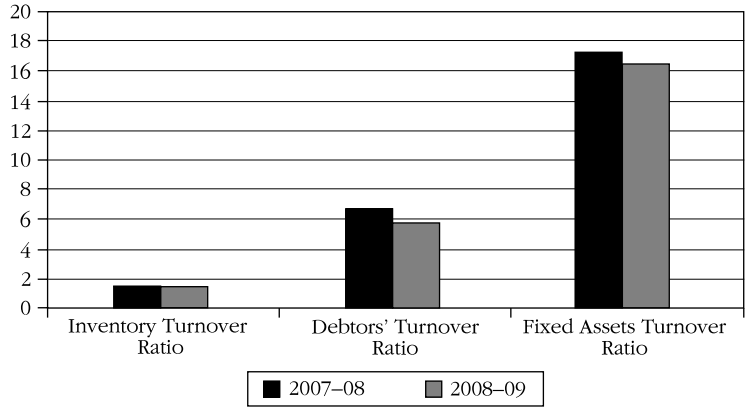
SAIL

Inventory turnover ratio has marginally increased due to the reduction in the inventory period, which is good for the company. Debtors' turnover ratio has decreased because of the increase in average collection period — due to the recession and the credit crunch faced by many customers. Fixed asset turnover ratio has been decreasing, implying that the sales generated by a single unit of fixed asset is on the decline. All turnover ratios of SAIL are decreasing and the reason for this decline has been the recession.

Table 6.6: Turnover Ratios of SAIL

	2007–08	*2008–09*
Inventory Turnover Ratio	1.51	1.55
Debtors' Turnover Ratio	6.65	5.69
Fixed Assets Turnover Ratio	17.15	16.22

Figure 6.7: Turnover Performance of SAIL



Liquidity

The liquidity analysis of the companies has been in Tables 6.7 and 6.8. Their trend can be seen in Figures 6.8 and 6.9.

Current Ratio (CR) = Current Assets/Current liabilities
Liquid Ratio (LR) = Liquid assets/Current liabilities
Super Quick Ratio (SQR) = Cash and Bank/Current liabilities

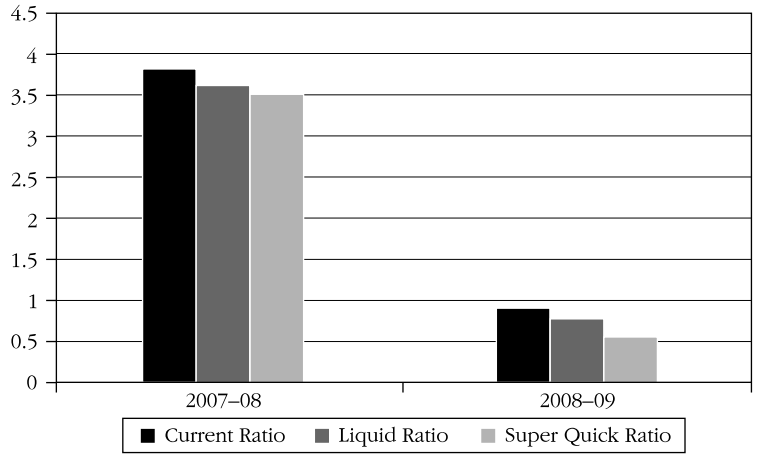
TATA STEEL

All liquidity ratios have fallen drastically indicating the poor liquidity of the company, resulting in the reduction of the debt paying ability of TATA Steel. This can be owed to recession as well as TATA Steel's

Table 6.7: Liquidity Ratios of TATA Steel

	Current Ratio	*Liquid Ratio*	*Super Quick Ratio*
2007–08	3.81	3.62	3.52
2008–09	0.91	0.78	0.57

Figure 6.8: Liquidity Trend of TATA Steel



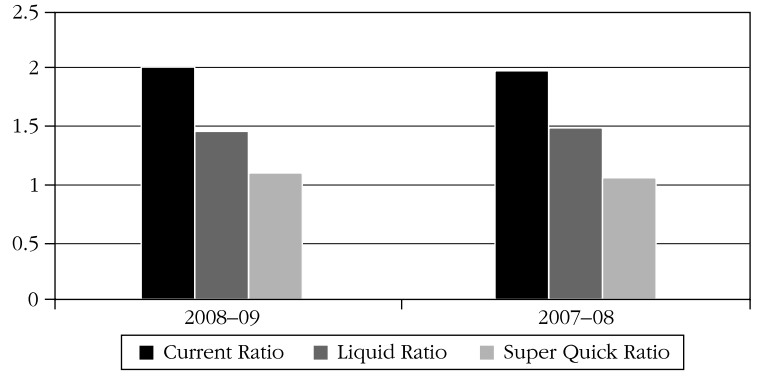
acquisition of Corus. In general for a steel industry, the liquidity is very less.

SAIL

Table 6.8: Liquidity Ratios of SAIL

	Current Ratio	*Liquid Ratio*	*Super Quick Ratio*
2007–08	1.98	1.45	1.02
2008–09	2.006	1.41	1.05

Figure 6.9: Liquidity Trend of SAIL



SAIL, on the other hand, has good liquidity ratio. Having a quick ratio of more than 1 is also a good indicator, as the company can pay its current liability with the cash in hand itself.

Solvency

The soundness of units has been discussed in Tables 6.9 to 6.10 and Figures 6.10 to 6.11.

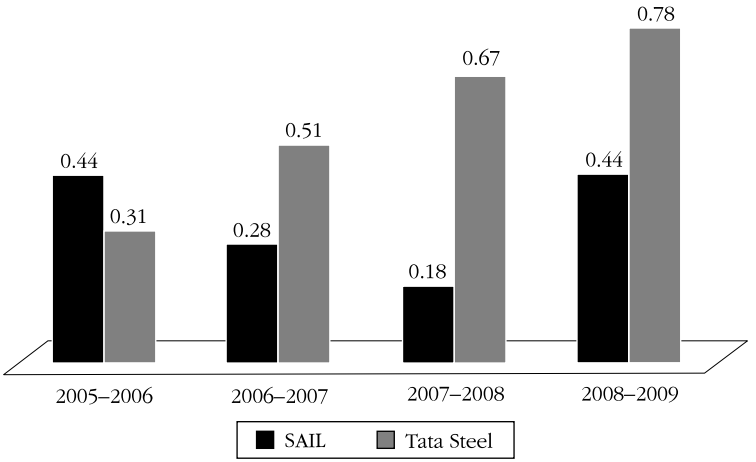
Debt-Equity (D/E) Ratio = DEBT/Equity
Interest Coverage Ratio (ICR) = EBIT/Interest

Debt–Equity Ratio

Table 6.9: Debt–Equity Ratio of TATA Steel and SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
SAIL	0.44	0.28	0.18	0.44
TATA Steel	0.31	0.51	0.67	0.78

Figure 6.10: Debt–Equity Trend of TATA Steel and SAIL



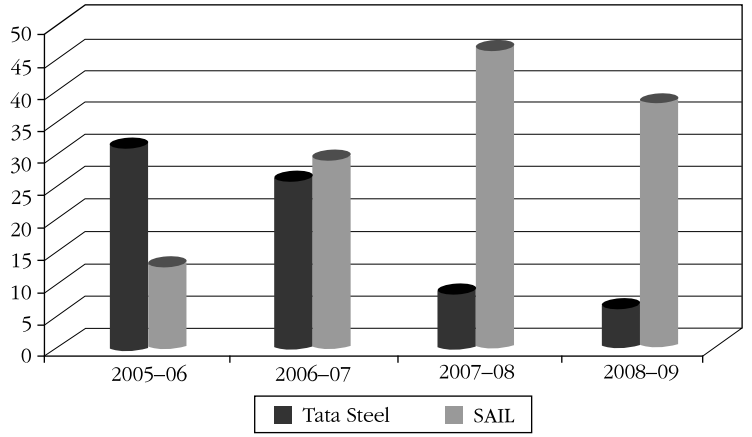
D/E ratio of TATA steel is on the rise and is higher than that of SAIL. Therefore, SAIL has good solvency when compared to TATA Steel. Furthermore, SAIL has a good D/E ratio and the ability to pay all its obligations on due. Consequently, it is financially stronger than TATA Steel.

Interest Coverage Ratio

Table 6.10: Interest Coverage Ratio of TATA Steel and SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
TATA Steel	31.03	25.92	8.61	5.91
SAIL	13.2	29.37	46.7	38.13

Figure 6.11: Interest Coverage Picture of TATA Steel and SAIL



A higher ICR is better for any company since only a small percentage of the operating profit is paid as interest, which means more is left over for shareholders. Higher interest coverage is an indication of the financial soundness of the company. As evident from Figure 6.11, SAIL has a very good ICR and is financially sound compared with that of TATA Steel.

Market-based Valuations

These ratios are used to calculate how the market responds to a company's performance.

Price–Earning Ratio (P/E) = Market price per share/EPS
Dividend Yield (DY) = Dividend per share/Market price per share
Book value per share (BVPS) = Net worth/Number of shares
Price-to-Book Ratio (PBR) = Market price per share/Book value per share

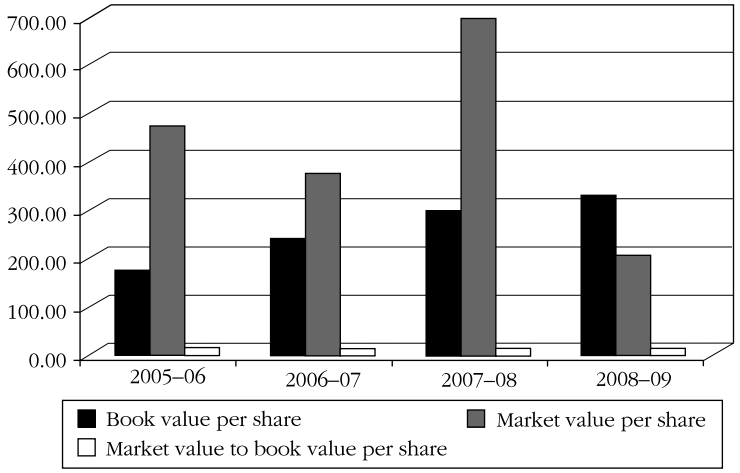
Market valuation of units has been given from Tables 6.11 to 6.14 and Figures 6.12 to 6.15.

TATA Steel Valuation

Table 6.11: Valuation Ratios of TATA Steel

	2005–06	*2006–07*	*2007–08*	*2008–09*
Book value per share	176.26	240.31	298.78	331.68
Market value per share	474.30	374.82	693.00	206.00
Market value to book value per share	2.69	1.56	2.32	0.62

Figure 6.12: Valuation Picture of TATA Steel



Book value of TATA Steel has been increasing over the years indicating strong fundamentals of the company. This has also been responded to in the market price of the company. Market has rewarded shareholders due to the company's good performance. Price-to-book value is a tool which investors use to pick stocks. A stock which has a good growth potential and a low P/B, such as TATA Steel, is a very good investment option.

SAIL Valuation

Like TATA Steel, SAIL also has shown a continuous increase in the book value, indicating strong internal strength of the company. Even the market has favoured the company, irrespective of good performance, as reflected in its P/B ratio.

Table 6.12: Valuation Ratios of SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
Book value per share	30.51	41.92	55.84	67.75
Market value per share	76.65	107.50	184.75	96.50
Market value to book value per share	2.51	2.56	3.31	1.42

Figure 6.13: Valuation Picture of SAIL

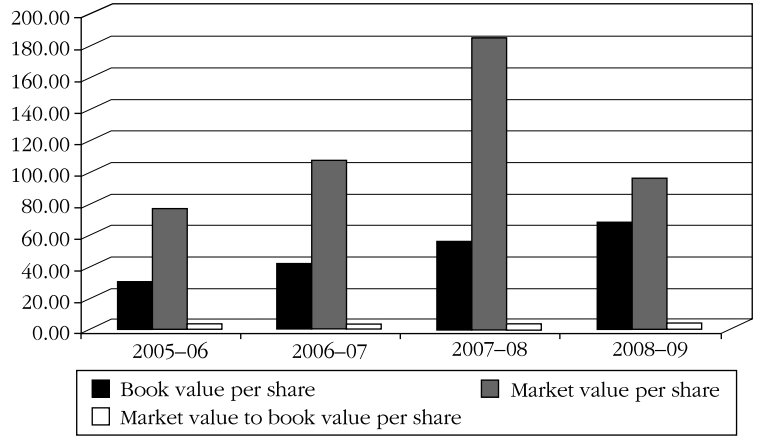
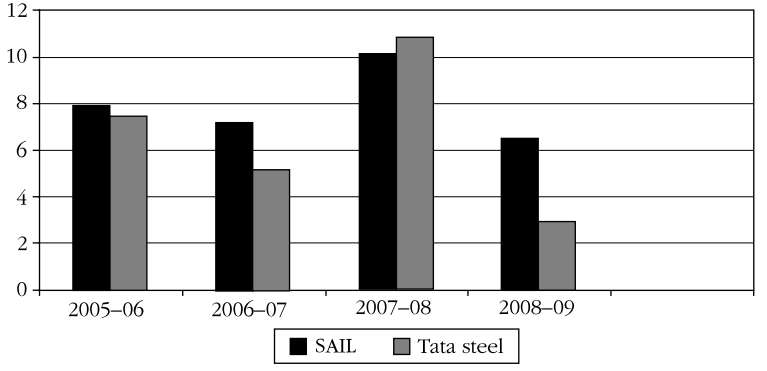


Table 6.13: Price-Earning Ratio of TATA Steel and SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
SAIL	7.89	7.16	10.12	6.45
TATA Steel	7.49	5.15	10.85	2.96

Figure 6.14: Price-Earning Chart of TATA Steel and SAIL

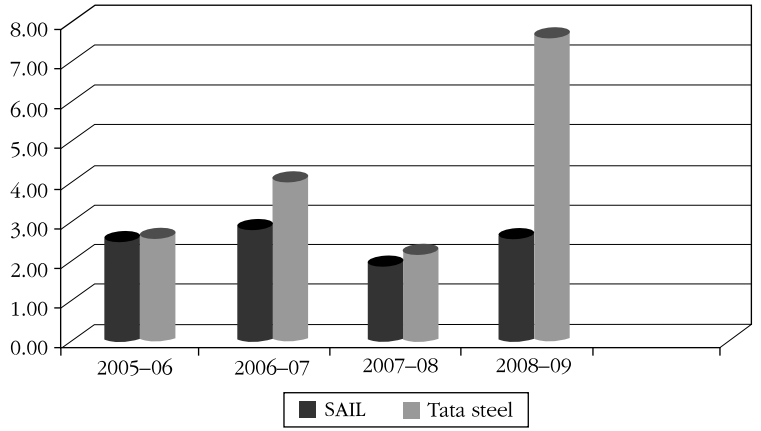


P/E ratio is widely used for picking stocks. TATA Steel with a P/E ratio of 2.96 is available at a cheap price and at a discount to retail investors. Both SAIL and TATA Steel have been trading at a low P/E ratio, when compared with the industry average. Therefore, both companies have the potential to grow and result in capital gains.

Table 6.14: Dividend-yield Ratio of TATA Steel and SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
SAIL	2.61	2.88	2.00	2.69
TATA Steel	2.74	4.14	2.31	7.77

Figure 6.15: Dividend-yield Chart of TATA Steel and SAIL



Dividend yield ratio is the return which shareholders get for the investment, in case there is no capital appreciation. Investment decisions will not be made on dividend yield as the investor will be more interested in capital appreciation than dividend yield. Nonetheless, TATA Steel has a good dividend yield as compared to SAIL.

Inventory Valuation

Inventories include finished products unsold, work in progress, and stores and spares. At TATA Steel and SAIL, raw materials, stores and spares and finished/semi-finished products are valued at lower of cost and net realisable value of the respective plants. In case of identified obsolete/surplus/non-moving items, necessary provision is made and charged to revenue. The net realisable value of semi-

finished special products, which have realisable value at finished stage only, is estimated for the purpose of comparison with cost. Iron ore fines not readily useable/saleable are recognised on disposal. Residue products and scrap of various natures are valued at estimated net realisable value. Hence, in terms of practices followed, there's not much deviation in both SAIL and TATA Steel as they follow the same inventory valuation practices.

Conclusion

These financial analysis give us excellent insights into the steel industry while the profitability, operating efficiency, solvency and efficiency in asset management (as well as other parameters) enabled us to engage in a comparison between SAIL and TATA Steel. It is evident that due to recession, the profitability of both companies reduced when compared to the previous years.

7

Automobile Sector

Maruti Suzuki India Limited vs Hindustan Motors

The Indian automobile industry has demonstrated a phenomenal growth, ever since the first car was seen on the streets of Mumbai in 1898. Today, the industry presents a galaxy of varieties and models, meeting all possible expectations and globally established industry standards. Some of the leading names in this sector include Maruti Suzuki, Tata Motors, Mahindra and Mahindra, Hyundai Motors, Hero Honda and Hindustan Motors.

During the early stages of its development, the Indian automobile industry (ranked seventh largest in the world) depended heavily on foreign technologies but, over the years, manufacturers had also started using their indigenous equipment. India manufactures more than two million cars every year and contributes an identifiable chunk in the world's total production; in 2011, it contributed 5 per cent to the total world production, amounting to 3,038,332 cars. The country is also the largest manufacturer of motorcycles and the fifth largest producer of commercial vehicles. India's automobile sector may become one of the global leaders by 2012. In fact, India's automobile sector is the tenth largest in the world with an annual car production of approximately 2 million out of the world's 73 million, and is the fifth largest commercial vehicle manufacturer. Currently, India dedicates 75 per cent of its automobile industry to small cars, more than any other country in the world. After the recent recessionary trend, vehicle sales increased substantially in the quarter ending June 2010, over the sales in the earlier precious quarter ending March 2010.

The major question, however, is whether this trend will continue or not. The major reason for the auto industry's progress was the

return of economic growth (at 7.4 per cent) in the financial year ending of March 2010, based on a strong urban and rural demand, which increased financial availability at affordable interest rates and improved exports while global auto players rushed for a share of the burgeoning market. This stability has given auto manufacturers the confidence to partially pass on rising raw material prices through increases in vehicle prices.

This chapter appraises and analyses the financial performances of Maruti Suzuki India Limited and Hindustan Motors. Maruti Suzuki India Limited is India's leading automobile manufacturer and the market leader (for over two decades) in the car segment, both in terms of volume of vehicles sold and revenue earned. Hindustan Motors, the maker of the iconic Ambassador, is a part of Birla Technical Services industrial group. The company was the largest car manufacturer in India before the rise of the erstwhile Maruti Udyog Limited. Hindustan Motors is currently facing erosion of its peak net worth.

Comparative Analysis of Maruti Suzuki and Hindustan Motors

For the comparative study, we have to use the ratio analysis pertaining to the data in the respective balance sheets of these companies over a period of observation (2006–10). We also need to compare the ratios of both companies to the standards of the automobile sector (cars) for the corresponding years. The financials have been discussed in the following sections.

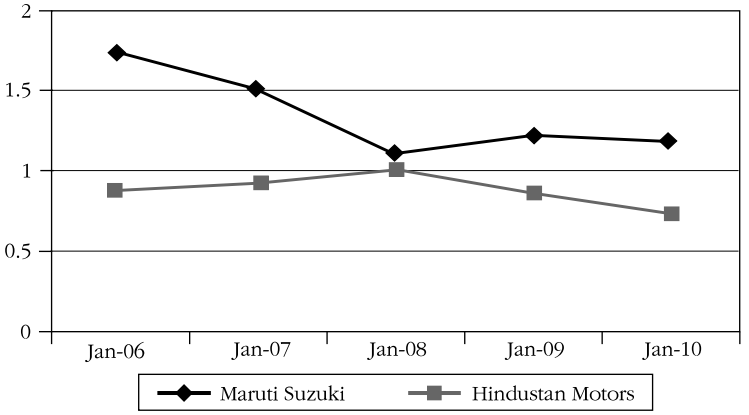
Short-Term Perspective

This is discussed with the help of short-term ratios as given in Tables and Figures 7.1 to 7.4.

Table 7.1: Current Ratio of Maruti and Hindustan Motors

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	1.19	1.22	1.13	1.52	1.73
Hindustan Motors	0.73	0.87	1	0.92	0.88

Figure 7.1: Current Ratio of Maruti and Hindustan Motors



(*a*) For the year 2010, the current ratio of Maruti Suzuki is higher than Hindustan Motors. Therefore, it can be inferred that Maruti is a better bet for short-term lending, as compared to Hindustan Motors.

(*b*) When we refer to the balance sheet in detail, the fall in Maruti's current ratio can be attributed to its recent expenditure on fixed assets leading to a reduction in cash assets.

(*c*) The decrease in Hindustan Motors' current ratio (over the year) can be ascribed to the greater percentage increase in current liabilities as compared to the percentage increase in current assets.

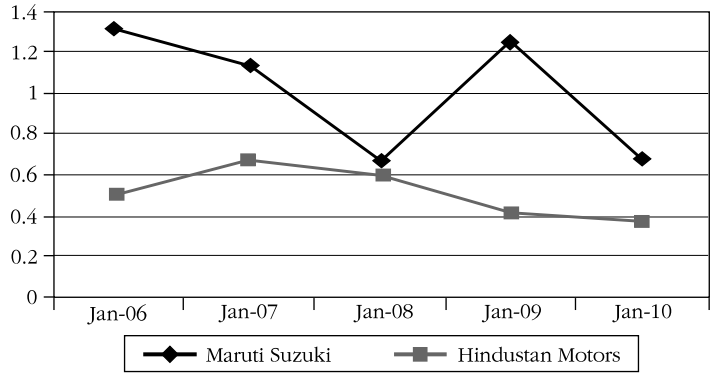
(*d*) Also, as is evident from the industry standard ratios (of 1), the current ratio for Maruti is greater than 1 while for Hindustan Motors it is less than 1. This clearly implies that Maruti is a safe bet for short-term lending, as per the industry standards, too.

Quick Ratio

Table 7.2: Quick Ratio of Maruti and Hindustan Motors

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	0.68	1.26	0.66	1.13	1.31
Hindustan Motors	0.37	0.42	0.59	0.68	0.51

Figure 7.2: Quick Ratio of Maruti and Hindustan Motors



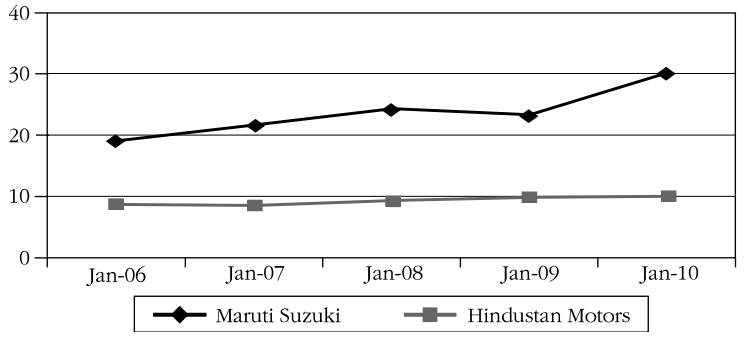
(*a*) Maruti has a greater quick ratio as compared to Hindustan Motors, which is why it is a safer option for short-term lending. In 2009 (and subsequently), however, the quick ratio for Maruti has fallen significantly and the percentage impact is greater than its current ratio, because of fall in cash due to the investment in fixed assets. On the other hand, the quick ratio has remained fairly unchanged for Hindustan Motors.

Inventory Turnover Ratio

Table 7.3: Inventory Turnover Ratio of Maruti and Hindustan Motors

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	30.27	23.89	24.18	21.74	19.06
Hindustan Motors	10.02	9.82	9.23	8.55	8.92

Figure 7.3: Inventory Turnover Ratio of Maruti and Hindustan Motors



(*a*) Inventory Turnover Ratio for Maruti has been consistently higher in comparison with Hindustan Motors, which means that Maruti's inventory is more frequently sold and replaced. A low turnover is usually a bad sign because products tend to deteriorate while they are stored in a warehouse. Therefore, as previously discussed, it seems to be a better deal to lend to Maruti, in the short term, over Hindustan Motors.

