

Financial Accounting
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Lecture – 38
Financial Statement Analysis: RIL Case 1

Namaste. In last few sessions, we are discussing Financial Statement Analysis, particularly in the last session we have discussed a case of TCS we are we have little bit gone beyond financial analysis, we have also taken other information and have calculated the ratios for TCS. In the current session and in the next session, we are going to take up Reliance Industries Limited, we know it is a premier listed company. It is a biggest listed company in India in terms of its market capitalization. So, we will try to analyze the company on different basis. The type of analysis which we are doing in portfolio management parlance, this is known as fundamental analysis. There are two types of analysis one is fundamental, other is technical.

In technical analysis; the price data of the company, the volume, the movements of prices, the charts all these things are studied whereas, in fundamental analysis the fundamentals of the company are studied which will mainly involve the financial statements and other data about the company. This part of fundamental analysis is known as company analysis, then there is a study of industry or the sector in which the company is operating that is known as industry analysis and the third part is known as economy analysis, where the whole of the country or whole of the economy is studied.

Now, all this three factors impact the performance of the company. Of course, we will not be able to go into details of industry or economy analysis, but we would try to look at how to do company analysis mainly based on the ratios...

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8	SECTOR:	ENERGY SOURCES					
9	GROUP:	MUKESH AMBANI					
10	TR AGENT:	Karvy Computershare, 17-24, Vit					
11	AUDITOR:	Chaturvedi & Shah					
12	CHM:	Mukesh D. Ambani (MD)					
13	COMP SEC:	K. Sethuraman (CCO)					
14	YEAR OF INC:	1966					
15	BSE CODE:	500325					

So, let us now, look at the reliance, you know that the MD, CEO and the chairman is Mukesh Ambani and the Company Secretary is K Sethuraman, the auditors are Chaturvedi and Shah. This is some details face value of the company is rupees 10.

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	A	B	C	D	E	F	G
13	COMP SEC:	K. Sethuraman (CCO)					
14	YEAR OF INC:	1966					
15	BSE CODE:	500325					
16	FV (Rs):	10					
17	Price and Shareholding information						
18	Price	Rs	1,255.0		% ch week	%	-6.7
19	Mkt Cap	Rs m	8,161,428		% ch 1-mth	%	-6.3
20	Vol	'000	691.8		% ch 12-mth	%	27.4
21	% ch	%	-0.4		52 week H/L	Rs	117.0/907.1
22	No. of shares	m	6,503.13				
23	Share Holding						
24	Indian Promoters:	%	45.2%				

The price is rupees 1255, this is in May 2019; the percentage change during the week etcetera is given. The market cap is 3161428 in terms of rupees millions, the volume you can see is fairly high which shows that the company shares are very liquid, the number of shares are 6503 millions ok.

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	A	B	C	D	E	F	G
22	No. of shares	m	6,503.13				
23	Share Holding						
24	Indian Promoters:	%	45.2%				
25	Foreign collaborators:	%	0.0%				
26	Indian inst/Mut Fund:	%	12.6%				
27	FIs:	%	18.8%				
28	ADR/GDR:	%	3.2%				
29	Free float:	%	20.2%				
30	Shareholders:		2,790,842				
31	Pledged promoter(s) h	%	0.0%				
32	Financials						
	No. of						

Now, let us go to the share holding pattern, again it is a Indian company. The percentage of shareholding of promoters is 45 percent. It belongs to Mukesh Ambani group. Indian institutions have about 12 percent foreign institutional investors 18 percent. They have issued securities abroad that is why ADR or GDR is 3.2 percent, free float is 20 percent. What is a free float? That means, these are the shares which are freely traded in the market which is about 20 percent. The number of shareholders are given. I think this is the largest number for any company in India 27,90,000 the percentage of shares pledged by promoters is 0 percent.