(*b*) The industry average for this ratio is around 13. Maruti is placed considerably higher in Table 7.3 in terms of this ratio while Hindustan Motors is rated much lower in comparison.

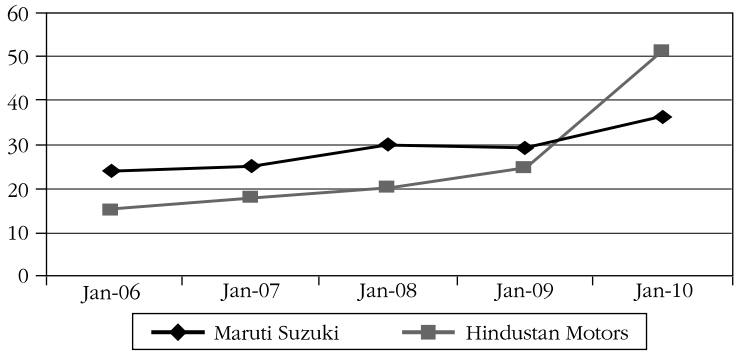
(*c*) With respect to 2009, both Maruti and Hindustan Motors have improved in terms of the inventory turnover ratio, which can be attributed to an improvement in their distribution frequency. The recovery of the overall economy may have also led to this increase.

Debtors' Turnover Ratio

Table 7.4: Debtors' Turnover Ratio of Maruti and Hindustan Motors

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	36.56	29.1	29.97	24.69	23.69
Hindustan Motors	50.81	25	20.24	17.92	15.7

Figure 7.4: Debtors' Turnover Ratio of Maruti and Hindustan Motors



(*a*) A sharp rise in the value of debtors' turnover ratio can be witnessed for both Maruti and Hindustan Motors. But this value has increased (relatively) more for Hindustan Motors as compared to Maruti. The indicator states that the rate at which

credit sales were converted into cash has accelerated for both firms, but Hindustan Motors has witnessed this change more dominantly. But the reason for this increase is different for both companies. For Maruti, the increase was predominantly due to the increase in its sales. For Hindustan Motors, on the other hand, this increase was mainly due to a sharp decrease in the number of debtors.

(*b*) The value of this ratio has increased for the auto industry from 18.94 in 2009 to 25.79 in 2010. Therefore, there is an overall improvement in the auto industry in this parameter. Both companies have also improved individually on this parameter, over the industry as a whole, which is a positive sign for the min the short run. But an in-depth observation of the balance sheet shows that Maruti is again a better bet according to this ratio, because the underlying reason is the increase in its sales.

Long-Term Perspective

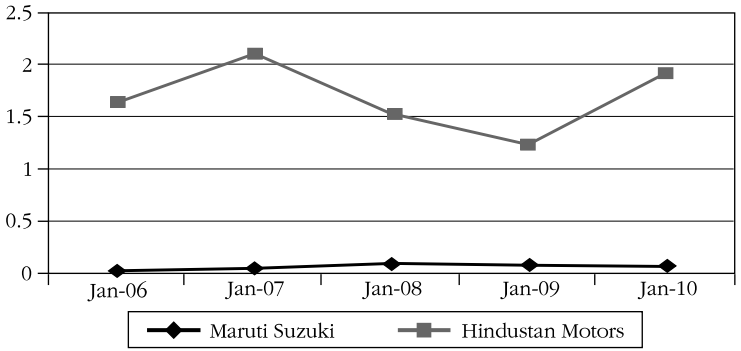
For long-term lending perspective, the company's inclination for expansion and growth of assets, over a period of time, are given as in Tables 7.5 and 7.6 and Figures 7.5 and 7.6.

Debt to Equity Ratio

Table 7.5: Debt–Equity Ratio of Maruti and Hindustan Motors

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	0.07	0.09	0.1	0.06	0.04
Hindustan Motors	1.94	1.24	1.52	2.1	1.64

Figure 7.5: Debt–Equity Ratio of Maruti and Hindustan Motors



(*a*) We can see a stark difference between the two balance sheets in terms of their debt to equity ratio. It is inferred that Maruti is a healthy firm as far as a long-term lending decision is concerned. The company has almost negligible loans whereas Hindustan Motors has a huge amount. Therefore, Maruti does not have long-term fixed obligations to pay, which is a sign of sound financial health. But the same cannot be said for Hindustan Motors.

(*b*) The industry average of this ratio is 0.67 for 2010 and even though Maruti scores very low on this rating, it suggests that the company has taken less amount of risk in terms of long-term debts, at the same time, indicating that they have a high room for leverage in terms of the loans it can take for expansion. Therefore, it is a positive sign for Maruti in the long run. And a reverse call for Hindustan Motors.

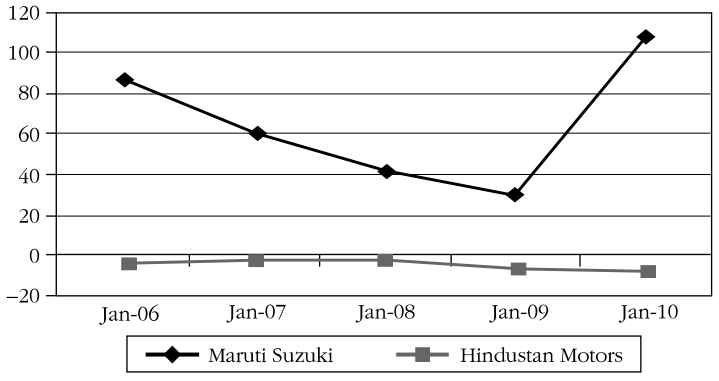
Interest Coverage Ratio

Interest coverage ratio is the ratio between 'net profit before tax and interest' and 'interest on long term loans'. It is also termed as 'Debt Service Ratio'.

Table 7.6: Interest Coverage Ratio of Maruti and Hindustan Motors

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	108.24	29.91	43	61.63	86.78
Hindustan Motors	–7.34	–7.06	–1.86	–2.62	–4.16

Figure 7.6: Interest Coverage Ratio of Maruti and Hindustan Motors



(*a*) The interest coverage ratio comparison between both companies again presents a very varied picture. While Maruti has got a high ratio of 108.24, Hindustan Motors has got a negative ratio. This simply implies that Maruti has a profit margin that is 108 times its requirement for paying back the interest due on its long-term debts while Hindustan Motors' negative ratio implies its incapability to pay off the interest due on their debts, in the long run. Even in comparison with the industry average of 8.86, Maruti is placed quite high.

Investment Perspective

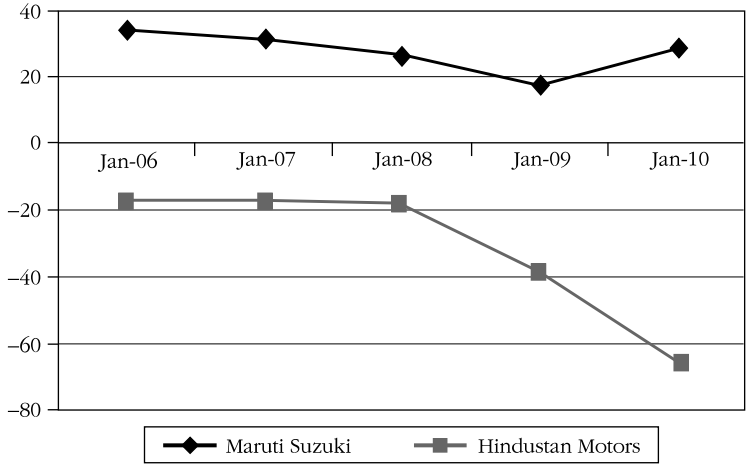
The investment perspective analyses has been presented with the help of Tables 7.7 to 7.9 and Figures 7.7 to 7.9.

Return on Capital Employed (ROCE)

Table 7.7: ROCE of Maruti and Hindustan Motors (%)

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	28.41	17.37	26.18	30.65	33.46
Hindustan Motors	–65.22	–38.22	–17.77	–16.99	–17.24

Figure 7.7: ROCE of Maruti and Hindustan Motors



Total capital includes long-term debt, and common and preferred shares. For those companies that receive income from other sources

or those that have other conflicting items in their net income, net operating profit after tax (NOPAT) may be used instead.

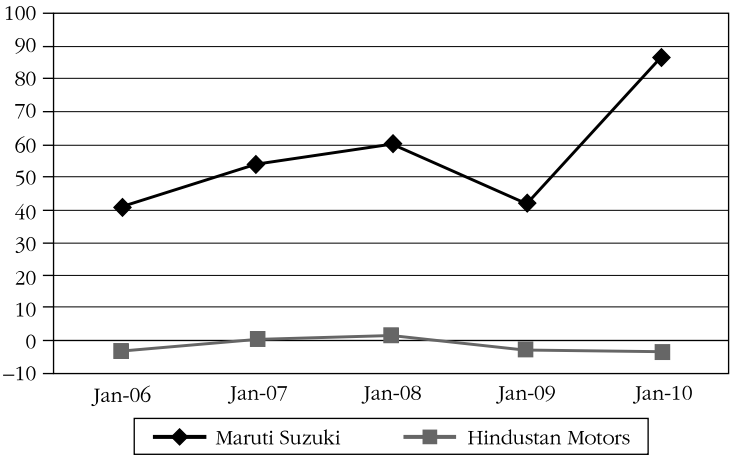
(*a*) ROCE is another indicator which proves that Maruti is performing (currently) and is expected to perform much better as compared to Hindustan Motors.
(*b*) It is also seen that the ROCE value for Maruti had decreased to about 17.3 in 2009 from 26 in 2008 but in 2010 it had considerably recovered to 28.1. The steep fall in 2009 can be attributed to the slump that the world economy had witnessed in the corresponding period.
(*c*) The industry average was around 18 in 2010. When compared against this value, Maruti seems to have been performing fairly well.

Earnings per Share (EPS)

Table 7.8: Earnings per Share of Maruti and Hindustan Motors

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	86.45	42.18	59.91	54.07	41.16
Hindustan Motors	–3.17	–2.41	1.91	0.82	–2.71

Figure 7.8: Earnings per Share of Maruti and Hindustan Motors



Earnings per share (EPS) is generally considered to be the single most important variable in determining a share's price. It is also a

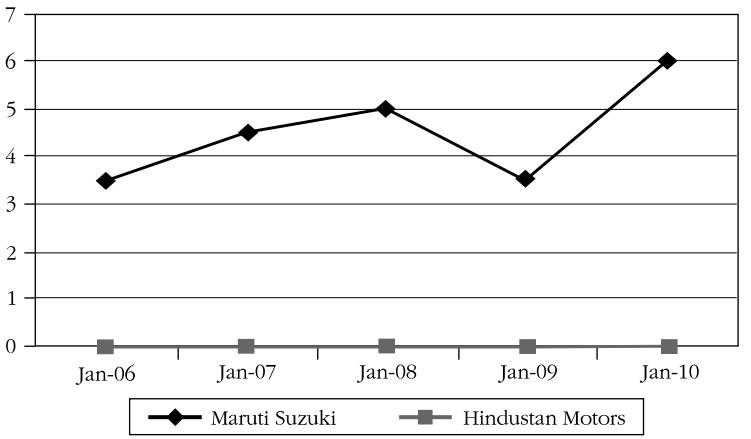
major component used to calculate the price-to-earnings valuation ratio. According to Table 7.8 and Figure 7.8, Maruti clearly has got a high EPS in comparison with Hindustan Motors, which has actually rendered a loss of INR 3.17 per share. If Hindustan Motors, at least, had a positive EPS, then it would have made sense to compare the capital required by both companies to generate respective amounts of profit per share. An important aspect of EPS that should not be ignored is the capital that is required to generate earnings (net income) in the calculation. Two companies could generate the same EPS number, but one could do so with less equity (investment) — that company then would be a 'better' one as it is more efficient at using its capital to generate income (when all other things are equal).

Dividend per Share (DPS)

Table 7.9: Dividend per Share of Maruti and Hindustan Motors

	March 2010	*March 2009*	*March 2008*	*March 2007*	*March 2006*
Maruti Suzuki	6	3.5	5	4.5	3.5
Hindustan Motors	0	0	0	0	0

Figure 7.9: Dividend per Share of Maruti and Hindustan Motors



(*a*) Dividend per share is a good indicator of long-term investment analysis. A long-term investor is interested in getting a good return from the firm in the form of dividend earnings.

While the dividend payment for Maruti is positive for all the years under observation, Hindustan Motors had paid no dividend in the corresponding years.

(*b*) For Maruti, the dividend paid per share has consistently increased over years, which only affirms the interest of long-term investors towards the capacity and intention of the firm to disburse profit share to its shareholders.

Conclusion and Suggestions

(*a*) The overall analysis of both firms indicates that a clear choice for both long- and short-term lending as well as investments should be Maruti, in comparison with Hindustan Motors. Also, Maruti's data shows that the company's balance sheet looks good even and can hold its own against the automobile sector as a whole.

(*b*) Since Maruti is a cash rich and zero debt company, they should either look to make acquisitions or return the cash to shareholders by giving special dividends and/or share buyback.

(*c*) Several reasons are attributed to Hindustan Motors' significant decline in sales over the years, such as (*i*) Obsolescence with respect to the technology being used by the company and (*ii*) lack of innovation in the operations of the company. Therefore, the company should first focus to improve its operations and then do away with its creditors, in a phased manner.

8

Cement Sector

Associated Cement Company Limited vs Cement Corporation of India Limited

Cement is a necessary constituent of infrastructure development and a key raw material for the construction industry, especially in the government's infrastructure development plans in the context of the nation's socio-economic development. Therefore, the cement and the total utilisation of cement in a year is used as an indicator of economic growth.

An increased outflow in the infrastructure sector, by the government as well as private builders, has raised a significant demand of cement in India. Major cement manufacturers and exporters have made huge investments in the last few years to increase their production capability. This heralds an optimistic outlook for the cement industry in India. The housing sector in India accounts for 50 per cent of the cement's demand, and this demand is expected to continue. With the constant efforts made by cement manufacturers and exporters, India has become the second largest cement producer in the world.[1] Associated Cement Company Ltd (ACC), Ambuja Cements Ltd, Grasim Industries Ltd and J.K Cement Ltd. feature among the major cement companies in India.

This chapter analyses the financial performances of Associated Cement Company Limited (ACC) and Cement Corporation of India Limited (CCIL) on a comparative basis. ACC is a market leader in the Indian cement sector. It is a private sector company whereas CCIL is a public sector company.

About the Companies

Associated Cement Company Limited (ACC)

ACC Limited[2] is India's foremost manufacturer of cement with a countrywide network of factories and marketing offices. Established

in 1936, ACC has been a pioneer and trendsetter in cement and concrete technology. Among the first companies in India to include commitment to environment protection as a corporate objective, ACC has won several prizes and accolades for their environment-friendly measures implemented various plants and mines.

Cement Corporation of India Limited (CCIL)

CCIL[3] was incorporated as a company wholly owned by the Government of India on 18 January 1965 with the principal objective of achieving self-sufficiency in cement production. CCIL is a multi-unit organisation at present, comprising 10 units spread over eight states with a total annual installed capacity of 38.48 lakh MT. They manufacture various types of cement such as Portland Pozzolana Cement (PPC), Portland Slag Cement (PSC) and Ordinary Portland Cement (OPC), of varying grades under strict quality control.

Financial Analysis

Profitability

Table 8.1 presents the profitability picture of the sample companies in the chapter. Figures 8.1 to 8.5 analyse the position on the basis of each indicator.

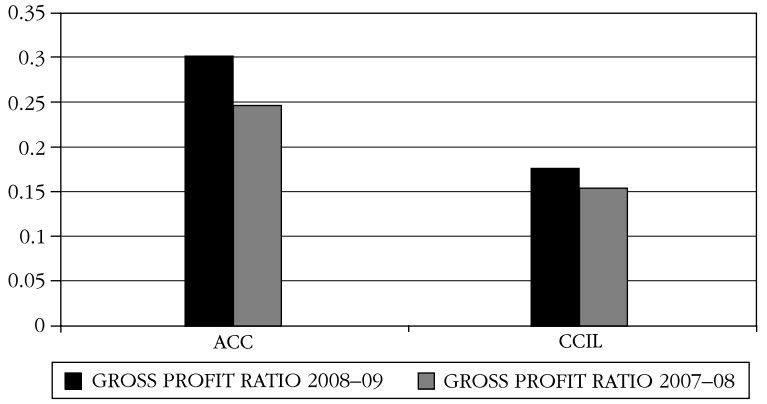
Table 8.1: Profitability Variants of ACC and CCIL

Figures in INR (million)	*ACC*		*CCIL*	
Parameter	*FY09*	*FY08*	*FY09*	*FY08*
Sales	87,242	82,340	3,639	3,427
Gross Profit	26,364	20,308	639	523
EBITDA	27,411	20,708	1,011	872
EBIT	23,990	17,766	902	759
PAT	16,068	12,128	526	409
Operating Expenses	58,626	57,274	2,810	984
Capital Employed	65,831	54,098	–2,496	–3,021
Net Worth	60,162	49,278	–6,468	–7,047

Gross Profit Margin

Gross Profit margin is an indicator of production efficiency. For ACC, the gross profit margin had increased from 0.24 to 0.30 (2007–08 to 2008–09) as also for CCIL (though marginally) from 0.15 to 0.17 (see Figure 8.1).

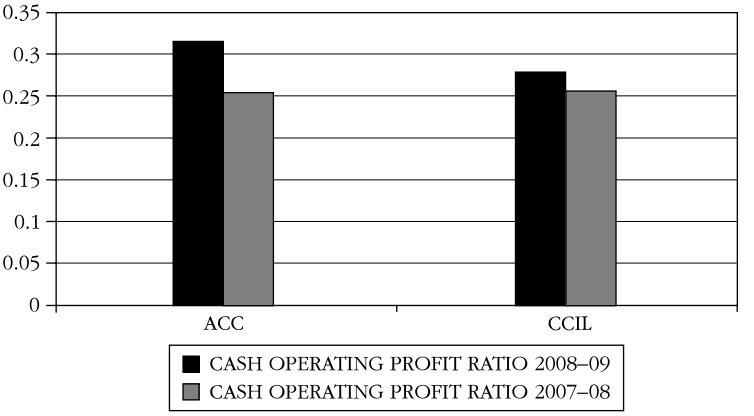
Figure 8.1: Gross Profit Margin of ACC and CCIL



Cash Operating Profit Margin

Again, with regard to cash operating profit margin (see Figure 8.2), there is a substantial improvement in ACC's position from 0.25 to 0.31 (2007–08 to 2008–09) and only a lesser improvement in CCIL's ratio from 0.25 to 0.27.

Figure 8.2: Cash Operating Profit Margin of ACC and CCIL

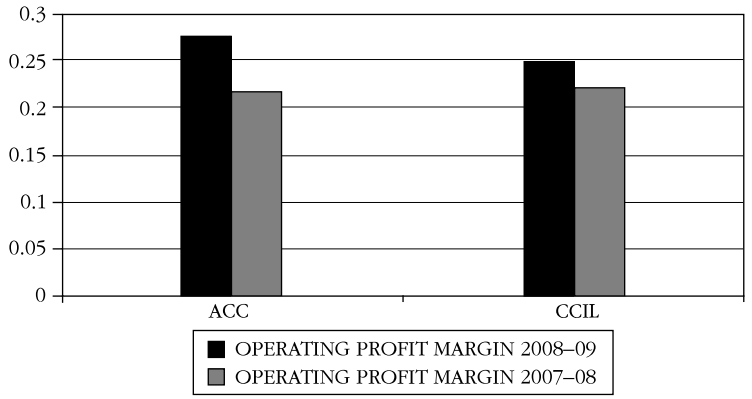


Operating Profit Margin

The operating profit ratio is almost similar in content to gross profit ratio except that operating profit (instead of gross profit) is compared to net sales to calculate this ratio. Here, we note that both

companies have improved upon their operating profit (see Figure 8.3), which is a healthy indicator for them. Any company's efficiency is measured by its core strength, and operating profit ratio is an indicator of core competence of the firm. Since, this ratio has improved for both the companies, it signifies their sound health for future viability.

Figure 8.3: Operating Profit Margin of ACC and CCIL



Net Profit Margin

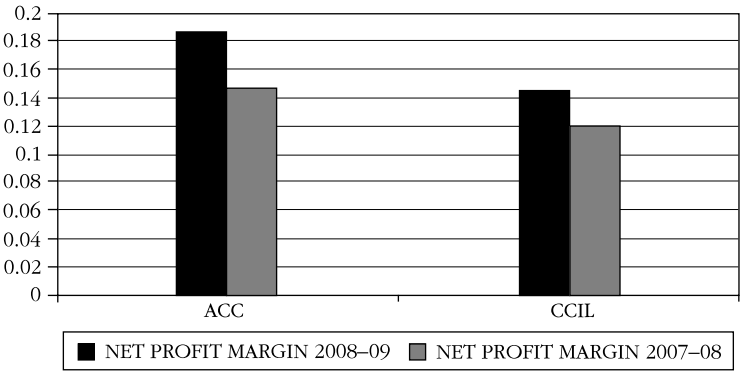
The Net Profit Ratio is based on Profit after Tax (PAT) to net sales. For ACC, the Net Profit Margin has increased from 0.14 to 0.18 whereas for CCIL it has increased from 0.11 to 0.14 (see Figure 8.4).

The performance of CCIL was adversely affected due to a severe liquidity crunch and infrastructural constraints, particularly related to power shortage. Seven units out of 10 are non-operational due to various reasons, such as location in remote areas, obsolete technology, non-modernisation of plants, inadequate captive power, shortage of working capital, and recession in the cement industry until 2004–05. The company became 'sick' and was referred to the Board for Industrial and Financial Reconstruction (BIFR), which directed the operating agency (OA) to appoint a merchant banker to explore the sale of CCIL as a whole as a going concern basis or its units individually or collectively.

Due to the losses accumulated over the years, the Reserves and Surplus (R&S) of the company is in the negative. Therefore, the profits of the last three years have been used to offset these R&S.

As a result, they have not paid any Income Tax for the time period, as allowed under the Income Tax Act.

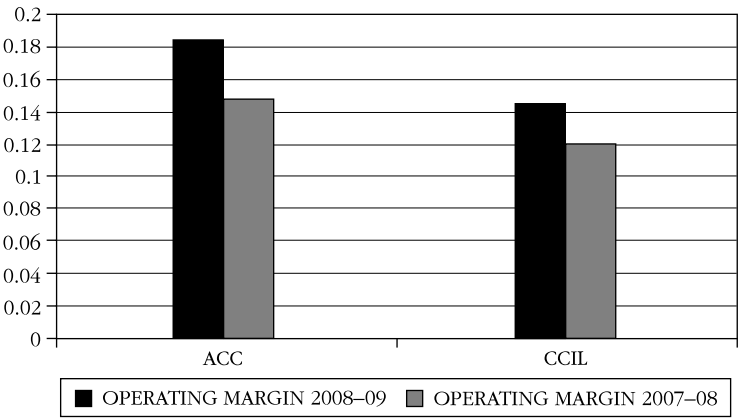
Figure 8.4: Net Profit Margin of ACC and CCIL



Operating Margin

Operating margin is the ratio of operating expenses to sales for a financial year. ACC and CCIL show a divergent trend in their operational efficiency (see Figure 8.5). While ACC has improved upon its operational efficiency, there is a drastic jump in operational expenses for CCIL, which is not a good sign. Operating ratio shows the coverage of expenses by a company. Therefore, any increase in the ratio is a direct indication of poor expenses management.

Figure 8.5: Operating Margin of ACC and CCIL



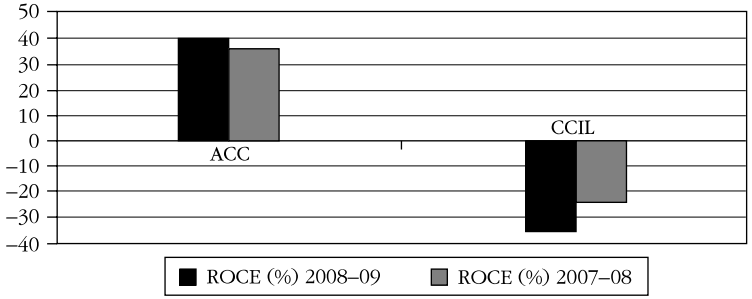
Return Generation

Figures 8.6 and 8.7 present the return generation trend of the companies.

Return on Capital Employed (ROCE)

ROCE indicates the earning power of any project in relation to the investment made, that is, capital fund and other term liabilities, which are deployed for long-term use to run the business. Here, we note that ACC's return on capital has been improving whereas CCIL's ROCE has been indicating losses (see Figure 8.6).

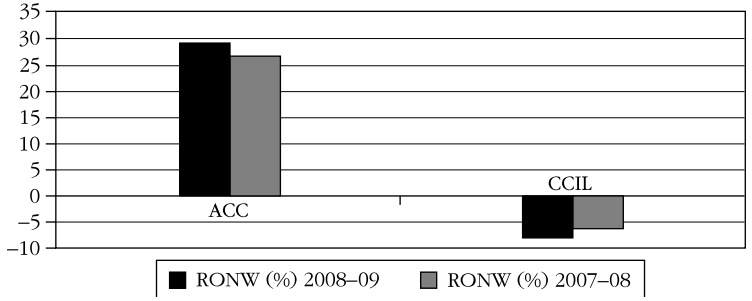
Figure 8.6: ROCE of ACC and CCIL



Return on Net Worth (RONW)

RONW indicates the real amount available to owners as a return on their investment after all claims on income including taxes. Here too, we see a trend similar to that in ROCE — ACC has been improving on its returns from 27 per cent to 30 per cent whereas CCIL has been facing losses (see Figure 8.7).

Figure 8.7: RONW of ACC and CCIL



Efficiency in Assets Utilisation

Table 8.2 and Figures 8.8 to 8.16 present the operating efficiency of the companies under study.

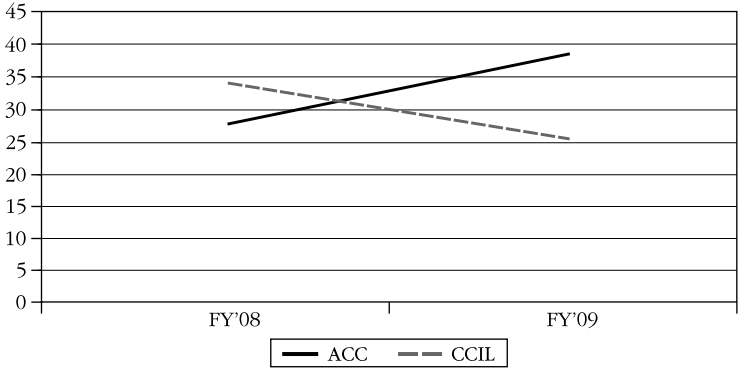
Table 8.2: Turnover/Operating Efficiency Ratios of ACC and CCIL

Ratios	*ACC*		*CCIL*	
	FY08	*FY07*	*FY08*	*FY07*
Debtors' Turnover Ratio	42.82	27.35	30.812	33.85
Working Capital Turnover Ratio	–10.17	–1352.05	8.35	–41.23
Fixed Asset Ratio	1.278	1.41	0.547	0.528
Average Collection Period	8.52 Days	13.34 Days	11.85 Days	10.78 Days
Creditors' Turnover Ratio	0.6	0.6	0.791	0.67
Average Payment Period	608.3 Days	608.3 Days	461.44 Days	544.77 Days
Asset Turnover Ratio	1.23	1.05	0.55	0.56
Stock Turnover Ratio	11.2	10.38	3.2	3.35
Inventory Holding Period	32.58 Days	35.16 Days	114.06 Days	108.95 Days

Debtors' Turnover Ratio

It is a measure of the relation between net credit sales and average account receivables of the year. This ratio signifies the efficiency of the firm to collect the amount due from debtors. ACC's Debtors' Turnover Ratio has significantly increased, by approximately 50 per cent, from FY'08 to FY'09. On the other hand, CCIL's Debtor Turnover Ratio has fallen slightly over the same period (see Figure 8.8).

Figure 8.8: Debtors' Turnover Ratio of ACC and CCIL

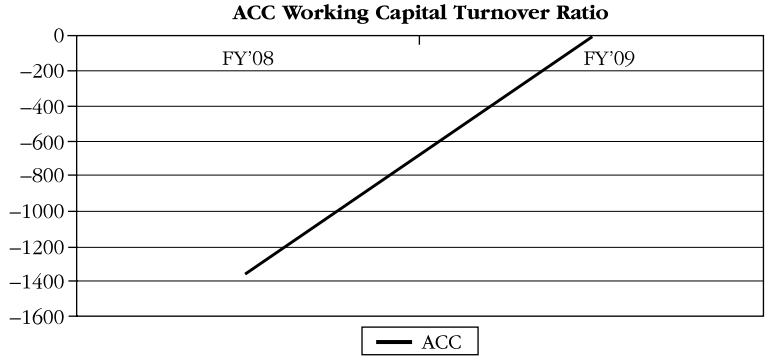


The main reason behind the sudden increase in ACC's Debtors' Turnover Ratio is the drastic fall in the number of debtors from FY'08 to FY'09.

Working Capital Turnover Ratio

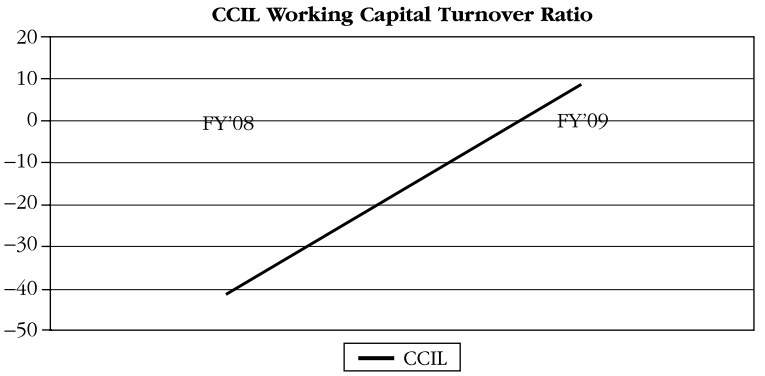
It indicates the number of times of the utilisation of working capital in the process of business. ACC's Working Capital Turnover Ratio had changed from –1352.05 to –10.17 (see Figure 8.9). The negative sign is on account of negative working capital.

Figure 8.9: Working Capital Turnover Ratio of ACC



Turnover Ratio had increased from –41.2 in 2008 to 8.35 in 2009 (see Figure 8.10). Thus, there is an increase in the efficiency with which the working capital has been utilised for the business.

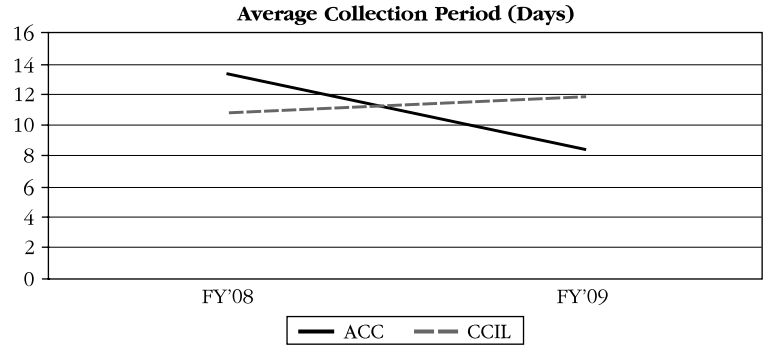
Figure 8.10: Working Capital Turnover Ratio of CCIL



Average Collection Period (ACP)

It indicates the rapidity or slowness with which a firm collects dues from its debtors. The lesser the Average Collection Period, the better it is for the firm. The Average Collection Period (ACP) for ACC has shown improvement from FY'08 to FY'09 with a fall of more than 33 per cent. However, the ACP for CCIL has fallen slightly and this does not augur well for the future of the company (see Figure 8.11).

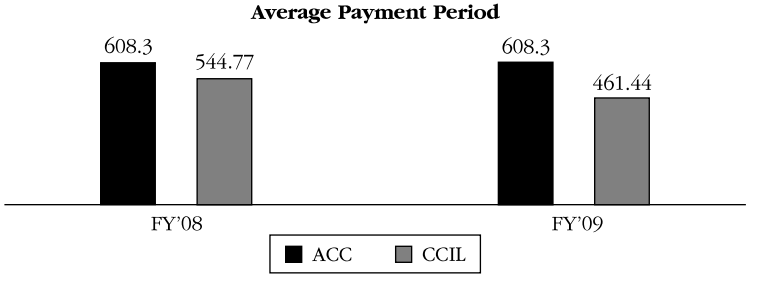
Figure 8.11: Average Collection Period of ACC and CCIL



Average Payment Period (APP)

It indicates the number of days a firm can enjoy credit on an average. It is an indicator of its standing in the market. ACC's APP is significantly higher than CCIL (see Figure 8.12). Also, CCIL's APP has fallen over 2007–08 whereas ACC has maintained the same APP of 608.3 days. Comparatively then, ACC has been able to enjoy debtors' funds more than CCIL, which is along expected lines given that CCIL has an inherent inefficiency usually associated with public sector companies, while ACC is a private company.

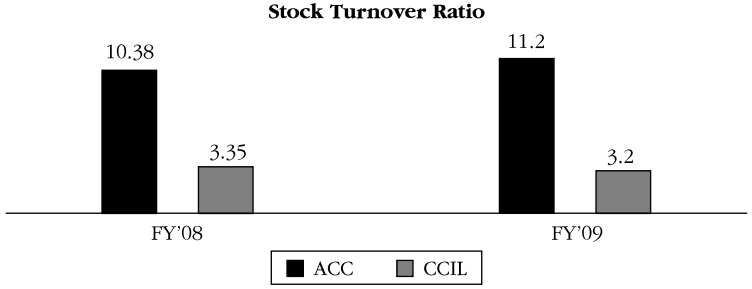
Figure 8.12: Average Payment Period of ACC and CCIL



Stock Turnover Ratio

The Stock Turnover Ratio indicates how fast the stock is moving through the firm and generating sales. For ACC, the Stock Turnover Ratio had increased to 11.2 in 2009 from 10.38 in 2008. For CCIL, it had fallen slightly from 3.35 to 3.2 (see Figure 8.13). Thus, we can see that the disparity between the Stock Turnover Ratios of CCIL and ACC had been huge with ACC's efficiency being more than three times of CCIL.

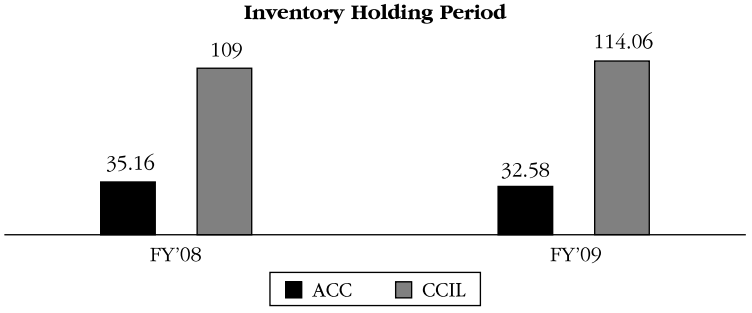
Figure 8.13: Stock Turnover Ratio of ACC and CCIL



Inventory Holding Period

The Inventory Holding Period indicates the average time for which a firm holds inventories. ACC's Inventory Holding Period had decreased from 35.16 to 32.58 days, which shows a marginal increase in the efficiency of managing inventories (see Figure 8.14). On the other hand, however, CCIL's Inventory Holding Period, which was already very high, had further increased to 114.06 days. Thus, CCIL (since it's a PSU) has been (comparatively) very inefficient at managing its inventories.

Figure 8.14: Inventory Holding Period of ACC and CCIL

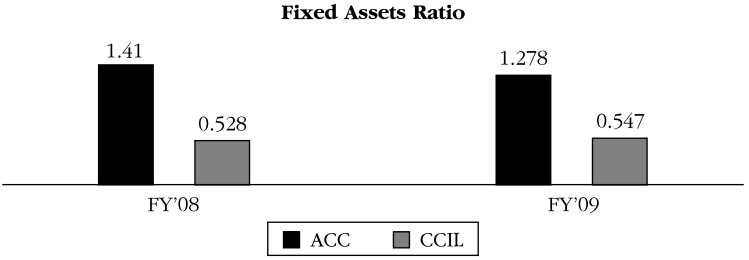


Fixed Assets Turnover Ratio

It measures the efficiency with which the company deals with the fixed assets it owns.

The Fixed Assets Ratio is comparatively very low for CCIL as compared to ACC as CCIL is fairly inefficient in transforming its Gross Block into sales revenues. Figure 8.15 shows the vast difference in terms of the Fixed Assets Ratio, which is more than double for ACC over CCIL. The only cause of concern for ACC is that its Fixed Assets Ratio has fallen over the 2007–08, which is not desirable.

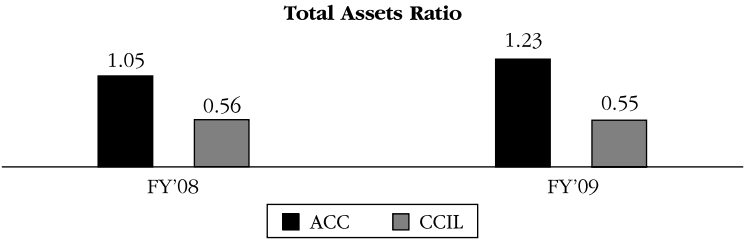
Figure 8.15: Fixed Assets Turnover Ratio of ACC and CCIL



Total Assets Turnover Ratio

It is the ratio of the Sales to the Total Assets of a company and is instrumental in measuring the extent to which the total assets contribute towards generating turnover for the company. The Total Assets Turnover Ratio for both companies (see Figure 8.16) is comparatively similar to the Fixed Assets Ratio with that of CCIL's being much lower than ACC's.

Figure 8.16: Total Assets Turnover Ratio of ACC and CCIL



Thus, most ratios tend to point towards ACC being generally a more efficient and competitive company than CCIL, which has indulged

in unproductive management, especially with respect to the Fixed Assets and the Total Assets of the company.

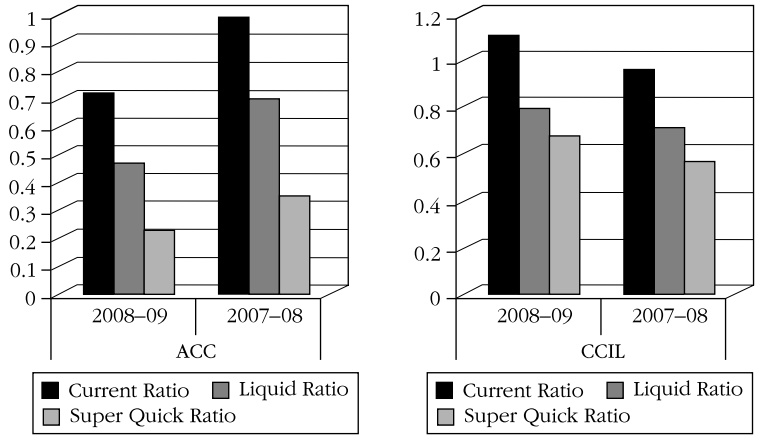
Liquidity

It's not sufficient to just look into the values of current assets, current liabilities and/or cash and bank (C&B) balances. We also have to take a look at the various liquidity ratios to analyse the financial soundness (long- and short-term) of both companies. The liquidity picture of the units under study, for the period of 2008–09, has been discussed and portrayed in Table 8.3 and Figure 8.17, respectively.

Table 8.3: Liquidity Ratios of ACC and CCIL

	ACC		*CCIL*	
Ratios	*2008–09*	*2007–08*	*2008–09*	*2007–08*
Current Ratio	0.73	1.00	1.12	0.98
Liquid Ratio	0.48	0.71	0.81	0.71
Super Quick Ratio	0.24	0.36	0.69	0.58

Figure 8.17: Liquidity Trend of ACC and CCIL



Here we can see that for ACC the current ratio had decreased to 0.73 in 2008–09 (which is less than 1) signifying poor liquidity. Therefore in the same period for the company, for each rupee of current liability, there was less than one rupee of current assets available and the short-term assets were not sufficient to meet short

term liabilities. For CCIL, the current ratio had increased from 0.98 to 1.12, which is good sign in terms of liquidity. The liquid ratio for ACC had decreased from 0.71 to 0.48. This can be attributed to the decrease in high liquid assets like C&B balances. The increase in current liability was also a major factor. For CCIL, the liquidity ratio increased from 0.71 to 0.81 in 2008–09 — the result of an increase in C&B balances. The super quick ratio for ACC decreased from 0.36 to 0.24.This is because of their C&B balance had decreased considerably. For CCIL, the super quick ratio increased from 0.58 to 0.69.

We have seen that for ACC, all three liquidity ratios had decreased. This was not because lower liquid assets like inventory had increased. On the contrary, the amount of inventory had actually decreased in 2008–09. However, there was a huge decrease in high liquid assets like C&B balances. Therefore, the management of ACC should work towards increasing their high liquid assets. For CCIL on the other hand, the picture was quite delightful. In this case too, the main factor was the increase in C&B balances. Even though there had been an increase in the lower liquid asset inventory, it didn't affect the ratios drastically.

Therefore, from a comparative approach, we can conclude that CCIL was in a much better position (in terms of liquidity) than ACC at the end of 2008–09.

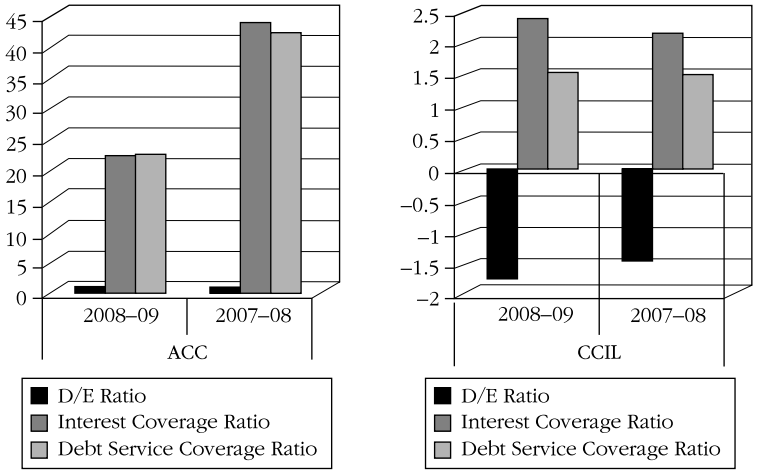
Solvency

Solvency gives us the picture of whether a company is financially sound, that is, whether the company can meet its long-term obligations in due time. For long-term lending, we need to look at the capital structure of the companies and then apply solvency ratios (See Table 8.4 and Figure 8.18) for the period of 2008–09, in comparison with 2007–08.

Table 8.4: Solvency Ratios of ACC and CCIL

	ACC		*CCIL*	
Ratios	*2008–09*	*2007–08*	*2008–09*	*2007–08*
D/E Ratio	0.09	0.10	–1.77	–1.47
Interest Coverage Ratio	22.93	44.46	2.42	2.19
Debt Service Coverage Ratio	22.92	42.75	1.57	1.54

Figure 8.18: Solvency Trend of ACC and CCIL



There was a slight decrease in the D/E ratio for ACC in 2008–09 compared to 2007–08, which was a good sign. For CCIL, the situation was quite alarming. It not only had high negative D/E ratios in both years but even the value of the D/E ratio had increased further in 2008–09. This indicates the company had been high on debt as well as suffering huge lossed resulting in negative reserves and surplus and, in turn, negative amount of shareholders' funds. Interest Coverage Ratio (ICR) had decreased by a huge amount for ACC. This indicates that they had deteriorated on their repayment activity, which is not good for long-term solvency of the company. For CCIL, ICR had increased by a small amount implying that they have been improving on their repayment activity. However, the value of ICR is still rather low, indicating high debt. Debt Service Coverage Ratio (DSCR) had decreased by a huge amount for ACC, which means that though they have earned more cash profit from operating activities, they, nonetheless, deteriorated on their repayment activity which is not a good sign for the short-term soundness of the company. For CCIL, DSCR had increased by a small amount. But the value of DSCR had been very low, indicating high debt and low short-term soundness.

Therefore, overall solvency for ACC decreased in 2008–09 (as compared to 2007–08), which signifies the deterioration of repayment activities because both EBIT and cash profit from operating activities had increased for them. For CCIL, overall solvency is really

a matter of concern because of negative D/E ratio and low values of ICR and DSCR. This indicates that the company is high on debt and is lacking both short-term soundness and long-term solvency.

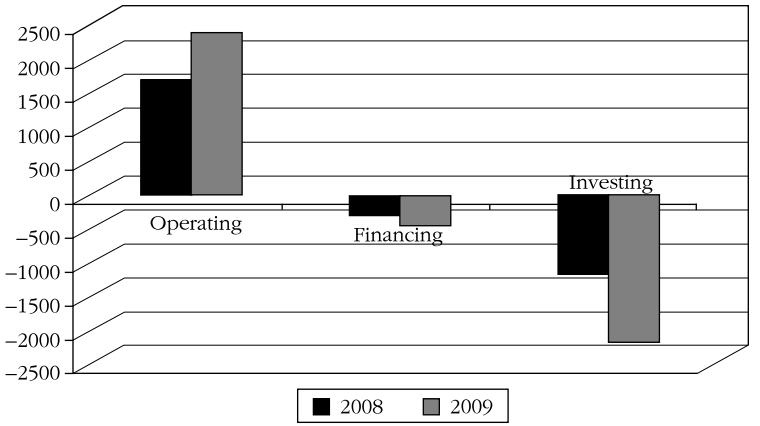
Cash Flow Position

The cash flow position has been discussed in Table 8.5 and Figures 8.19 and 8.20.

Table 8.5: Cash Flow Position of ACC and CCIL (INR in million)

Activity	*ACC*		*CCIL*	
Cash Flow (Year)	*2009*	*2008*	*2009*	*2008*
Cash Flow from Operating	23,980	17,080	440	590
Cash Flow from Financing	–4,550	–2,970	–1.30	8.450
Cash Flow from Investing	–21,810	–11,700	–70	–130

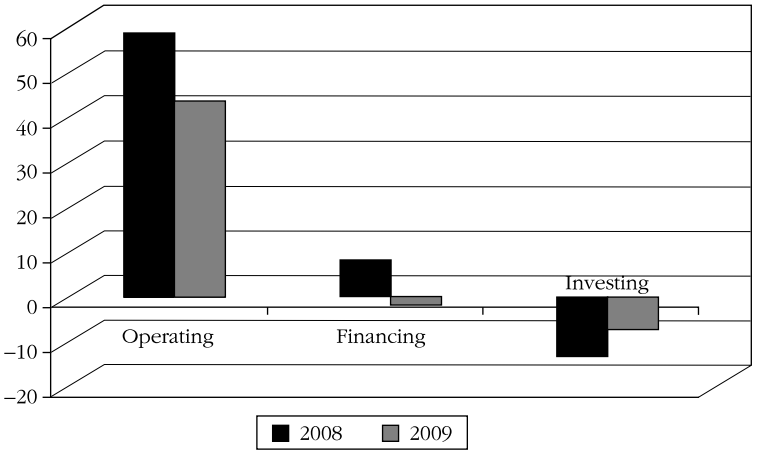
Figure 8.19: Cash Flow Picture of ACC



For ACC, the cash flow from operating activities had increased quite significantly, which means that the operating efficiency of the company had also increased. The net outflow from financial activities had increased as well — mainly because of the repayment of long-term loans and the dividends paid. This has reduced the liability of the company and pleased the shareholders. They have also obtained a long-term loan for INR 3,000 million. Overall, the financing activities were good. The investment of the company had increased almost twice, from the purchase of investments. Since the

cash flow from operating investing activities signifies the future earning capacity of any company, it looks promising for ACC from the investments they have made. But the cash flow from operating activities has not been sufficient to cover the financing and investing activities; hence, there is a net negative cash flow. However, here we are concerned with the company's investing activities which is why the negative cash flow is not a cause of concern.

Figure 8.20: Cash Flow Picture of CCIL



Already threatened by a huge negative R&S, CCIL's operating efficiency had decreased as evident from Figure 8.20, and this is a big cause of concern. No loans had been procured 2009, which is absolutely necessary for the company. Even their investing cash flow had decreased due to the sale of fixed assets. On the whole, the company has been performing poorly and needs to improve its cash flow in the proper areas to perform better.

Depreciation Policy

The following points elaborate on the depreciation policy followed by ACC:

(*a*) Fixed assets were stated at cost of acquisition or construction minus accumulated depreciation and impairment losses.
(*b*) Depreciation was provided on the straight line method (SLM) at the rates prescribed in Schedule XIV of the Companies

Act, 1956, on a pro-rata basis. Assets acquired on or before 1 August 1986 were depreciated on the then applicable rates.

(*c*) Capital assets, whose ownership does not vest in the company, had been depreciated over a period of five years.

(*d*) Machinery spares which could be used only in connection with a particular item of fixed Assets and the use of which is irregular, were capitalised at cost net of Central Value Added Tax (CENVAT) and depreciated over the remaining useful life of the related asset. The written down value of such spares was charged to the Profit and Loss Account, on issue for consumption.

(*e*) Average Age of assets (in %) for 2008 = 40.54; Average Age of assets (in %) for 2009 = 39.08.

In this case too, since there was not much difference between the average age of the assets as well as the gross investment had increased, it shows that depreciation was able to account for the replacement of assets.

(*f*) There had been no change in the depreciation method this year.

(*g*) Due to the difference in the depreciation method followed for taxable income and accounting income, the deferred tax liability of the company had increased by INR 134 million.

The following points elaborate on the depreciation policy followed by CCIL:

(*a*) Depreciation on fixed assets was charged on the SLM at the rates as prescribed in Schedule XIV of the Companies Act, 1956, except in the cases of certain electrical installation and non-plant residential buildings where the same had been charged at rates which were higher than those prescribed in Schedule XIV.

(*b*) Depreciation was provided on assets after they were completed and became available for use.

(*c*) Depreciation on assets added during the year was charged pro-rata from the month in which these were capitalised and upto the month in which these were discarded, as the case may be.

(*d*) Any individual asset whose written down value was INR 5,000 or less at the beginning of the year was fully depreciated

during the year without retaining the residual value as it was considered insignificant.

(*e*) Any individual asset costing upto INR 5000 purchased during the year was taken to gross block and depreciated fully in the same year.

(*f*) Average Age of assets (in %) in 2007–08 = 83.05; Average Age of assets (in %) in 2008–09 = 82.72.

The increase in investments were very less while the age of assets was too high. The company had not been increasing their investments to a sufficient level to provide for the replacement of its old assets.

Inventory Valuation

ACC

(*a*) Stores, spare parts and raw materials except as indicated in the following point were stated at weighted average cost. The obsolete/unserviceable stores and spares, when determined, were treated as scrap and valued at net realisable value.

(*b*) Clinker and other semi-finished goods were stated at lower of units' weighted average cost or net realisable value on the basis of work back formula. However, in case of negative valuation, it was stated at Nil value.

(*c*) Finished goods at factories/projects/in dumps or in transit to dumps were stated at lower of units' weighted average cost or realisable value. Freight included in selling expenses upto dump was incorporated in value of finished goods lying at various dumps.

(*d*) The total quantity of various scrap items as at the close of each financial year was valued as per rates available according to the latest sale orders for respective items. However, where no such rates were available, because of the scrap being generated for the first time or not disposed off earlier, reserve price fixed for disposal of such scrap items was adopted for the purpose of valuation.

(*e*) Loose tools and tackles were written off over a period of three years.

(*f*) There had been no change in the inventory valuation method.

CCIL

(*a*) Raw materials, fuels, packing materials, stores and spares were stated at lower of cost and net realisable value. However, materials and other items held for use in the production of inventories were not written down below cost if the finished products in which they will be incorporated were expected to be sold at or above cost. Cost was determined on a weighted average basis.

(*b*) Work-in-progress and finished goods were stated at lower of cost and net realisable value. Cost included direct materials and labour and a proportion of manufacturing overheads, based on normal operating capacity. Cost of finished goods included excise duty. Net realisable value was the estimated selling price in the ordinary course of business less estimated costs of completion and estimated costs necessary to make the sale.

(*c*) There had been no change in the inventory valuation method.

(*d*) The basis of preparation of the financial statements was historical cost, except in cases where impairment or revaluation occurred.

Annexure 8.1

Significant Accounting Policies of ACC and CCIL

The annual reports of both companies mention the accounting policies in great detail; I have tried to put together certain important accounting policies from the same.

ACC

(*a*) Revenue recognition: Revenue is recognised to the extent that it is probable that economic benefits will flow to the company and the revenue can be reliably measured.

(*b*) Fixed assets are stated at cost of acquisition or construction less accumulated depreciation and impairment losses.

  (*i*) Depreciation is provided on the straight line method at the rates prescribed in Schedule XIV of the Companies Act, 1956, on a pro-rata basis. Assets acquired on or before 1 August 1986 are depreciated on then applicable rates.

(*ii*) Cost of leasehold land is amortised over the period of the lease.

(*iii*) With respect to quarry freehold land, amortisation reserve is created by amortising the cost over the number of years of the mining rights of the quarries.

(*iv*) Capital assets, whose ownership does not vest in the company, have been depreciated over a period of five years.

(*v*) Machinery spares which can be used only in connection with a particular item of fixed Assets and the use of which is irregular, are capitalised at cost net of CENVAT and are depreciated over the remaining useful life of the related asset. The written down value of such spares is charged to the Profit and Loss Account, on issue for consumption.

CCIL

(*a*) Revenue Recognition: Sales are stated exclusive of Excise Duty and Sales Tax.

(*b*) Land and Amortisation: Land given free by the state Government is valued at nominal cost or on the basis of incidental expenditure incurred on its acquisition.

(*i*) Land freehold under mining lease at quarry and land leasehold with less than 99 years lease is amortised within a period of 10 years from the date of commercial production of the respective unit.

(*c*) Investments

(*i*) Long term investments are stated at cost. Permanent decline in the value of such investments is recognised and provided for.

(*ii*) Current investments are stated at lower of cost and quoted/fair value. Unquoted current investments are stated at cost.

(*d*) Borrowing Costs that are attributable to acquisition or construction or production of qualifying assets are capitalised as part of the costs of such assets. A qualifying asset is one that necessarily takes a substantial period of time to get ready for its intended use. All other borrowing costs are charged to revenue.

(*e*) Classification of Expenditure

(*i*) Expenditure incurred on Repairs and Maintenance (R&M) of fixed assets, including cost of stores and spares except as mentioned in the following point, are charged to Profit & Loss Account.

(*ii*) Expenditure incurred on R&M of fixed assets including cost of stores and spares that increase the future benefits from the existing assets beyond its previously assessed standard of performance is capitalised; for example: an increase in capacity.

(*iii*) Salaries and wages incurred on R&M of plant and machinery, building etc. are charged directly to the salaries and wages account.

(*iv*) Other sundry expenses, such as expenditure on parks, planting of trees and purchase of tents and tarpaulins, are charged off as revenue expenditure.

Annexure 8.2

Future Trends in the Cement Industry

(*a*) The cement industry is expected to grow steadily in future and increase capacity by another 50 MT in spite of the recession in the past and decrease in demand from the housing sector.

(*b*) The industry experts project the sector to grow by 9–10 per cent in the next few years provided India's GDP grows at 7 per cent.

(*c*) India will rank second in cement production (after China).

(*d*) The major Indian cement companies, such as Associated Cement Company Ltd (ACC), Grasim Industries Ltd, Ambuja Cements Ltd, J.K. Cement Ltd and Madras Cement Ltd, have all made investments to increase the production capacity, heralding a positive outlook for the industry.

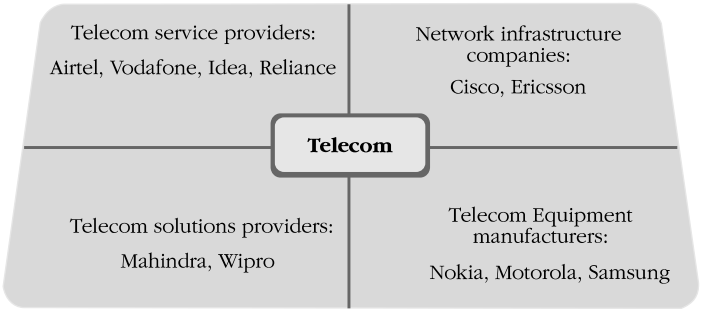
9

Telecom Sector

Bharti Airtel Limited vs Idea Cellular

The telecommunication (telecom) industry of India is the world's fastest growing telecom industry. Today, India has 671.68 million telephone subscribers (mobile and landline) as against the five million subscribers in the country in 2001 and 635.51 million mobile phone subscribers in June 2010. It has been projected that India is going to have 1.159 billion mobile subscribers by 2013. Figure 9.1 gives an overview of what comprises the Indian telecom industry.

Figure 9.1: An Overview of the Indian Telecom Industry



This chapter is an attempt to compare and analyse the financial performance of Bharti Airtel Limited and Idea Cellular.

A Brief Introduction to the Companies

Bharti Airtel Limited

Bharti Airtel Limited[1] is a leading global telecommunications company with operations in 20 countries across Asia and Africa. It was founded in 1995. In India, its product offerings include 2G, 3G and 4G wireless services, mobile commerce, fixed line services, high

speed DSL broadband, IPTV, DTH, enterprise services including national and international long-distance services to carriers. It also offers 2G, 3G wireless services and mobile commerce abroad. Bharti Airtel had over 269 million customers across its operations at the end of March 2013.

Idea Cellular

Idea Cellular[2] is an Aditya Birla Group Company, India's first truly multinational corporation and was a publicly listed, as of March 2007. It is the third largest mobile services operator in India with wireless revenue market share at 15 per cent in Q1 FY 2013, and subscriber base of over 117 million. Idea is a pan-India integrated GSM operator and has its own NLD and ILD operations, and ISP license.

Financial Appraisal

Profitability

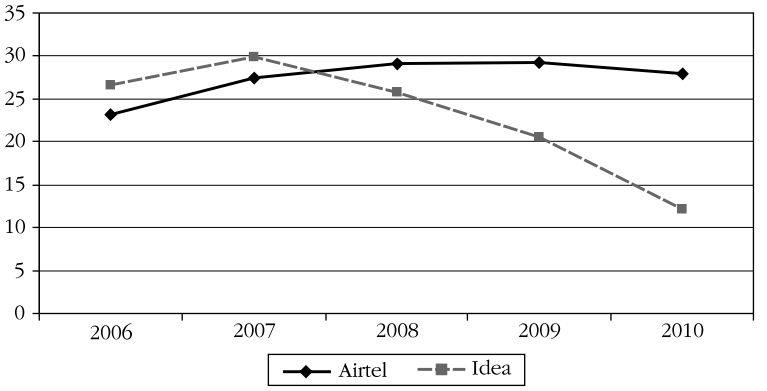
The profitability analysis of the companies under study (2006–10) is discussed in Tables 9.1 to 9.6 and Figures 9.2 to 9.7.

Gross Profit Ratio

Table 9.1: Gross Profit Ratio of Airtel and Idea (%)

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	23.14	27.47	29.08	29.33	27.97
Idea	26.64	29.91	25.81	20.51	12.21

Figure 9.2: Gross Profit Ratio of Airtel and Idea



The gross profit margin of Airtel has been healthy throughout the period studied, but for Idea, it was on the decline due to increased cost of network operating expenditure. Therefore, Airtel is more efficient in terms of utilising its resources and providing sufficient funds to meet additional expenses.

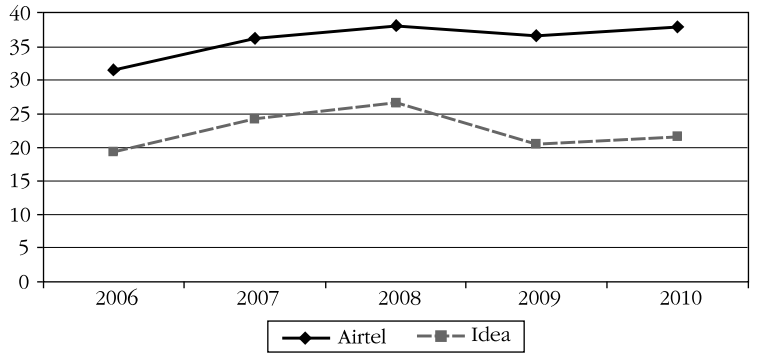
Cash Operating Profit Ratio

Table 9.2: Cash Operating Profit Ratio of Airtel and Idea (%)

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	31.57	36.26	38.3	36.69	37.88
Idea	19.32	24.29	26.60	20.45	21.56

Note: Industry average — 32.96 % in 2010.

Figure 9.3: Cash Operating Profit Ratio of Airtel and Idea



Airtel's earnings before interest, tax, depreciation and amortisation (EBITDA) margin is nearer to the industry average as opposed to Idea's, which is far below and more volatile.

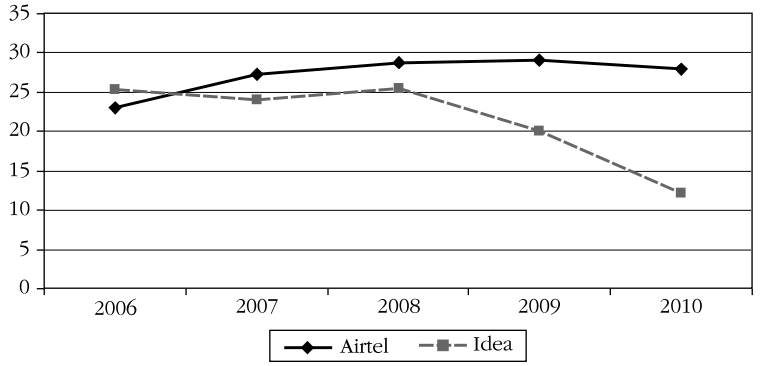
Earnings Before Interest and Tax (EBIT) Margin

Table 9.3: EBIT Margin of Airtel and Idea (%)

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	23.05	27.31	28.78	29.12	27.90
Idea	25.24	23.94	25.47	20.02	12.13

Note: Industry average — 16.76 % (2010).

Figure 9.4: EBIT Margin of Airtel and Idea



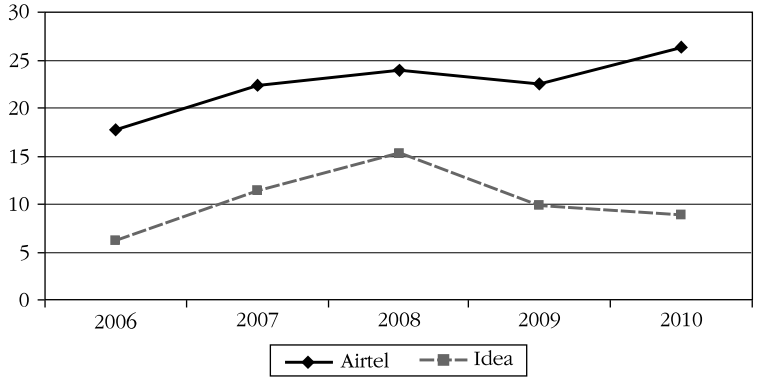
EBIT margin for both Airtel and Idea are more than the industry average, with Airtel faring better than Idea. There was also a drastic fall in Idea's margin (2009–10) due to the decrease in gross profit.

Net Profit Ratio

Table 9.4: Net Profit Ratio of Airtel and Idea (%)

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	17.80	22.46	23.99	22.58	26.40
Idea	6.24	11.44	15.33	9.91	8.83

Figure 9.5: Net Profit Ratio of Airtel and Idea



As previously discussed, Airtel is better placed (than Idea) in terms of the net profit ratio.

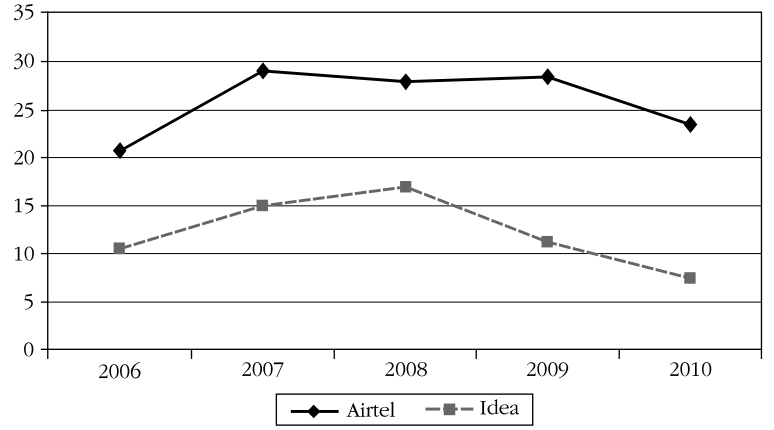
Return on Investment (ROI)/Return on Capital Employed (ROCE)

Table 9.5: ROI of Airtel and Idea (%)

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	20.74	29.06	27.95	28.40	23.56
Idea	10.44	14.96	16.92	11.20	7.46

Note: Industry average — 7.35 % (2010).

Figure 9.6: ROI of Airtel and Idea



Airtel's ROI is much better than that of Idea and the industry average, which indicates that the company has been utilising its resources better to produce ROCE.

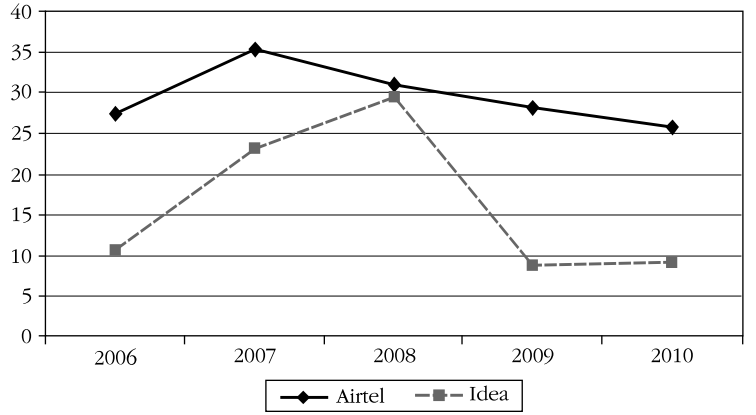
Return on Equity (ROE)/Return on Net Worth

Table 9.6: ROE of Airtel and Idea (%)

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	27.47	35.35	30.94	28.13	25.78
Idea	10.75	23.04	29.48	8.87	9.23

Note: Industry average — 5.97 % (2010).

Figure 9.7: ROE of Airtel and Idea



Both companies fare better than the industry average; however, Airtel has been generating more earnings for its investors per rupee of the share capital employed.

Activity Performance

This is measured in terms of activity ratio. This category includes several ratios and is also referred to as asset utilisation or turnover ratios (for examole: inventory turnover, receivables turnover and total assets turnover). They often give indications of how well a firm utilises their various assets, such as inventory and fixed assets. The operational efficiency of the units regarding debtors' management is discussed in Table 9.7 and Figure 9.8.

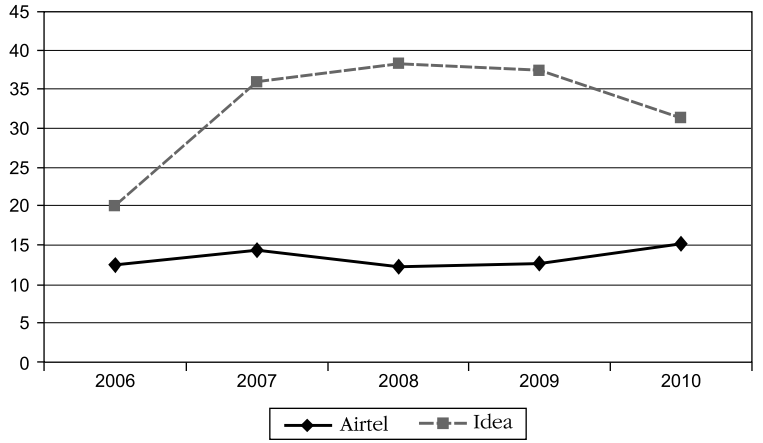
Receivables Turnover/Debtors' Turnover

Table 9.7: Debtors' Turnover Ratio of Airtel and Idea

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	12.57	14.31	12.28	12.78	15.30
Idea	20.01	35.89	38.28	37.32	31.20

Note: Industry average — 8.33 (2010).

Figure 9.8: Debtors' Turnover Ratio of Airtel and Idea



The inverse of receivables turnover times 365 is called the average collection period or days of sales outstanding, which is the average number of days it takes for the company's customers to pay their bills. Both Airtel are Idea are well-placed in terms of the industry standards in their timely recovery from debtors.

(*Note*: Ratios such as inventory turnover and assests turnover are not relevant in the telecom sector or the service industry. Therefore, they have neither been calculated nor discussed here.)

LIQUIDITY

The liquidity picture of the units is given in Tables 9.8 to 9.9 and Figures 9.9 to 9.10.

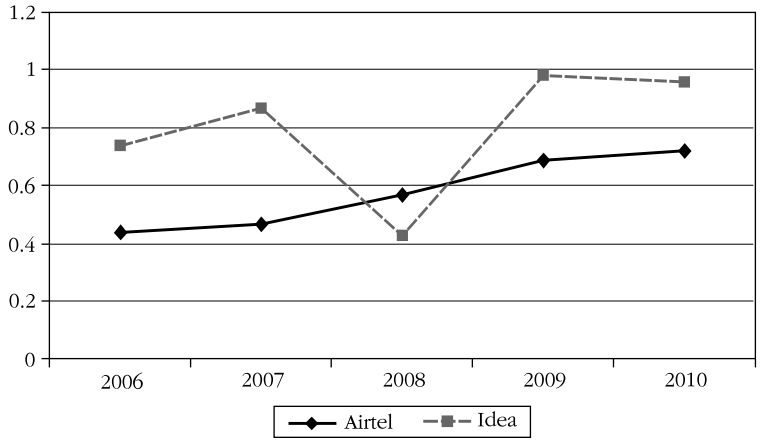
Current Ratio

Table 9.8: Current Ratio of Airtel and Idea

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	0.44	0.47	0.57	0.69	0.72
Idea	0.74	0.87	0.43	0.98	0.96

Note: Standard average — 1.

Figure 9.9: Current Ratio of Airtel and Idea



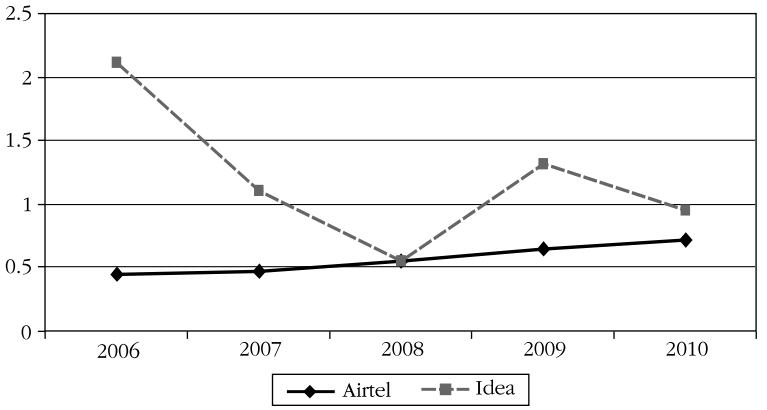
Since both companies have a negative working capital, their current ratio is < 1.

Quick Ratio

Table 9.9: Quick Ratio of Airtel and Idea

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	0.45	0.47	0.55	0.65	0.72
Idea	2.11	1.10	0.55	1.31	0.95

Figure 9.10: Quick Ratio of Airtel and Idea



SOLVENCY

Solvency ratios are discussed in Tables 9.10 to 9.11 and represented in Figures 9.11 to 9.12.

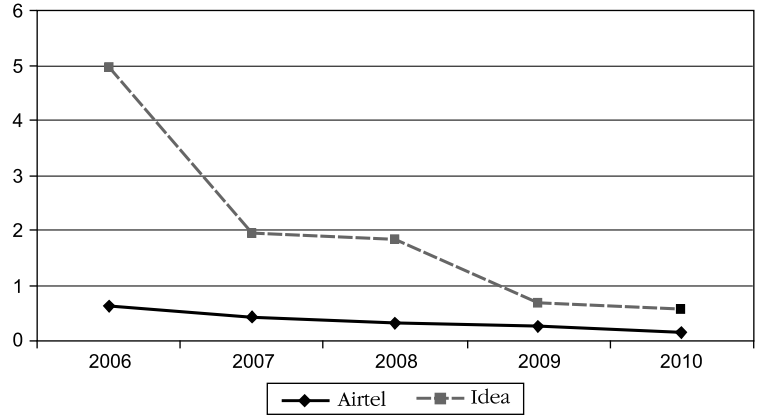
Debt–Equity Ratio

Table 9.10: Debt–Equity Ratio of Airtel and Idea

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	0.61	0.43	0.3	0.26	0.14
Idea	4.96	1.95	1.84	0.67	0.57

Note: Industry Average — 0.31 (2010).

Figure 9.11: Debt–Equity Ratio of Airtel and Idea



Both companies have, over the years, decreased their debt–equity ratio. Since, Airtel has a lower D/E ratio (than Idea), it would be a safer bet to invest in Airtel.

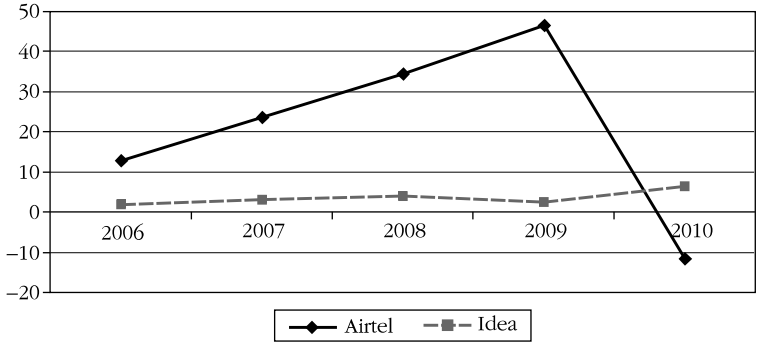
Interest Coverage Ratio

Table 9.11: Interest Coverage Ratio of Airtel and Idea

	2006	*2007*	*2008*	*2009*	*2010*
Airtel	12.76	23.45	34.38	46.28	–11.5
Idea	1.79	2.99	3.89	2.55	6.51

Note: Industry Average — 3.26 (2010).

Figure 9.12: Interest Coverage Ratio of Airtel and Idea



Interest coverage ratio for Idea has not fluctuated much during the period under study (2006–10). Airtel's interest coverage ratio, which had been increasing until 2009, decreased to a negative value in 2010 because of the higher interest income received — showing a better performance by the company. Each of these factors has a role to play in the selection of the company for investment. However, the degrees to which they affect the returns vary in response to the other factors. Hence, for arriving at a decision for investment, the entire range of factors needs to be considered.

Depreciation Accounting

Bharti Airtel Limited

Depreciation on fixed assets is provided on the straight line method (SLM) based on the useful lives of respective assets, as estimated by the management or at the rates prescribed under Schedule XIV of the Companies Act, 1956, whichever is higher. With regard to Airtel, the company has been providing adequate depreciation for replacement of assets as prescribed by the Companies Act. Leasehold land is amortised over the period of lease. However, age of assets is an important factor in depreciation. The average age, in per cent of assets, can be calculated by the following formula:

$$\text{Average Age (in \%)} = \text{Accumulated Depreciation} / \text{Gross investments}$$

In 2008, Average Age in % was 32.88, while in 2009, Average Age in % was 36.61.

The closer a percentage is to 100, the older is the asset base. Since the age has been increasing by only a small amount along with investments, it shows that the older assets are being replaced continuously and depreciation has been able to account for them.

Deferred Taxes

Deferred income taxes reflect the impact of current year timing differences between taxable income and accounting income for the year and reversal of timing differences of earlier years. Deferred tax is measured based on tax rates and laws enacted or substantively enacted at the balance sheet date. Deferred tax assets are recognised and reviewed at each balance sheet date, to the extent of a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised. In situations where the company has unabsorbed depreciation or carried forward tax losses, all deferred tax assets are recognised only if there is virtual certainty supported by convincing evidence that they can be realised against future taxable profits. At each balance sheet date, unrecognised deferred tax assets of earlier years are reassessed and recognised to the extent that it has become reasonably certain that future taxable income will be available against which such deferred tax assets can be realised.

Deferred tax liabilities due to depreciation claimed as deduction under the Income Tax Act but chargeable in the financial statement in future years had increased to INR 7,99,54,36,000, in March 2010, from INR 5,82,03,67,000, in March 2009. Hence, there is a difference in the depreciation method used in the financial statement vis-à-vis the tax computation. Since the company has been using the SLM, which leads to higher net income in initial years and lower net income in later years, as compared to the Written Down Value (WDV) method, therefore, they have a deferred tax liability.

Idea Cellular

Depreciation on fixed assets is provided on the SLM (except stated otherwise), on the pro-rata basis of estimated useful economic lives.

In 2008, the Average Age (in %) was 29.22 while in 2009 it was 32.85. Like Airtel, in this case, since the age has been increasing by only a small amount along with investments, it shows that the older

assets are being replaced continuously and depreciation has been able to account for them.

Deferred Taxes

As of 31 March 2010, the company has deferred tax liability of INR 6,934.59 million and deferred tax asset of INR 4,792.57 million, and there has been no change in the depreciation method in last two years of comparison (2008–09 and 2009–10).

Inventory Valuation

Bharti Airtel Limited

In 2008–09, inventory had been valued at lower of cost and net realisable value. Cost is determined on the 'first-in, first-out' (FIFO)[3] basis. Net realisable value is the estimated price in the ordinary course of business minus estimated costs of completion and the estimated costs necessary to make the sale. The company provides for obsolete and slow-moving inventory based on management estimates of the usability of inventory. In 2009–10, the same inventory valuation method was followed by the company. Since the valuation has been done by FIFO, therefore, the cost of goods sold is lesser than the weighted average method, which will lead to higher operating profits.

Idea Cellular

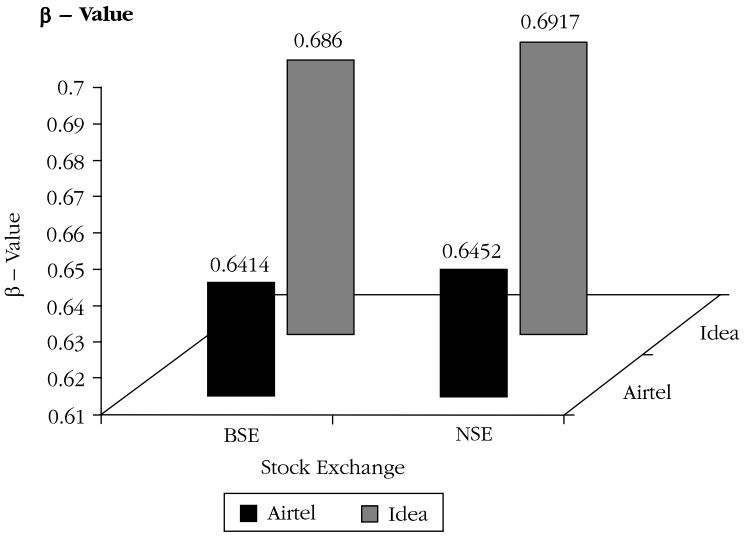
In 2008–09, inventories were valued at cost or net realisable value, whichever is lower. Cost is determined on weighted average basis. In 2009–10, the same inventory valuation method was followed by the company.

Market Performance

Beta Value

Beta indicates the tendency of a security's returns to respond to swings in the market. Beta is calculated using regression analysis. A beta of 1 indicates that security's price will move with the market. A beta of less than 1 means that security will be less volatile than the market while a beta of greater than 1 indicates that security's price will be more volatile than the market. For example: if a stock's beta is 1.2, it's theoretically 20 per cent more volatile than the market. Beta trend of the companies is depicted in Figure 9.13.

Figure: 9.13: Beta Performance



According to the figure, the beta value is almost the same for both Airtel and Idea, with a value of less than 1, which is less risky with respect to the Sensex. However, Airtel's shares are less volatile and more stable in the sector; hence, the shareholder sentiment is positive, which means the general public will want to invest in the company — as is evident in their increasing and very high market cap.

Conclusion

After the acquisition of Zain Telecom,[4] Airtel has become the fifth largest mobile operator in the world. According to the Management and Discussion Analysis (MDA) report (2010–11),[5]

> Being the frontrunner in Indian telecom space, Bharti Airtel's outlook is promising in line with the future growth potential of the sector. The company's successful forays in Sri Lanka and Bangladesh add two emerging markets to its growth potential. The company has entered into definitive agreements with the Zain Group to acquire Zain Africa B.V., for an enterprise value of USD 10.7 bn. Bharti Airtel lays stronger emphasis of data business across domestic and international markets, going forward. It will continue to focus on DTH business and build scale in

> newer verticals of commerce and entertainment. Bharti Airtel's unwavering focus on cost and synergies across the organisation will keep it in good stead and this very business model augurs well for its expansion and success in new geographies.

The same report also mentioned Idea Cellular:

> The year was marked by the uncommonly large new service launches by new licensees, leading to an over-crowded sector. Resultant hyper-competitive market conditions led to a steep decline in tariffs and introductory offerings of free minutes. Consequently, while subscriber growth was high, the sector revenue growth slowed to 5.1% compared to 22.3% in the preceding year.
>
> The business models of telecom operators are being stress-tested by overcapacity led hyper-competition. With several licensees operating at tariffs lower than cost, the eventual phasing out of this period of overcapacity is inevitable. The Company, with a focus on strengthening its leadership position in its incumbent service areas, and a calibrated and measured approach to newer service areas, is well placed to emerge competitively stronger. The telecom sector provides lucrative long term opportunities for strong operators, of which the Company is one of a handful (ibid.).

Annexure 9.1

Significant Accounting Policies of Bharti Airtel and Idea

Bharti Airtel Limited

Basis of Preparation

For Airtel, financial statements had been prepared to comply in all material respects with notified accounting standards by Companies Rules (Accounting Standards), 2006 ('as amended'), and the relevant provisions of the Companies Act, 1956. The financial statements were prepared under the historical cost convention on an accrual basis except in case of assets, for which revaluation is carried out. Accounting policies have been consistently applied by the company and are consistent with those used in the previous year.

Revenue Recognition

It considers revenues on mobile services only. Service revenue is recognised on completion of provision of services and includes income on roaming commission and an access charge recovered from other operators, and is the net of discounts and waivers. Revenue (net of discount) is recognised on the transfer of all significant risks and rewards to the customer, when no significant uncertainty exists regarding realisation of consideration. Processing fees on recharge is being recognised over the estimated customer relationship period or voucher validity period, as applicable. Revenue from prepaid calling cards packs is recognised on the actual usage basis.

Voluntary Disclosure

All the disclosures have been provided under the given schedule (22) in the company's Annual Report.

IDEA CELLULAR

Basis of Preparation

Like Airtel, for Idea, financial statements had been prepared to comply in all material respects with notified accounting standards by Companies Rules (Accounting Standards), 2006 ('as amended'), and the relevant provisions of the Companies Act, 1956. The financial statements were prepared under the historical cost convention on an accrual basis except in case of assets, for which revaluation is carried out. Accounting policies have been consistently applied by the company and are consistent with those used in the previous year.

Revenue Recognition

They also consider revenues on mobile services only. Revenue on account of telephone services (mobile and long distance) and sale of handsets and related accessories is recognised net of rebates, discount and service tax (and the like) on rendering of services and supply of goods, respectively. Recharge fees on recharge vouchers is recognised as revenue, as and when the recharge voucher is activated by the subscriber.

Voluntary Disclosure

For Idea Cellular, all voluntary disclosures were made in annexure to the Director's report.

10

Banking Sector

State Bank of India vs ICICI Bank

The banking system remains, as always, the most dominant segment of the financial sector. Indian banks continue to build on their strengths under the regulator's watchful eye and hence, have emerged stronger. The Indian Banking Industry can be categorised into non-scheduled and scheduled banks. The latter constitute of commercial banks and co-operative banks, and there are about 67,000 branches spread across the country. Currently, though, the banking industry in India is going through a transitional phase. The private sector banks include IDBI Bank, ING Vyasa Bank and HDFC Bank while the public sector banks (PSBs) comprise Punjab National bank, Vijaya Bank, UCO Bank, Oriental Bank and Allahabad Bank, among others. ANZ Grindlays Bank, ABN–AMRO Bank, American Express Bank Ltd, and Citibank are some of the foreign banks operating in India.

In the annual international ranking conducted by the UK based Brand Finance Plc, 18 Indian banks have been included in the Brand Finance® Global Banking 500. In fact, the State Bank of India (SBI), which is the first Indian bank to be ranked among the top 50 banks in the world, has improved its ranking from 36 to 34, as per the Brand Finance study released on 1 February 2011. The brand value of SBI has enhanced to US$ 1,119 million. ICICI Bank, the only other Indian bank in the top 100 club has improved its position with a brand value of US$ 2,501 million. According to the study, Indian banks contributed 1.7 per cent to the total global brand value at US$ 14,741 million and grew by 19 per cent in 2011.

According to RBI's 'Quarterly Statistics on Deposits and Credit of Scheduled Commercial Banks: June 2010', nationalised banks, as a group, accounted for 51.3 per cent of the aggregate deposits, while SBI and its associates accounted for 22.8 per cent. The share (in aggregate deposits) of new private sector banks, old private sector banks,

foreign banks and regional rural banks was 13 per cent, 4.8 per cent, 5.1 per cent, and 3.1 per cent, respectively. Significantly, on a year-on-year basis, bank credit grew by 24.4 per cent in 2010, against RBI's projection of 20 per cent for the entire fiscal year 2010–11. However, deposits lagged behind at 16.5 per cent against a projection of 18 per cent for the same year.

PSBs form the base of the banking sector in India and account for more than 78 per cent of the total banking industry assets. Unfortunately, they are burdened with excessive Non-Performing assets (NPAs), massive manpower and lack of modern technology. Conversely, private sector banks have been making tremendous progress. They are the frontrunners in Internet banking, mobile banking, phone banking, and ATMs. As far as foreign banks are concerned, they are also quite likely to succeed in the Indian Banking Industry. This chapter analyses the financial performance of SBI, as a public sector bank, and ICICI Bank, as a private sector enterprise, on comparative basis.

State Bank of India (SBI) and ICICI Bank Profiles

State Bank of India (SBI)[1] is the largest state-owned banking and financial services company in India, in almost every parameter such as revenues, profits, assets, and market capitalisation, among others. The bank traces its ancestry to British India, through the Imperial Bank of India and the founding of the Bank of Calcutta (in 1806), making it the oldest commercial bank in the Indian subcontinent. The Government of India nationalised the Imperial Bank of India in 1955, renamed it as the State Bank of India, while the Reserve Bank of India (RBI) had a 60 per cent stake. In 2008, the government took over RBI's stake. According to Forbes, they are the 10th most reputed company in the world.

SBI provides a range of banking products through its vast network of branches (16,000 and counting) in India and overseas, including products aimed at NRIs, and has the largest banking branch network in India. With an asset base of US$352 billion and US$285 billion in deposits, it is a regional banking behemoth. They have a market share of about 20 per cent in deposits and advances, among Indian commercial banks and account for almost one-fifth of the nation's loans.

ICICI Bank[2] (formerly Industrial Credit and Investment Corporation of India) is a major banking and financial services organisation. It is the second largest bank in India and the largest private sector bank in India by market capitalisation. The bank also has a network of 2,016 branches (as on 31 March 2010) and about 5,219 ATMs in India and wholly-owned subsidiaries, branches and representative offices in 19 countries, including an offshore unit in Mumbai. These include wholly-owned subsidiaries in Canada, Russia and the UK (the subsidiary through which the HiSAVE savings brand is operated), offshore banking units in Bahrain and Singapore, an advisory branch in Dubai, branches in Belgium, Hong Kong and Sri Lanka, and representative offices in Bangladesh, China, Malaysia, Indonesia, South Africa, Thailand, the United Arab Emirates and USA. Overseas, the bank is targeting the NRI (Non-Resident Indian) population in particular.

ICICI Bank offers a wide range of banking products and financial services to corporate and retail customers through a variety of delivery channels and specialisation subsidiaries and has affiliations in the areas of investment banking, life and non-life insurance, venture capital, and asset management. Their shares are listed on the stock exchanges at BSE, NSE, Kolkata and Vadodara; their (American Depositary Receipt (ADR) trade on the New York Stock Exchange (NYSE).

Profitability Analysis

The profitability of the banks under study has been discussed in Tables 10.1 and 10.2 and represented in Figures 10.1 to 10.9.

Table 10.1: Profitability Ratios of SBI

	March 2010	*March 2009*
1. Credit Deposit Ratio (%)	75.96	74.97
2. CAR (Capital Adequacy Ratio) %	12.00	12.97
3. CASA (Current and Savings Account Ratio) %	47	39
4. Interest Expended/Interest Earned (%)	66.66	67.28
5. ROE (%)	14.8	17.05
6. Dividend Payout Ratio %	21.33	20.75
7. EPS	140.65	139.76
8. NPA (Net Non-performing assets/net advances) %	1.72	1.79
9. Net Profit Ratio (%)	0.13	0.14

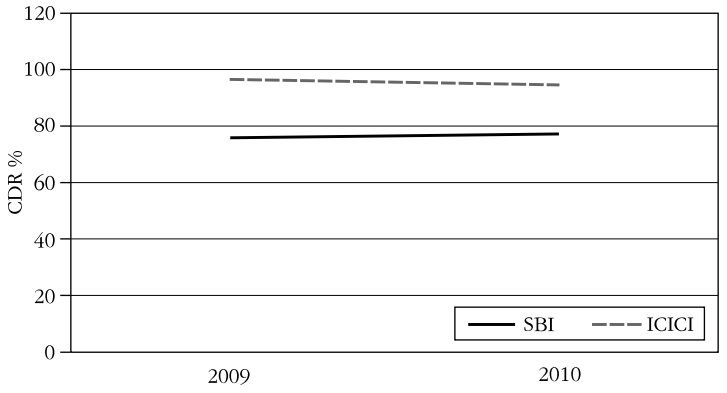
Table 10.2: Profitability Ratios of ICICI Bank

	March 2010	*March 2009*
1. Credit Deposit Ratio (%)	95.04	95.93
2. CAR (Capital Adequacy Ratio) %	19.14	15.92
3. CASA (Current and Savings Account Ratio) %	41.7	28.7
4. Interest Expended/Interest Earned (%)	68.44	73.09
5. ROE (%)	7.96	7.83
6. Dividend Payout Ratio (%)	34.65	33.95
7. EPS	34.63	32.4
8. NPA (Net Non-performing assets/net advances) %	2.12	2.09
9. Net Profit Ratio (%)	0.16	0.12

Credit Deposit Ratio

The ratio indicates the percentage of funds lent by the bank out of the total amount raised through deposits. Higher ratio reflects the ability of the bank to make optimal use of the available resources and, hence, the possibility of earning higher returns through non-idle resources. The loans would also include its investments in debentures, bonds and commercial papers of the companies. As seen in Figure 10.1, a higher percentage of the amount received through deposits is utilised optimally by ICICI Bank.

Figure 10.1: Credit Deposit Ratio of SBI and ICICI Bank

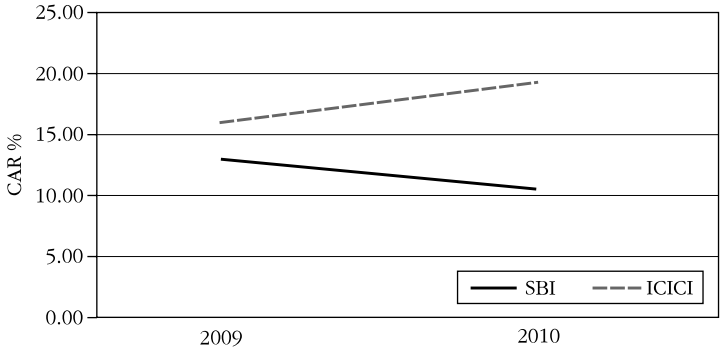


Capital Adequacy Ratio (CAR)

This is capital to risk weighted assets ratio which signifies the risk exposure of the bank. Its minimum limit is 9 per cent, as prescribed

by the RBI for scheduled banks. Higher the ratio, more is the capacity of the bank to absorb losses. Figure 10.2 shows that the CAR of ICICI Bank is higher than SBI's. A bank's capital is the cushion it provides for potential losses to its depositors. As a private company ICICI Bank is expected to have a higher CAR.

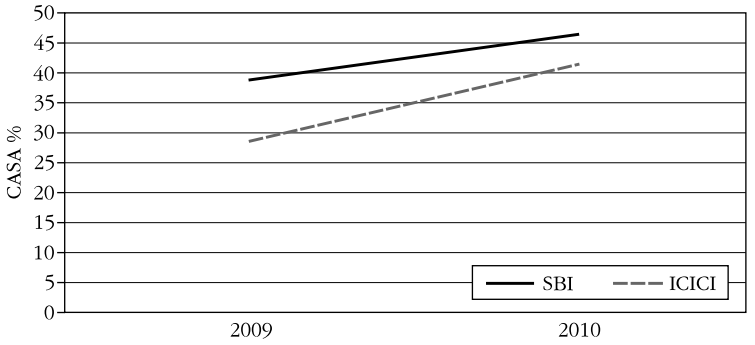
Figure 10.2: Capital Adequacy Ratio of SBI and ICICI Bank



Current and Savings Account Ratio (CASA)

This represents the ratio of current account and savings account to total deposits. A higher ratio means that the bank has comparatively more current accounts and saving deposits. Current deposits are (practically) free funds available to the bank whereas a mere 3–4 per cent is given on saving deposits. Thus, higher deposits mean higher net interest income for the bank and, hence, higher the profits. SBI scores better than ICICI Bank on this front (see Figure 10.3).

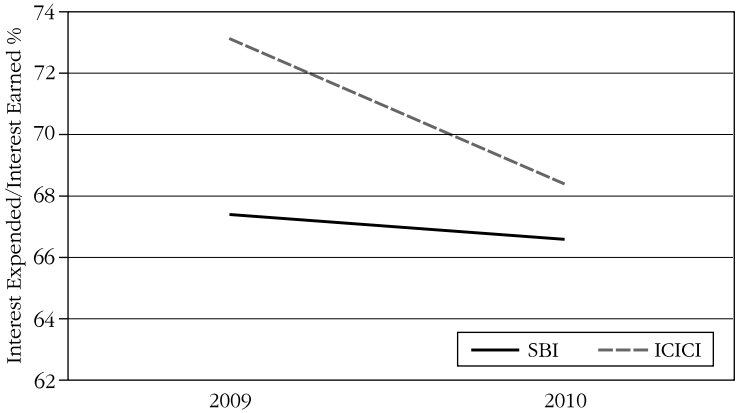
Figure 10.3: Current and Saving Accounts (CASA) Ratio of SBI and ICICI Bank



Interest Expended/Interest Earned

This ratio indicates the potential of earnings of the banks by way of interests paid or received from the bank's deposits and loans. A lower ratio of interest expended/interest earned indicated higher efficiency of the bank in managing and matching interest expenditure and interest income. A steep reducing trend of ICICI Bank (see Figure 10.4) indicates higher efficiency in managing the interest expenditure and earnings. Therefore, this will have a strong effect on the bottom-line of the company. This ratio signifies the income from core efficiency of a bank, and therefore, any decrease in it has a direct impact on the PAT.

Figure 10.4: Interest Ratio of SBI and ICICI Bank



Return on Equity (ROE)

It shows the ratio of profit and net worth of the company. Higher ROE indicates better returns to the shareholders. ROE for SBI has been greater than ICICI Bank's for the period of 2008–09 and 2009–10 (see Figure 10.5).

Dividend Payout Ratio

Dividend payout ratio (DPR) is defined as the ratio of Dividends per Share (DPS) and Earnings per share (EPS). It signifies the proportion of earnings paid out as dividends and shows the growth plan of the company. The payout of ICICI Bank is better than that of SBI (see Figure 10.6); hence, a larger share of earnings of ICICI Bank is distributed as dividends to its shareholders as compared to SBI.

Figure 10.5: ROE of SBI and ICICI Bank

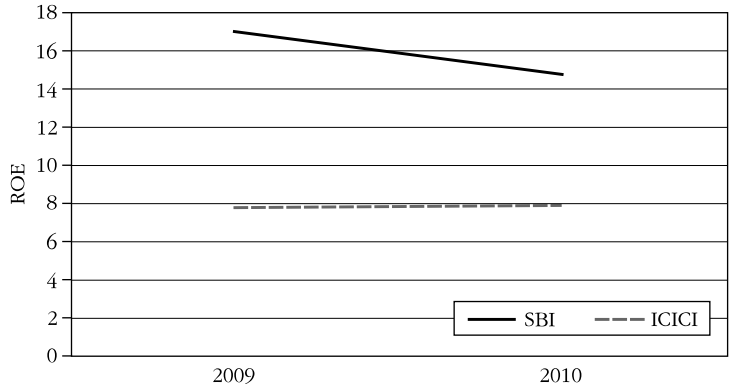
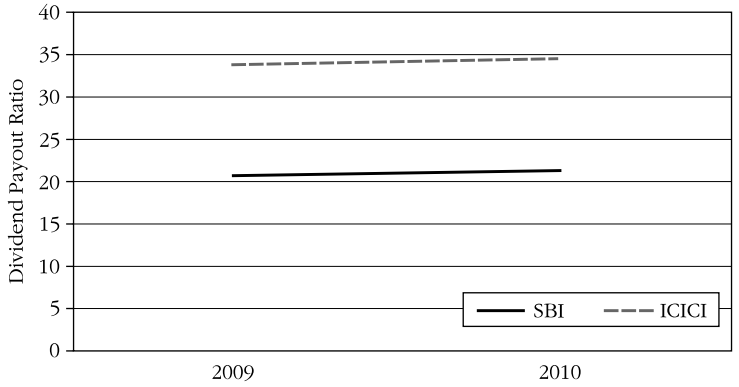


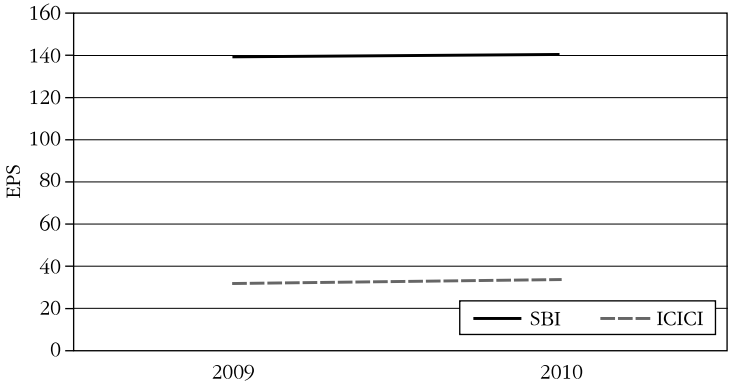
Figure 10.6: Dividend Payout Ratio of SBI and ICICI Bank



Earnings per Share (EPS)

EPS is the portion of a company's profit allocated to each outstanding share of common stock. It serves as an indicator of a company's profitability. We should not compare the EPS of these two banks as their share face value is different. An increasing trend over the past few years shows increased profitability of the company. For both SBI and ICICI Bank, the EPS has been moving upwards, but marginally, over the past two years, from 2008–09 to 2009–10 (see Figure 10.7). Analysis over a larger period of time can give more useful inputs.

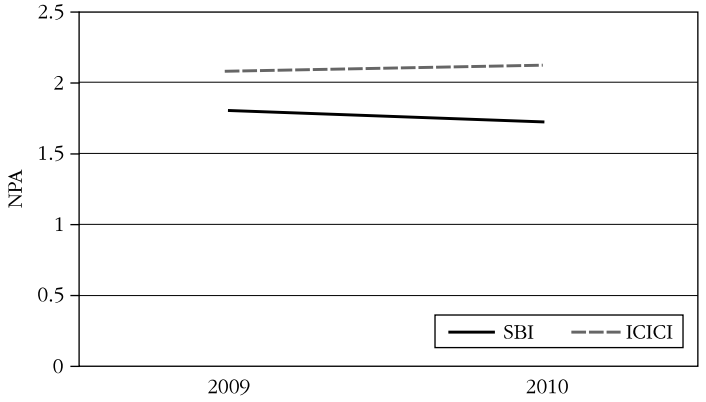
Figure 10.7: Earnings per Share of SBI and ICICI Bank



Non-Performing Assets (NPA)

The net non-performing assets to loans (advances) ratio are used as a measure of the overall quality of the bank's loan book. Net NPAs are calculated by reducing cumulative balance of provisions outstanding at a period end from gross NPAs. Higher ratio reflects the rising bad quality of loans. Therefore, in the long run, any bank has high chances of huge losses which would affect its profitability. In this regard, SBI fares better than ICICI Bank (see Figure 10.8); it can be inferred that the loans issued by SBI are better as there are more chances of earning returns from these loans.

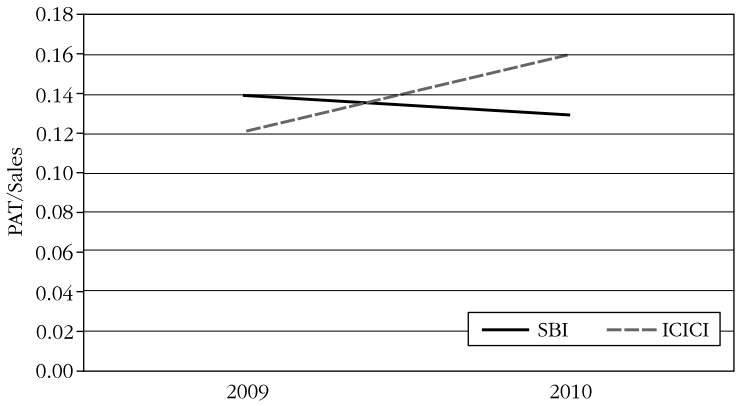
Figure 10.8: Non-Performing Assets (NPA) Ratio of SBI and ICICI Bank



Net Profit Ratio

The two basic components of the net profit ratio (NPR) are the net profit (after taxes) and sales. The net profits are obtained after deducting Income Tax; generally, non-operating expenses and incomes are excluded from the net profits for calculating this ratio. Thus, incomes such as interest on investments outside the business, profit on sales of fixed assets and losses on sales of fixed assets are excluded. NPR is very useful to proprietors as it is used to measure the overall profitability. ICICI Bank has been showing a trend while SBI had had a declining tendency over the past couple of years (see Figure 10.9). The reason for SBI's decreasing NPR has been the company's increased expenses incurred in the last financial year (2008–09) for provisions of contingency and doubtful loans/NPA. It is an area of concern if this trend continues for a period time. However, no conclusions can be drawn by a comparison over two years.

Figure 10.9: Net Profit Ratio of SBI and ICICI Bank



Efficiency in Assets Utilisation

The assets efficiency of the banks has been discussed in Table 10.3 and represented in Figure 10.10.

Return on Assets

It is an indicator of how profitable a company is, relative to its total assets. Return on assets (ROA) gives an idea on how efficient the management is at using its assets to generate earnings. Calculated

by dividing a company's annual earnings by its total assets (that is, Net Profit/Total Assets), ROA is displayed as a percentage and is, sometimes, referred to as 'Total Assets Turnover Ratio'. ROA tells us what earnings were generated from invested capital (assets). It is one of the standards of gauging a bank's profitability. An excellent ROA is in the range of 1.2 to 1.4 per cent.

ICICI Bank

For ICICI Bank, the total assets (including the impact of exchange fluctuation on foreign currency denominated assets) decreased by 4.2 per cent, from INR 3,793.01 billion at the end of the fiscal year 2008–09 to INR 3,634.00 billion the end of the fiscal year 2009–10. The increase in profits and decrease in total assets meant that the ROA increased from 0.98 to 1.13 (from 2008–09 to 2009–10) indicating better profitability (see Table 10.3).

SBI

The total assets of SBI increased by 9.23 per cent — from INR 96,44,320 million at the end of the fiscal year 2009 to INR 1,05,34,138 million at the end of the fiscal year 2010. The rate of increase of the total assets was more than the rate of increase in the net profits. This caused a drop in the ROA of SBI from 1.04 in 2009 to 0.88 in 2010 (see Table 10.3).

Table 10.3: Comparative Picture of ROA of SBI and ICICI Bank (%)

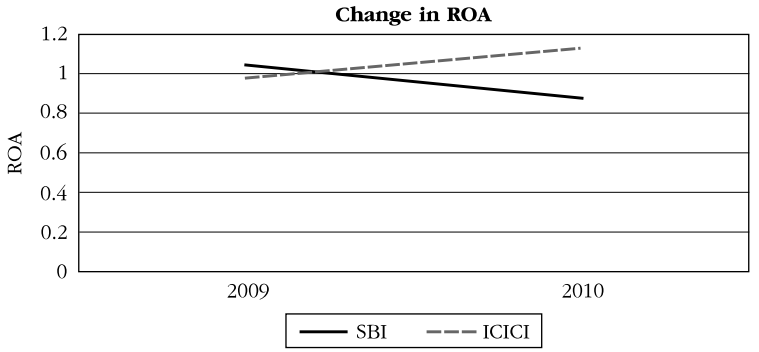
	2009	*2010*
SBI	1.04	0.88
ICICI Bank	0.98	1.13

The increase in ROA in ICICI Bank and a decrease in the same for SBI (see Figure 10.10) suggests that ICICI Bank utilises its assets more efficiently.

Liquidity and Solvency

Since they belong to the banking sector, it is necessary that we take a look at both SBI's and ICICI Bank's loans and advances, investments, reserves, and borrowings. Consequently, we will also have to look at the various short-term and long-term liquidity ratios, given in Tables 10.4 to 10.8 and Figures 10.11 to 10.15.

Figure 10.10: ROA Picture of SBI and ICICI Bank

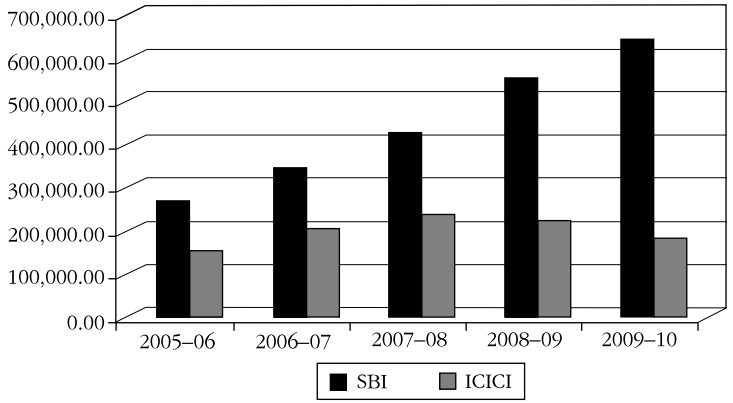


Advances

Table 10.4: Advances Position of SBI and ICICI Bank (INR in million)

Advances	*2005–06*	*2006–07*	*2007–08*	*2008–09*	*2009–10*
SBI	26,18,009	33,73,364	41,67,682	54,25,032	63,19,141
ICICI	14,61,631	19,58,657	22,56,160	21,83,109	18,12,057

Figure 10.11: Advances Trend of SBI and ICICI Bank



SBI has shown a consistent growth in its advances throughout the past five (2005–06 to 2009–10) years. It has remained a strong lender, even in the recession phase in 2008–09. The bank's advances grew by 16.4 per cent and deposits by 8.3 per cent, leading to a business growth of 11.79 per cent. The rate of growth in advances from ICICI

Bank in the same period, however, has been relatively lower. There was a dip in advances, post 2007–08, due to recession.

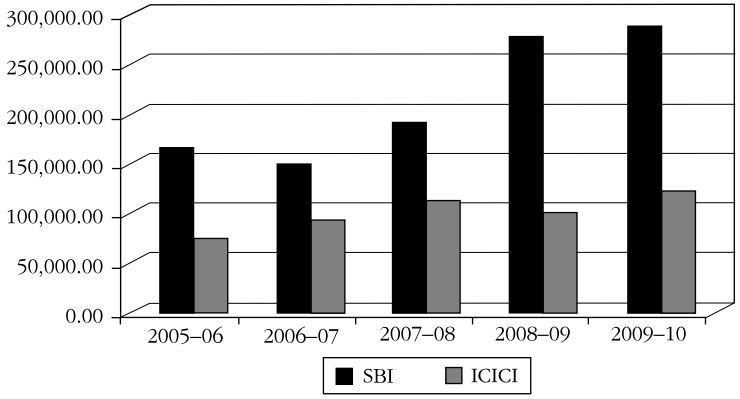
Investment

Table 10.5: Investment Picture of SBI and ICICI Bank (INR in million)

Advances	*2005–06*	*2006–07*	*2007–08*	*2008–09*	*2009–10*
SBI	16,25,342	14,91,489	18,95,012	27,59,539	28,57,900
ICICI	7,15,473	9,12,579	11,14,543	10,30,583	12,08,929

SBI's investments have increased continuously over the last five years (2005–06 to 2009–10) as compared to ICICI Bank, whose investments remained almost flat (see Figure 10.2). Therefore, Investments for SBI are better than to ICICI Bank's.

Figure 10.12: Investment Trend of SBI and ICICI Bank



Deposits

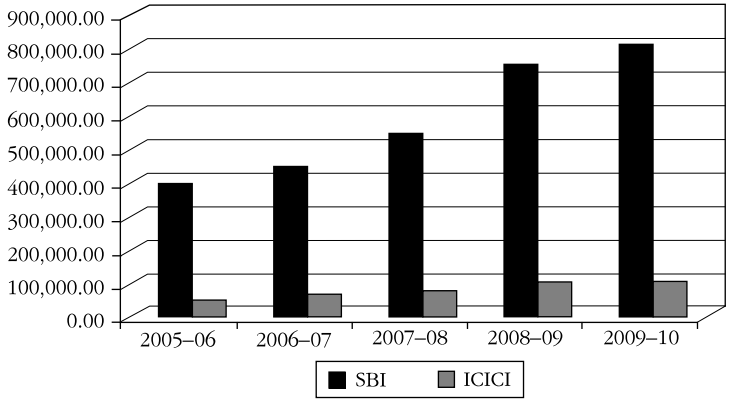
Table 10.6: Deposits of SBI and ICICI Bank (INR in million)

Advances	*2005–06*	*2006–07*	*2007–08*	*2008–09*	*2009–10*
SBI	38,00,460	43,55,210	53,74,039	74,20,731	80,41,162
ICICI	3,85,219	5,12,560	6,56,484	9,31,554	9,42,636

The deposits in SBI have been traditionally high and have also been increasing at a higher rate, in the past five years (2005–06 to 2009–10) as compared to that of ICICI Bank. Deposits also include the Current Account and Savings Account Deposits, which are very

high for SBI (as compared to ICICI Bank) because of their pan-Indian presence and large number of accounts. Also, the rate of growth of deposits was higher for SBI than for ICICI Bank for the financial year 2009–10.

Figure 10.13: Deposits Trend of SBI and ICICI Bank

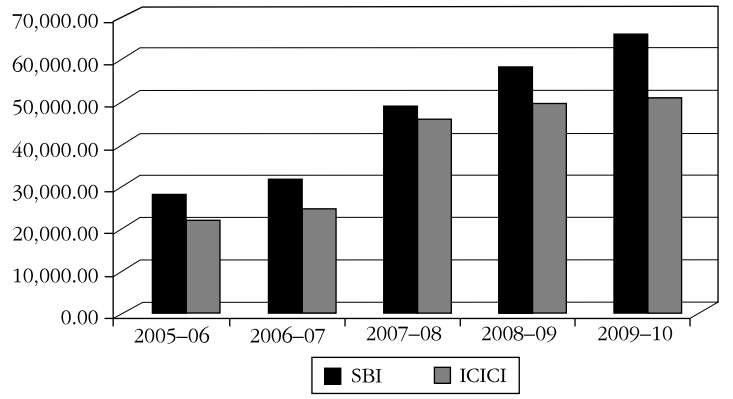


Reserves

Table 10.7: Reserves of SBI and ICICI Bank (INR in million)

Advances	*2005–06*	*2006–07*	*2007–08*	*2008–09*	*2009–10*
SBI	2,71,178	3,07,722	4,84,011	5,73,129	6,53,143
ICICI	2,13,161	2,34,139	4,53,576	4,84,198	5,05,034

Figure 10.14: Reserves Trend of SBI and ICICI Bank



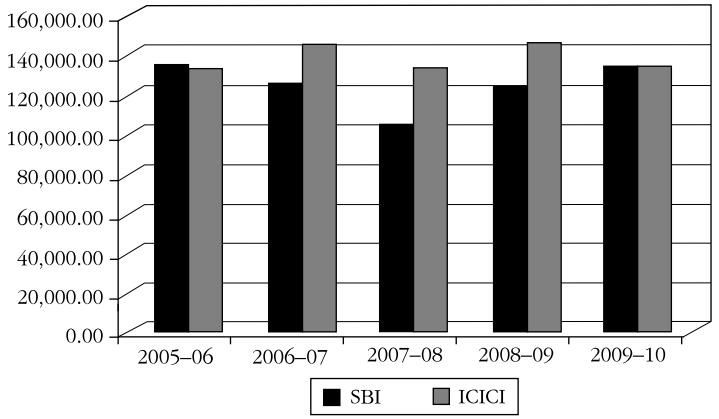
The reserves for SBI and ICICI Bank had been increasing steadily over the last five years (2005–06 to 2009–10). However, SBI's growth of reserves has been better than ICICI Bank's, due to their higher earnings in the last few years. ROE for SBI has been greater than ICICI Bank's for the last two years, that is, 2008–09 and 2009–10.

Borrowings

Table 10.8: Borrowings of SBI and ICICI Bank (INR in million)

Advances	*2005–06*	*2006–07*	*2007–08*	*2008–09*	*2009–10*
SBI	13,36,529	12,37,612	10,34,549	12,37,612	13,36,529
ICICI	13,27,854	14,44,114	13,12,969	14,44,114	13,27,854

Figure 10.15: Borrowings Trend of SBI and ICICI Bank



The borrowings for SBI and ICICI Bank have remained almost equal and constant over the last five years.

Cash Flow Position

The cash position of the banks is given in Tables 10.9 to 10.12 and represented in Figures 10.16 to 10.20.

ICICI Bank had been able to increase its cash flow from operating activities significantly, while SBI's cash flows from operating have decreased significantly. The overall cash position of SBI had weakened compared to its last year's (2008–09) performance due to a decrease in all three cash flow components while ICICI Bank's cash position strengthened during the year 2009–10.

Table 10.9: Cash Flow Position of SBI (INR in million)

Cash Flow Summary for SBI	*2009–10*	*2008–09*
Cash and Cash Equivalents at Beginning of the Year	10,44,040	6,74,663
Net Cash from Operating Activities	–30,987	3,15,379
Net Cash Used in Investing Activities	–17,616	3,021
Net Cash Used in Financing Activities	–33,597	50,973
Net Inc./(Dec.) in Cash and Cash Equivalents	–82,199	3,69,374
Cash and Cash Equivalents at End of the Year	9,61,839	10,44,039

Table 10.10: Cash Flow Position of ICICI Bank (INR in million)

Cash Flow Summary for ICICI	*2009–10*	*2008–09*
Cash and Cash Equivalents at Beginning of the Year	2,99,667	3,80,411
Net Cash from Operating Activities	13,738	–1,35,579
Net Cash Used in Investing Activities	61,508	38,579
Net Cash Used in Financing Activities	13,827	16,253
Net Inc./(Dec.) in Cash and Cash Equivalents	89,071	–80,746
Cash and Cash Equivalents at End of the Year	3,88,738	2,99,666

Figure 10.16: Operating Cash Flow Chart of SBI and ICICI Bank (INR in crore)

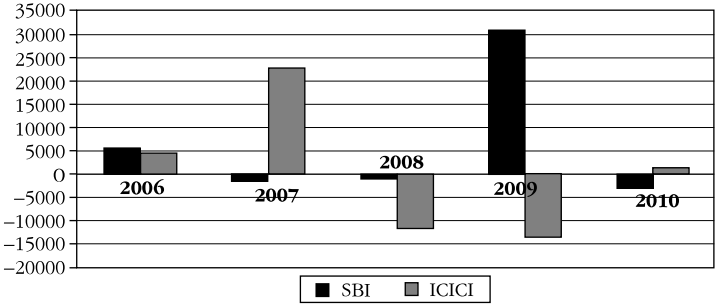


Figure 10.17: Investing Cash Flow Chart of SBI and ICICI Bank (INR in crore)

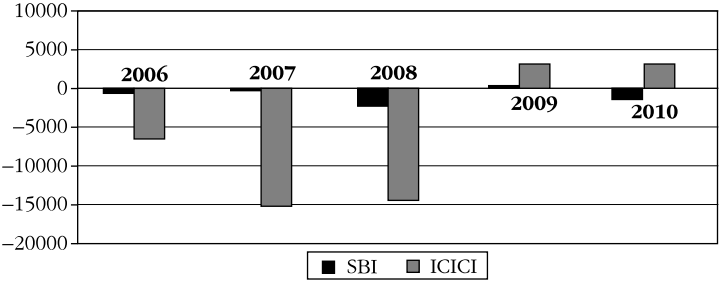


Figure 10.18: Financing Cash Flow Chart of SBI and ICICI Bank (INR in crore)

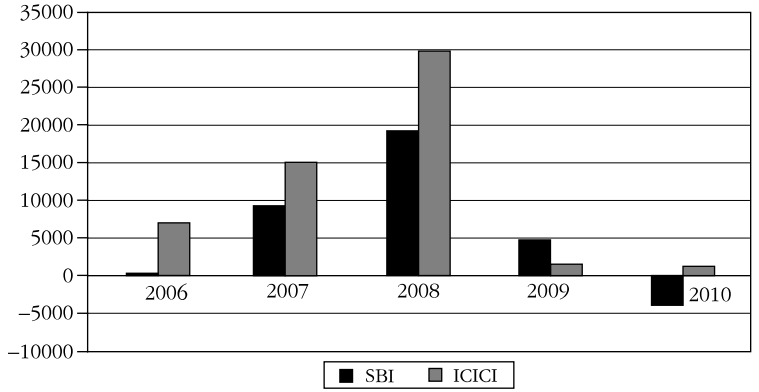
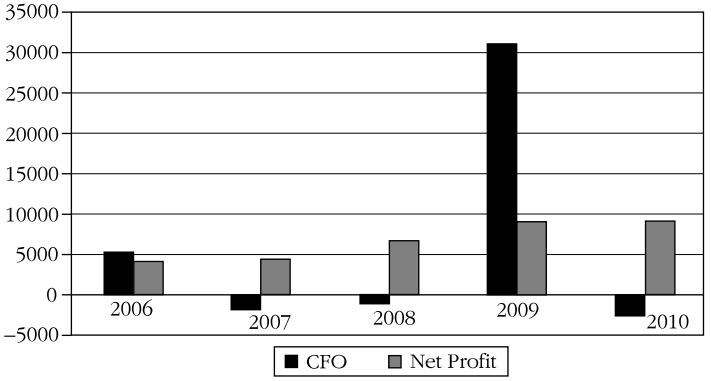


Table 10.11: Comparative Analysis of CFO and Net Profit of SBI (INR in million)

	2006	*2007*	*2008*	*2009*	*2010*
CFO	56,080	−17,890	−10,750	3,15,379	−30,987
Net Profit	44,050	45,360	67,220	91,230	91,720

Figure 10.19: Comparative Picture of CFO and Net Profit of SBI



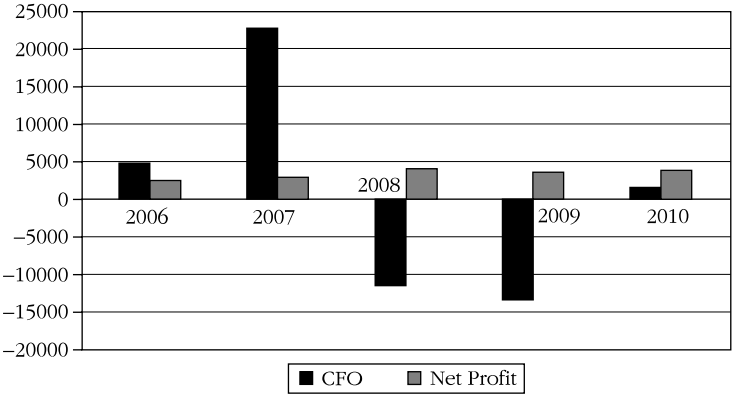
As evident in Table 10.12, SBI had a negative cash flow from operations for 2010 though its net profit had been increasing. This indicates an inclination towards credit sales and, hence, higher receivable (debates in Accounts).

Table 10.12: Comparative Analysis of CFO and Net Profit of ICICI Bank (INR in million)

	2006	*2007*	*2008*	*2009*	*2010*
CFO	46,530	2,30,290	–1,17,200	–1,35,579	13,738
Net Profit	25,340	30,250	41,130	37,470	39,310

In Figure 10.20, we see that ICICI Bank had improved their CFO in 2010 over 2009 and 2008 when it had increased the credit period for the borrowers in view of the financial crisis.

Figure 10.20: Comparative Picture of CFO and Net Profit of ICICI Bank



Depreciation Accounting

State Bank of India

According to the balance sheet, SBI follows a depreciation policy of fixed assets at cost less accumulated depreciation. The company uses a combination of straight line method (SLM) and Written Down Value (WDV) method. Some of the assets depreciated at SLM include computers (33.33 per cent), while computer software, which is an integral part of its hardware (for example: driver software) is depreciated at 60 per cent of the WDV of the software every year.

(*a*) SBI spent a total of INR 15,380 million for new additions to its fixed assets, while they charged a total of INR 9,320 million as total depreciation in the year 2009–10. Therefore, we can

conclude that depreciation methods followed by SBI Bank are adequate for replacement of assets.

(*b*) Consistency was maintained in the methods. Objects were depreciated over their useful life in equal proportions. There were no significant changes in the depreciation method in the last two years (2008–09 to 2009–10). Hence, there was no requirement of a retrospective reclassification of the balance sheet.

ICICI Bank

According to the accounting policies followed in their balance sheet, ICICI Bank follows the cost less accumulated depreciation method for calculating depreciation on premises and fixed assets. Here, the cost includes freight, duties, taxes, and incidental duties relating to acquisition and installation of the asset. SLM (for depreciation) is charged over the estimated useful life of the asset.

(*a*) In the financial year end of March 2009, the net fixed assets of the company were INR 55,706 million. In the financial year end of March 2010, the gross fixed assets were INR 96,137 million. This means that ICICI Bank spent INR 40,431 million on purchase of new fixed assets in the financial year of 2009–10. The net depreciation charged in financial year end of March 2009 was INR 40,689 million. We can see that this figure is higher than the amount spent on new fixed assets. Therefore, we can conclude that depreciation methods followed by ICICI Bank are adequate for replacement of assets.

(*b*) Consistency is maintained in the method. Objects are depreciated over their useful life in equal proportions. For example, the useful life of all computers is estimated to be three years; hence, depreciation is charged at 33.33 per cent, per year. ATMs are assumed to last eight years, while plant and machinery are estimated to have a life of 10 years. There has not been any significant change in the depreciation method over the last couple of years (2008–09 to 2009–10). Hence, there was no requirement of a retrospective reclassification of the balance sheet.

11

BPO Sector

TCS e-Serve Ltd vs Triton Corporation Ltd

Business process outsourcing (BPO) is a broad term that refers to outsourcing in all fields. A BPO differentiates itself from other business domains by either putting in new technology or applying existing technology in a new way to improve a process. BPO is the delegation of one or more Information Technology (IT) intensive process to an external vendor, who manages the work under pre-defined and measurable measures. It is one of the fastest growing sectors in Information Technology Enabled Services (ITES) in India. Factors responsible for their gaining popularity include:

(*a*) Superior competency
(*b*) Business risk mitigation
(*c*) Utilisation improvement
(*d*) Economies of scale
(*e*) Factor cost advantage

BPOs offer different types of services, such as:

(*a*) 24×7 and 365 days customer service (through centres) to manage customer concerns and queries through telephonic conversations.
(*b*) They provide round-the-clock technical assistance for computer hardware, software, peripherals, and other internal management services.
(*c*) BPO companies provide telesales and telemarketing services through target interaction with potential customers, to promote the brand and product/services of the company.
(*d*) They provide data entry or processing services to clients who have large chunk of manual data to be processed or fed into systems on regular basis. They also provide data conversion services where clients require some data to be transferred from one platform to another or in different formats.

(*e*) BPO companies provide third-party services to act as a midway layer between customers and insurance companies. They are the first point of contact for customers in case of any insurance claims; further more, BPOs help clients in expanding their business.
(*f*) They provide 'Employee IT helpdesk services' for companies to provide technical assistance for corporate clients.
(*g*) Finally, BPOs also provide book-keeping and accounting services to clients who want to outsource their daily accounts work to avoid incurring accounting department costs.

The sector has grown rapidly in the last few years and has extended its portfolio in many verticals, such as healthcare, retail, airlines and transportation, and manufacturing, but even then Banking and financial services (BFSI) and HiTech/Telecom (a vertical in Enterprise IT infrastructure solutions) continues to account for more than 60 per cent of the market. The healthcare industry is likely to witness increased IT investments due to increased focus on public health, making healthcare and insurance affordable to all. Other industries that will see growth (in the near future) include telecom and retail and utilities.

However, the industry has many risks and threats attached. In terms of outsourcing of information, any failure can cause major security risks, both from the perspective of communication and privacy. For example, the security of North American data is more difficult to maintain when it has accesses in the Indian subcontinent. Also, a changing attitude in employees, underestimation of running costs and outsourcing, among others can lead to a friction between the organisation and contractor. Thus, risks and threats of outsourcing must be managed in a structured way, while maximising positive outcomes to achieve benefit. This chapter analyses the financial performance of TCS e-Serve Ltd and Triton Corporation Ltd on a comparative basis.

Companies Overview

TCS e-Serve Ltd

E-Serve International Ltd.,[1] formerly known as Citicorp Securities and Investments (CSIL) was incorporated as Havelock Leasing and Finance in September 1984 and was renamed in October 1991.

The company was promoted originally by the V. B. Desai group and later taken over by the Citicorp Overseas Investment Corporation (COIC). They came out with an INR 80 million public issue in June 1992 to part finance premises and infrastructural facilities, operations and processing systems, communication networks, and stock broking operations.

CSIL is currently engaged in providing transaction processing services across a range of processes related to the financial service industry. The subsidiary of CSIL, Citicorp Credit Services India, also provides services to the same clients. In order to gain synergies, the company has merged with Citicorp Credit Services India Ltd with effect from 1 July 2000. Further, with effect from January 2001, the company has changed the name of the combined entity from 'Citicorp Securities and Investments' to 'e-Serve International' due to shift the business focus from a non-banking finance company to being the provider of sophisticated processing services to a global set of customers.

During 2004–05 the company has expanded its seating capacity about 7500 seats and with this the total office space has increased upto over 600,000 sq.ft. Further the company has planned to expand its services to its existing clients by adding new delivery capabilities and also enlarge its global footprint and this purpose the company has already started the work on the premises & Telecommunications expansions in Mumbai and Chennai, which will add in excess of 400,000 sq.ft. of office space.

Triton Corporation Ltd

Triton Corp. Ltd[2] (formerly known as Stencil Apparel) was promoted/incorporated by Amit Judge and his associates in April 1990 as a public limited company. The company came out with a public issue in February 1991 to part finance its project of setting up a plant at Noida, Uttar Pradesh, to manufacture 7,000 shirts and 2,500 trousers/jeans.

Commercial production at the trouser and the shirt plant commenced in September 1991 and December 1991 respectively. In 1992–93, the company incurred losses. In the following year, it changed the product mix, resulting in lower raw material costs and substantial reduction in expenses, therefore posting a profit. On the export front, the company supplies to global brands including Cacharel, C&A, Grigio Perla, FILA, Boggi, and Liz Claiborne, among others. In 1994–95, they implemented a restructuring scheme with

the consent of the financial institutions to pay back the high cost debts of the institutions.

As a part of its growth strategy Triton entered the BPO sector by acquiring Saffron, a 900-seater (247) international call centre at Gurgaon (in Haryana, India), in 2004, through the process of amalgamation. The capacity was further expanded to 2,550 seats in 2007. In continuation with its growth strategy, Triton acquired another BPO, Maple e-Solutions, a 450-seater (247) international call centre, strategically placed at Noida (in Uttar Pradesh) in January 2007.

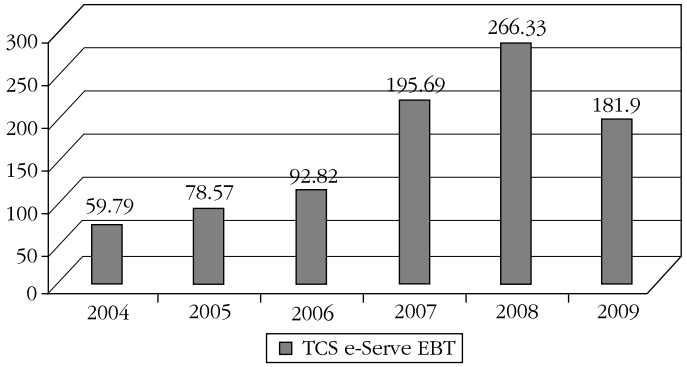
Profit Picture

The profit picture of these select companies is given in Tables 11.1 to 11.2 and Figures 11.1 to 11.2.

Table 11.1: TCS e-Serve EBT (INR in million)

Year	*March 2004*	*March 2005*	*March 2006*	*March 2007*	*March 2008*	*March 2009*
Profit before Tax	598	786	929	1,957	2,663	1,819

Figure 11.1: TCS e-Serve EBT Picture

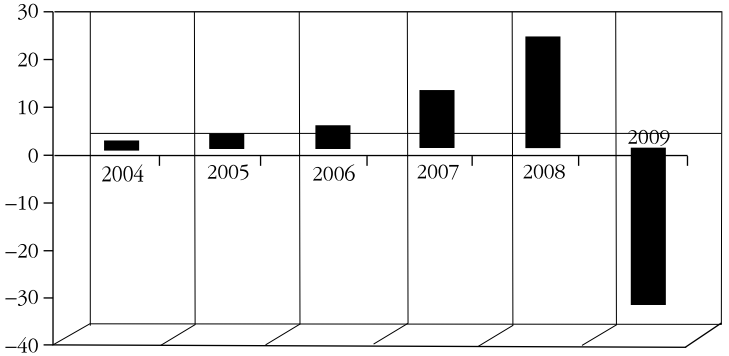


For TCS, the earnings before tax (EBT) had consistently increased over time, which shows the strength of company and also points out their growth, but, in 2009 there was a dip in the same due to ongoing recession in the industry. However, the company had given high dividends to shareholders as a motivational factor, to show that they have enough reserves and strengths to do better in the following year (2010).

Table 11.2: Triton EBT (INR in million)

Year	*Mar-04*	*Mar-05*	*Mar-06*	*Mar-07*	*Mar-08*	*Mar-09*
Profit before Tax	–0	14	46	122	236	–329

Figure 11.2: Triton EBT Picture



For Triton, the EBT had remained low over the years, but there was an increase over the years until 2008, which was a good sign. But company was unable to handle the recession in 2009, as is visible from Figure 11.2.

Return Analysis

Return generation of the companies has been analysed using profitability ratios. They are given in Tables 11.3 to 11.4 and represented in Figures 11.3 to 11.4.

Return on Investment (ROI)

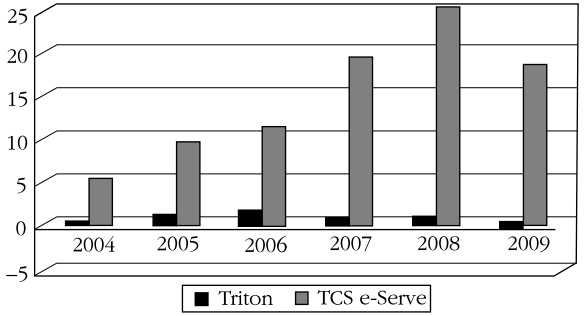
It indicates the percentage of return on the total capital employed in the business. It is calculated as

$$\frac{\text{(Operating Profit)}}{\text{(Capital Employed)}} \times 100$$

Table 11.3: ROI of TCS e-Serve and Triton

ROI	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	4.9707	9.1511	11.0048	19.0298	24.8500	18.3766
Triton Corp. Ltd.	–0.0149	0.8342	1.4139	0.4918	0.6271	–0.3952

Figure 11.3: ROI of TCS e-Serve and Triton



ROI is the returns on the total investment made by the company. This includes the preference and normal shareholders and also creditors who made long-term loans to the company (such as bond-holders and banks). TCS e-Serve has been performing much better than Triton, over the years.

Return on Equity (ROE)

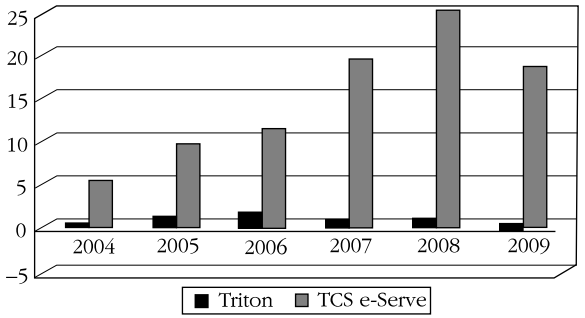
ROE measures the net income as a percentage of the shareholders' investments. Net income after tax is the amount available to share-holders for compensating their investment. It is calculated as

$$\frac{\text{(PAT)}}{\text{(Net Worth)}} \times 100$$

Table 11.4: ROE of TCS e-Serve and Triton

ROI	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	3.6145	4.8218	5.7548	12.9879	17.6750	8.6185
Triton Corp. Ltd.	–0.0204	0.2633	0.7983	0.5298	1.0365	–1.6458

Figure 11.4: ROE of TCS e-Serve and Triton



ROE is the retuns to the common shareholders of a company. TCS has been continuously doing good, but had a great dip in 2009 due to recesion in industry. Triton had tried to increase the ratio over the year, from 2004 to 2008, but dropped in 2009 due to recession in market.

Efficiency of Resources

The efficiency level of the units has been analysed in Tables 11.5 to 11.8 and Figures 11.5 to 11.8.

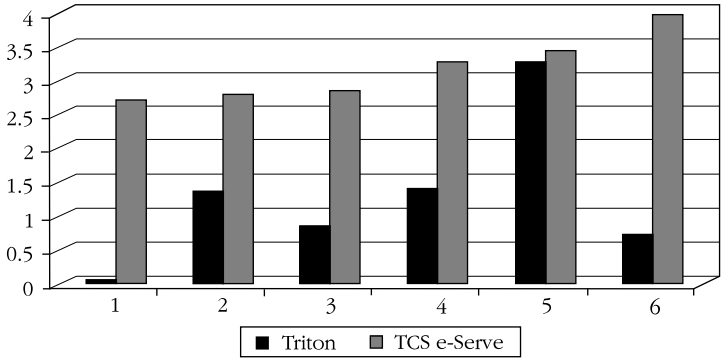
Fixed Assets Turnover Ratio

This financial ratio is used to determine the efficiency of use of the fixed assets. It is the ratio of sales to the total fixed assets.

Table 11.5: Fixed Assets Turnover Ratio of TCS e-Serve and Triton

Fixed Assets Turnover Ratio	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	2.66	2.76	2.8	3.24	3.41	3.92
Triton Corp. Ltd.	0.00	1.33	0.81	1.35	3.24	0.69

Figure 11.5: Fixed Assets Turnover Ratio of TCS e-Serve and Triton



As is evident from Figure 11.5, Triton had a low fixed asset turnover ratio in 2009, due to huge losses as well as faced a major drop in sales, as compared to TCS e-Serve.

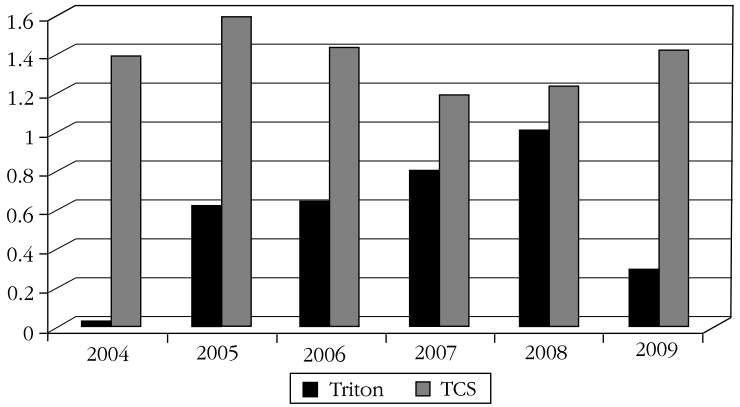
Total Assets Turnover Ratio

This financial ratio is used to determine the efficiency of use of the company's assets. It is the ratio of sales to the total assets.

Table 11.6: Total Assets Turnover Ratio of TCS e-Serve and Triton

Total Assets Turnover Ratio	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	1.371	1.546	1.408	1.167	1.212	1.396
Triton Corp. Ltd.	0.000	0.617	0.637	0.761	0.990	0.294

Figure 11.6: Total Assets Turnover Ratio of TCS e-Serve and Triton



Triton has very low total fixed asset turnover ratio as compared to TCS e-Serve; also, the value had declined drastically for Triton in 2009, due to huge operating losses. While TCS had good total fixed asset turnover ratio, it decreased in 2007 because of a huge increase in fixed assets.

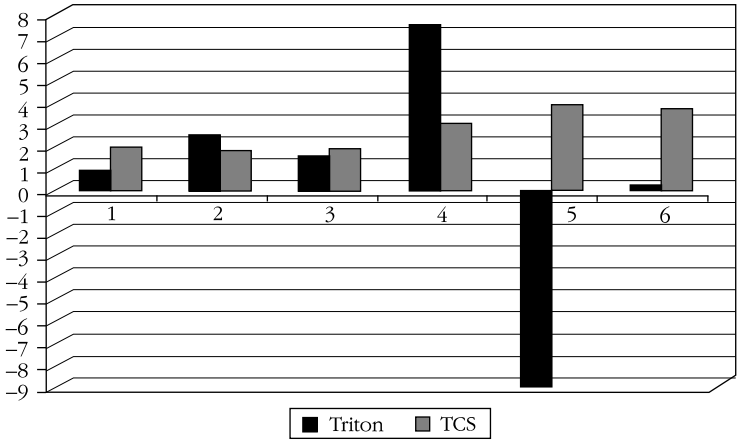
Working Capital Turnover Ratio

This ratio indicates whether or not working capital has been effectively utilised in making sales. The ratio is calculated as (Net Sales)/(Working Capital).

Table 11.7: Working Capital Turnover Ratio of TCS e-Serve and Triton

Working Capital Turnover Ratio	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	2.0000	1.8661	1.9189	3.0418	3.9425	3.7445
Triton Corp. Ltd.	0.9384	2.5911	1.5262	7.5776	–8.9295	0.0000

Figure 11.7: Working Capital Turnover Trend of TCS e-Serve and Triton



This ratio indicates how quickly and efficiently working capital is being utilised to generate revenue. However, it should not be viewed in isolation but with respect to the particular industry.

TCS e-Serve has consistently done well, and had an increase in the ratio, except for a few dips, which can be attributed to external factors; but Triton did not have good ratios over the year, except in 2007, and that too was due to extremely low working capital, which is not a good factor, as is evident in the subsequent years.

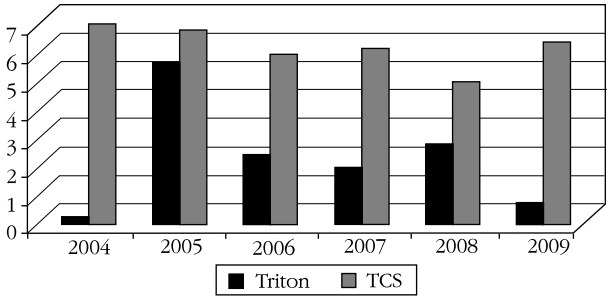
Debtors' Turnover Ratio

Debtors constitute an important section of current assets and, therefore, the quality of debtors, to a great extent, determines a firm's liquidity. The ratio is calculated as (Credit Sales)/(Average accounts receivable).

Table 11.8: Debtors' Turnover Ratio of TCS e-Serve and Triton

Debtors' Turnover Ratio	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	6.91	6.69	5.82	6.02	4.81	6.25
Triton Corp. Ltd.	0	5.53	2.21	1.74	2.6	0.56

Figure 11.8: Debtors' Turnover Trend of TCS e-Serve and Triton



Debtors' turnover ratio is a measure of how quickly the company is able to recover money from debtors. A high ratio is always a good sign; it could mean that the company has been following strict credit policy with its customers, which might lead to loss of market share. This ratio should be viewed with respect to the average in the industry. For Triton, it has continuously decreased while for TCS it has been almost constant, except for a decrease in 2007.

LIQUIDITY

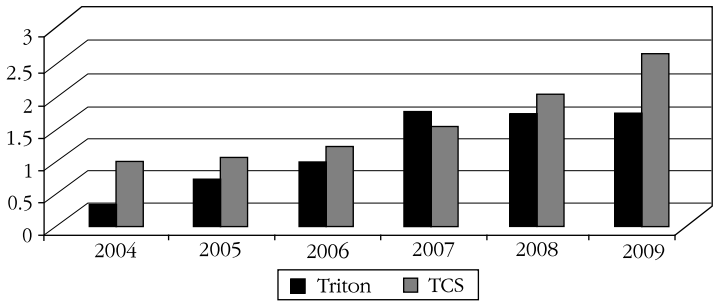
The liquidity pattern of the units is given in Tables 11.9 and 11.10 and Figures 11.9 and 11.10.

Current Ratio

Table 11.9: Current Ratio of TCS e-Serve and Triton

Current Ratio	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	1.03	1.08	1.25	1.56	2.07	2.71
Triton Corp. Ltd.	0.34	0.74	1.02	1.8	1.78	1.77

Figure 11.9: Current Trend of TCS e-Serve and Triton



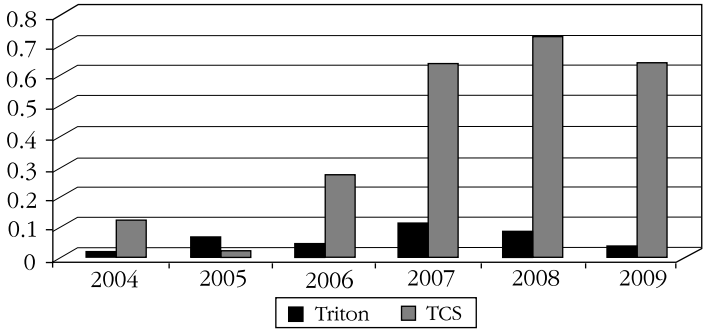
This is one of the most important ratios for evaluating a company's short-term liquidity. TCS' current ratio increased over time, from 1.03 to 2.71 (2004–09), which is good for the company; for Triton too, the ratio was on the rise but was quite low, nonetheless, which is a matter of concern for the company. A high ratio is desirable as it indicates that the company can meet its short-term liabilities. However, a too high ratio could mean that current assets were not being utilised efficiently. This ratio should not be viewed independently but in conjunction with the industry average.

Super Quick Ratio

Table 11.10: Super Quick Ratio of TCS e-Serve and Triton

Quick Ratio	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	0.1104	0.1195	0.2605	0.6317	0.7198	0.6259
Triton Corp. Ltd.	0.0052	0.0548	0.0335	0.1003	0.0734	0.0228

Figure 11.10: Super Quick Trend of TCS e-Serve and Triton



This is not an important measure of liquidity, since it takes only cash balances into account. Good ratio for TCS e-Serve had a good ratio, continuously on the rise, thus providing surety for company back-up and risk mitigation. On the other hand, Triton has really low values for the ratio, which is a matter of concern, as the company will not be able to pay back its debts in a quick emergency through its cash reserves.

SOLVENCY

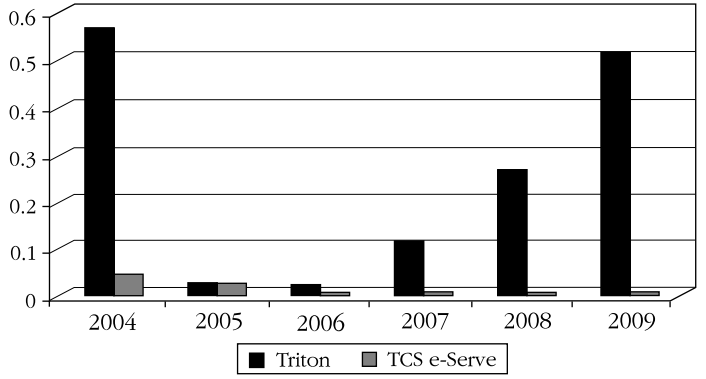
The soundness of the units is given in Tables 11.11 and 11.12 and Figures 11.11 and 11.12.

Debt to Equity Ratio

Table 11.11: Debt to Equity Ratio of TCS e-Serve and Triton

Debt-Equity Ratio	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	0.04	0.02	0	0	0	0
Triton Corp. Ltd.	0.56	0.02	0	0.11	0.26	0.51

Figure 11.11: Debt to Equity Ratio of TCS e-Serve and Triton



As a service company, TCS e-Serve had an extremely low debt–equity ratio at the beginning, which had been reduced to zero since 2006. However, Triton had been incurring huge debts from the start, and the figure had been on the rise again in the last two years (2008 and 2009), as the company was unable to generate any profits in the face of the global recession.

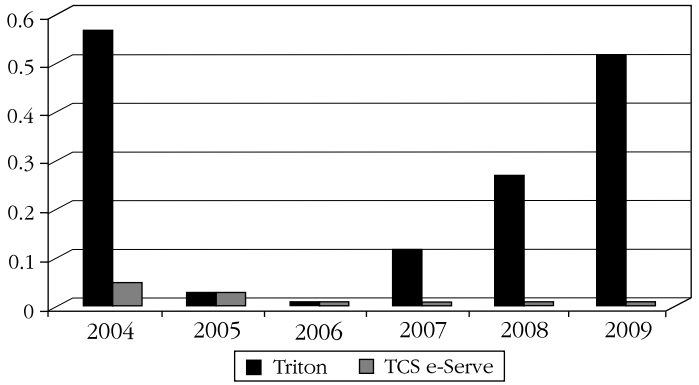
Interest Coverage Ratio

A ratio used to determine how easily a company can pay interest on outstanding debt. The interest coverage ratio is calculated by dividing a company's earnings before interest and taxes (EBIT) of one period by the company's interest expenses of the same period.

Table 11.12: Interest Coverage Ratio of TCS e-Serve and Triton

Interest Coverage Ratio	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
TCS e-Serve	230.96	188.07	207.27	214.72	146.54	49.51
Triton Corp. Ltd.	–32	177.33	93.6	24.96	9.55	–4.86

Figure 11.12: Interest Coverage Trend of TCS e-Serve and Triton



Since they belong to the service industry, the companies had low interest to be paid out, in comparison to PBIT and, thus, had high ratio values. But Triton had negative values, which is a matter of concern as company will not be able to pay back its interests for a given period. Therefore, the company's financial statements in 2010 should be checked properly.

Shareholders' Wealth Maximisation: Du-Pont Analysis

It has been discussed with the help of Tables 11.13 and 11.14. Du-Pont Analysis is the most widely used model for determining whether the company is contributing for shareholders or not. Here, Return on Equity (ROE) is separated into three components of asset turnover ratio, net profit and financial leverage.

Table 11.13: Du-Pont Analysis of TCS e-Serve

Year	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
ROE	3.6145	4.8218	5.7548	12.9879	17.675	8.6185
Total Asset Turnover Ratio	1.371	1.546	1.407	1.167	1.212	1.396
Financial Leverage Ratio	0.4323	0.0298	0.0000	0.0000	0.0000	0.0000
Net Profit Margin	0.1360	0.1286	0.1196	0.2029	0.2331	0.0878

The decrease in ROE from 2008 to 2009 is because of the decrease in the total asset turnover ratio and net profit margin only. These three

components of ROE explain the effect of asset utilisation efficiency, leverage and net profit margin on ROE. An increase in these ratios leads to an increase in ROE.

Table 11.14: Du-Pont Analysis of Triton

Year	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
ROE	–0.0204	0.2633	0.7983	0.5298	1.0365	–1.6458
Total Asset Turnover Ratio	0	0.617	0.637	0.761	0.99	0.294
Financial Leverage Ratio	0.0285	0.0018	0.0000	0.4576	1.3487	1.9755
Net Profit Margin	0.0285	0.0535	0.1446	0.2282	0.1422	–1.0040

The increase in ROE from 2007 to 2008 was because of increase in total asset turnover ratio and financial leverage ratio, against the decrease in net profit margin. In 2009, ROE was negative, which is because of net loss to the economy due to recession in industry.

Annexure 11.1

Significant Accounting Policies of TCS e-Serve and Triton

TCS e-Serve Ltd.

Basis of Preparation of Financial Statements

The financial statements are prepared under the historical cost convention and the requirements of the Companies Act, 1956.

Use of Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires the management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses, and the disclosure of contingent liabilities on the date of the financial statements. The estimates and assumptions used in the accompanying financial statements are based upon the management's evaluation of the relevant facts and circumstances as on the date of the financial statements. Actual results may differ from the estimates and assumptions used in preparing the accompanying financial statements. Any revision to accounting estimates is recognised prospectively in current and future periods.

Fixed Assets and Depreciation

Fixed assets are carried at cost of acquisition less accumulated depreciation. Cost includes freight, duties, taxes and incidental expenses related to the acquisition and installation of the asset.

Depreciation is provided on the straight line method. The rates of depreciation prescribed in Schedule XIV to the Companies Act, 1956, are considered as minimum rates. If the management's estimate of the useful life of a fixed asset at the time of acquisition of the asset or of the remaining useful life on a subsequent review is shorter than that envisaged in the aforesaid schedule, depreciation is provided at a higher rate. Pursuant to this policy, depreciation on fixed assets, except assets given on lease, has been provided at the following rates, which are higher than the corresponding rates prescribed in schedule XIV to the Companies Act, 1956:

(*a*) All fixed assets individually costing less than INR 5,000 are fully depreciated in the year of purchase.
(*b*) The Company provides pro-rata depreciation from the month the asset is put to use and for any asset sold, up to the month of sale.

Impairment of Assets

The company assesses, at each balance sheet date, whether there is any indication that an asset may be impaired. If any such indication exists, the company estimates the recoverable amount of the asset. If such recoverable amount of the asset is less than its carrying amount, the carrying amount is reduced to its recoverable amount. The reduction is treated as an impairment loss and is recognised in the Profit and Loss Account. If (at the balance sheet date) there is an indication that a previously assessed impairment loss no longer exists, the recoverable amount is reassessed and the asset is reflected at the recoverable amount subject to a maximum of depreciated historical costs and the reversal of impairment loss is recognised immediately as income in the Profit and Loss Account.

Leases

Lease arrangements, where the risks and rewards incident to ownership of an asset substantially vest with the leaser, are recognised as operating leases. Lease rentals under operating leases are recognised in the Profit and Loss Account on a straight line basis.

Investments

Long-term investments are stated at cost less provision for other than temporary diminution in value. Current investments comprising investments in mutual funds are stated at the lower of cost and fair value, determined on a portfolio basis.

Cash and Cash Equivalents

Cash and Bank balances, which have duration of up to three months from the date of acquisition, are included in the company's cash and cash equivalents in the cash flow statements. Actuarial gains and losses are recognised immediately in the Profit and Loss Account.

Revenue Recognition

Revenues from BPO services are recognised on time and material and unit priced contracts. Revenues from contracts priced on a time and material basis are recognised when services are rendered and related costs are incurred. Revenue on unit priced contracts is recognised as the related services are rendered. Revenue from services is recognised as gross of service tax in the period in which the service is rendered.

Interest income is recognised on time proportionate basis. Dividend income is recognised when the right to receive the dividend is established.

Foreign Currency Transactions

Income and expenses in foreign currencies are converted at exchange rates prevailing on the date of the transaction. Foreign currency monetary assets and liabilities other than net investments in non-integral foreign operations are translated at the exchange rate prevailing on the balance sheet date. Exchange difference arising on a monetary item that, in substance, forms part of the enterprise's net investments in a non-integral foreign operation are accumulated in a foreign currency translation reserve.

Premium or discount on forward exchange contracts are amortised and recognised in the Profit and Loss Account over the period of the contract. Forward exchange contracts outstanding at the balance sheet date, other than designated cash flow hedges, are stated at fair values and any gains or losses are recognised in the Profit and Loss Account. Exchange differences, other than on foreign currency loans to acquire fixed assets from countries outside India are recognised in the Profit and Loss Account.

Taxation

Current income tax expense comprises taxes on income from operations in India. Income tax payable in India is determined in accordance with the provisions of the Income Tax Act, 1961.

Deferred tax expense or benefit is recognised on timing differences being the difference between taxable incomes and accounting income that originate in one period and are capable of reversal in one or more subsequent periods. Deferred tax assets and liabilities are measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

In the event of unabsorbed depreciation and carry forward of losses, deferred tax assets are recognised only to the extent that there is virtual certainty of sufficient taxable income available to realise such assets. In other situations, deferred tax assets are recognised only to the extent that there is reasonable certainty that sufficient future taxable income will be available to realise these assets.

Advance taxes and provisions for current income taxes are presented in the balance sheet after off-setting advance taxes paid and income tax provisions arising in the same tax jurisdiction, provided the company has a legally enforceable right to set off the recognised amounts. The company offsets deferred tax assets and deferred tax liabilities relating to taxes on income levied by the same governing taxation laws.

Provision and Contingencies

The company creates a provision when there is a present obligation as a result of a past event that probably requires an outflow of resources and a reliable estimate can be made of the amount of the obligation. A disclosure for a contingent liability is made when there is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources. When there is a possible obligation or a present obligation, for which the likelihood of outflow of resources is remote, no provision or disclosure is made.

Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that the outflow of resources would be required to settle the obligation, the provision is reversed. Contingent assets are neither recognised nor disclosed in the financial statements.

Earnings Per Share (EPS)

The basic earnings per share are computed by dividing the net profit attributable to the equity shareholders by weighted average number of equity shares outstanding during the reporting year. The number of equity shares used in computing diluted earnings per share comprises the weighted average number of shares considered for deriving basic earnings per share and also the weighted average number of equity shares which would have been issued on the conversion of all dilutive potential shares. In computing diluted earnings per share, only potential equity shares that are dilutive are included.

Derivative Instruments and Hedge Accounting

The company uses foreign currency forward contracts and currency options to hedge its risks associated with foreign currency fluctuations relating to certain firm commitments and forecasted transactions. The company

designates these hedging instruments as cash flow hedges applying the recognition and measurement principles set out in the Accounting Standard 30 (AS-30) 'Financial Instruments: Recognition and Measurement'. The use of hedging instruments is governed by the company's policies approved by the board of directors, which provide written principles on the use of such financial derivatives consistent with the company's risk management strategy. Hedging instruments are initially measured at fair value, and are re-measured at subsequent reporting dates. Changes in the fair value of these derivatives that are designated and effective as hedges of future cash flows are recognised directly in shareholders' funds and the ineffective portion is recognised immediately in the Profit and Loss Account.

Changes in the fair value of derivative financial instruments do not qualify for hedge accounting are recognised in the Profit and Loss Account as they arise. Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised or no longer qualifies for hedge accounting. At that time for forecasted transactions, any cumulative gain or loss on the hedging instrument recognised in shareholders' funds is retained there until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in shareholders' funds is transferred to Profit and Loss Account for the period.

Triton Corporation Ltd.

Basis of Preparation of Financial Statement

The financial statements have been prepared under the historical cost convention (except land and building which have been restated after revaluation) in accordance with the GAAP, comprising the Accounting Standards issued by the Institute of Chartered Accountants of India and provisions of the Companies Act, 1956, as adopted consistently by the Company.

It follows mercantile systems of accounting and recognises significant items of income and expenditure on accrual basis, unless stated otherwise. The preparation of financial statement in conformity with GAAP requires that the management of the company to make estimates and assumptions that affect the reported amount of income and expenses of the period, the reported balances of assets and liabilities and the disclosures relating to contingent liabilities as on the date of the financial statement. Examples of such estimates include the useful life of fixed assets, provision for doubtful debts/advances, and future obligation in respect of retirement benefit plans. Actual results could differ from these estimates.

Fixed Assets and Depreciation

Fixed assets are accounted for at cost net of MODVAT and include cost of installation, wherever incurred, except land and building which are restated

at revalued amounts. Depreciation is provided on Straight Line Method at the rates and in the manner specified in Schedule XIV of the Companies Act, 1956, read with the relevant circulars issued by the Department of Company Affairs from time to time.

Investments

Long-term investments are stated at cost. Provision for diminution in the value of long-term investments is made only if such decline is other than temporary in the opinion of the management. Investments are accounted as per Accounting Standard 13 'Accounting for Investment', issued by the Institute of Chartered Accountants of India.

Revenue Recognition

Revenue from sales and services are recognised when the invoice is raised in accordance with the terms of the contract. Sales return are adjusted from the sales of the year in which the return takes place.

Inventory

Inventory consists of goods that are held in the normal course of business. Inventories are valued at lower of cost or net realisable value.

Miscellaneous Expenditure

Preliminary, public issue, preoperative and capital issue expenses incurred are amortised according to Accounting Standard 26, 'intangible Assets'.

Claims

Claims against/by the company arising on any account are provided in the books of account on receipt basis.

Taxation

Income tax liability is ascertained based on assessable profit computed in accordance with the provisions of Income Tax Act, 1961. Deferred income tax reflects the impact of current year timing difference between taxable income/losses and accounting income for the year and reversal of timing difference of earlier years. Deferred tax is measured based on the tax rates and the tax laws enacted or substantively enacted at the balance sheet date. Deferred tax assets are recognised only to the extent that there is reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realised. With respect to carry forward losses, deferred tax assets are recognised only to the extent where there is virtual certainty that sufficient future taxable income will be available against which such losses can be set off.

Foreign Currency Transactions

Export sales, services and expenditures in foreign currency are recorded at the exchange rate of the date of transaction. Exchange differences are recorded when the amount actually received/paid is converted in Indian rupees. Monetary items denominated in foreign currency remaining unsettled at the end of the year are translated at the rate prevailing on the balance sheet date and the resultant exchange differences are recognised in the Profit and Loss Account other than those relating to fixed assets, which are adjusted in the carrying cost of fixed assets and accordingly depreciation is charged.

Research and Development

Research and development costs are expensed as incurred. Software product development costs are expenses as incurred until technological feasibility is achieved. Capital expenditure incurred on research and development is depreciated over the estimated useful life of the related assets. Events occurring after the balance sheet date, which are material in nature, have been considered in the preparation of financial statements.

Contingent Liabilities

Depending on the facts of each case and after due evaluation of relevant legal aspects, claims against the company not acknowledged as debts are regarded as contingent liabilities. In respect of statutory matters, contingent liabilities are recognised based on demand(s) that are contested by the company.

Impairment of Fixed Assets

At each balance sheet date, the company reviews the carrying amounts of its Fixed Assets to determine whether there is any indication that these assets suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of impairment loss. Accordingly, the carrying amount is reduced to its recoverable amount by treating the difference between them as impairment loss and is charged to the Profit and Loss account, unless stated otherwise.

Cash Flow Statement

The cash flow statement is prepared by the indirect method set out in AS 3, on 'Cash Flow Statement', and presents cash flows by operating, investing and financing activities of the firm.

Notes

Introduction

1. The Indian Partnership Act, 1932 extends to the whole of India except the State of Jammu and Kashmir. It came into force on 1 October 1932, except section 69 which came into force on 1 October 1933. It defines the 'act of a firm' as any act or omission by all the partners, or by any partner or agent of the firm making enforceable by or against the firm. The 'business' includes every trade, occupation and profession. Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm', and the name under which their business is carried on is called the 'firm-name'. Available at http://www.mca.gov.in/Ministry/actsbills/pdf/Partnership_Act_1932.pdf (accessed on 25 July 2012).
2. The Companies Act, 1956 extends to the whole of India. 'Company' means a company formed and registered under this Act or an existing company as defined in clause (ii). No company shall be registered by a name which, in the opinion of the Central Government, is undesirable, or a name which is identical with, or too nearly resembles the existing company (Available at http://www.mca.gov.in/Ministry/pdf/Companies_Act_1956_13jun2011.pdf [accessed on 25 July 2012]).

Chapter 2

1. Horizontal is the traditional 'T' form, while vertical is the modern, corporate form of reporting — from top to bottom. Additional disclosures include the director's report and management discussion and analysis (MDA), discussed at the end of this chapter.
2. Flow concept implies the period of time. Profit and Loss Account is prepared for the entire year. It takes into consideration the total income earned and total expenses incurred in the year.

Chapter 4

1. CAGR is the year-over-year growth rate of an investment over a specified period of time. It is calculated by taking the nth root of the total percentage growth rate, where n is the number of years in the period

under consideration. It is an important tool of financial management for analysing investment alternatives.

2. GDP is one the primary indicators of determining the health of a country's economy. It represents the monetary value of all goods and services produced over a specific time period. It is generally calculated on an annual basis.
3. SEZ is a geographical region that has economic laws that are more liberal than a country's typical economic laws. The Special Economic Zone (SEZ) policy in India first came into force on 1 April 2000. The prime objective was to attract the foreign investment and technology and provide an internationally competitive and hassle free environment for exports.
4. Foreign Direct Investment (FDI) means 'cross border investment made by a resident in one economy in an enterprise in another economy' or an 'investment into the business of a country by a company in another country'.
5. Public–private partnership (PPP) is a partnership between the government and private people for a joint project. It refers to the involvement of private enterprise (in the form of management expertise and/or monetary contributions) in the government projects for the benefit of the society at large.
6. Available at http://www.hccindia.com (accessed on 11 April 2013).
7. Available at www.larsentoubro.com (accessed on 11 April 2013).
8. BETA is a measure of the volatility of the company's stock as compared to the market index.

Chapter 5

1. Public Sector Undertakings (PSUs) are broadly divided in three categories, based on their performance for better growth opportunities: Maharatna, Navratna and Miniratna CPEs. Navratna is a company which has comparative advantage of autonomy for global operations. This status was the first one which was initiated before other status. Miniratna status is given to the enterprises for increasing autonomy to profitable PSUs. Maharatna status is given to a company which is already Navratna. It is given in order to enable them to increase their investment from INR 1,000 crore to INR 5,000 crore without the approval of the government.
2. Available at http://www.indsec.co.in/Fundamental/Reports.aspx?reptype=POL&companycode=15130008.00 (accessed on 11 April 2012).
3. Schedule XIV provides for the rates of depreciation to be charged on the assets by the companies while preparing their balance sheet and profit and loss account.

4. LAA is a credit rating symbol — the high credit quality rating assigned by ICRA. The rated instrument carries low credit risk.

Chapter 8

1. Available at http://www.investindia.gov.in/?q=cement-sector (accessed on 21 April 2013).
2. Available at http://www.acclimited.com/newsite/index.asp (accessed on 10 June 2012).
3. Available at http://www.cementcorporation.co.in/page.php?id=24 (accessed on 10 June 2012).

Chapter 9

1. Available at http://www.airtel.in/ (accessed on 19 April 2013).
2. Available at http://www.ideacellular.com/wps/wcm/connect/aboutus/idea/info/overview (accessed on 19 April 2013).
3. It is one of the methods commonly used to calculate the value of inventory on hand at the end of a period and the cost of goods sold during the period. This method assumes that inventory purchased or manufactured first is sold first and newer inventory remains unsold.
4. Bharti Airtel's acquisition of Zain Telecom's Africa operations on 8 June 2010 for US $10.7 billion made it the world's fifth largest mobile operator. The company's subscribers increased to 180 million in 18 Asian and African nations. The transaction was the largest ever cross-border deal in an emerging market. Available at http://www.thehindu.com/business/companies/bharti-airtel-completes-zain-acquisition/article449759.ece (accessed on 10 April 2012).
5. Available at http://www.airtel.in/AnnualResults/Bharti_Airtel_annual_report_full_2010-2011.pdf (accessed on 10 April 2012).

Chapter 10

1. Available at http://www.sbi.co.in/user.htm (accessed on 25 June 2012).
2. Available at http://www.icicibank.com/aboutus/about-us.html (accessed on 25 June 2012).

Chapter 11

1. Available at http://www.indiainfoline.com/Markets/Company/Background/Company-Profile/TCS-e-Serve-Ltd/509028 (accessed on 18 November 2012).

2. Available at http://www.indiainfoline.com/Markets/Company/Background/Company-Profile/Triton-Corp.-Ltd/523387 (accessed on 18 November 2012).

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