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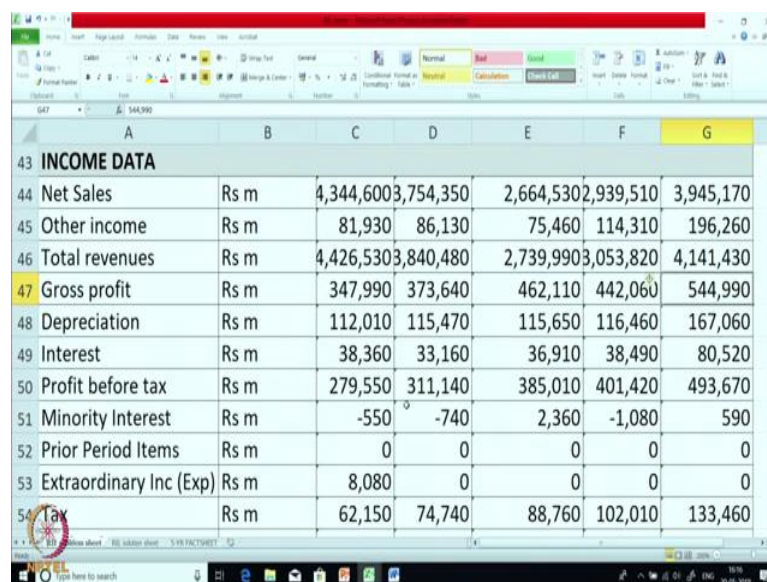
	A	B	C	D	E	F	G
34	EQUITY SHARE DATA						
35	High	Rs	939	1,143	1,090	1,336	1,665
36	Low	Rs	765	797	813	926	780
37	Average	RS	810	980	990	1231	1432
38	Shares outstanding (eom		2,939.55	2,943.33	2,948.02	2,958.92	5,921.83
39	Bonus/Rights/Conversion		ESOS	ESOS	-	ESOS	ESOS
40	Avg Mkt Cap	Rs m	2,504,938	2,854,000	2,804,451	3,346,095	7,239,437
41	No. of employees	'000	23.9	24.9	24.1	24.2	187.7
42	Total wages/salary	Rs m	55,720	62,620	74,070	83,880	95,230
43	INCOME DATA						
44	Net Sales	Rs m	4,344,600	3,754,350	2,664,530	2,939,510	3,945,170
45	Other income	Rs m	81,930	86,130	75,460	114,310	196,260

Now, let us look at the stock market data, this is the high and low prices for last 5 years. Average price is also given for last 5 years. The shares outstanding at the end of year in terms of millions is given. Do you see any movement in the number of shares? Yes if you look at the last 2 years there is a major rise from 2958 to 5921 and that is because of the fresh issue of bonus shares. So, they have given bonus ESOS conversion etcetera.

So, every year some slight amount of ESOS are given and this year it looks like major rise in the share because of the bonus. Average market capitalization over the period is also given. The number of employees are pretty high in terms of thousands so, its 23000 employees and now it is 187000 employees. Now the total salary over a period of time is given, I think this needs a bit of correction the number of employees. So, we will do the correction in the number of employees.

Now, the net sales, the net sales data over the period you can see that right from March 14 in fact, the net sales have slightly gone down and in the last year again the net sales have increased the other income is pretty stable.

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43	INCOME DATA					
44	Net Sales	Rs m	4,344,600	3,754,350	2,664,530	2,939,510
45	Other income	Rs m	81,930	86,130	75,460	114,310
46	Total revenues	Rs m	4,426,530	3,840,480	2,739,990	3,053,820
47	Gross profit	Rs m	347,990	373,640	462,110	442,060
48	Depreciation	Rs m	112,010	115,470	115,650	116,460
49	Interest	Rs m	38,360	33,160	36,910	38,490
50	Profit before tax	Rs m	279,550	311,140	385,010	401,420
51	Minority Interest	Rs m	-550	-740	2,360	-1,080
52	Prior Period Items	Rs m	0	0	0	0
53	Extraordinary Inc (Exp)	Rs m	8,080	0	0	0
54	Tax	Rs m	62,150	74,740	88,760	102,010

The total revenue went down in first 3 years and then again it has gone up understand that they are in oil business. So, oil prices fluctuate their sales are also fluctuating. The gross profits surprisingly show a pretty stable sign. The gross profit have more or less increased in all the years except in last year they decreased a bit and again they have jumped up to 544. Depreciation is a substantial amount. Why it is high compared to that

in TCS? Mainly because its a manufacturing company, they have got vast amount of fixed assets.

So, depreciation is 112 now it has increased to 167. Interest cost is also high and it has gone up substantially. Profit before tax is increasing steadily, minority interest is also pretty high and this minority interest is because of the shareholding of other people in their subsidiaries. There is a extraordinary income in March 14, there is no extraordinary income in any other year taxes you can see last 2 years the taxes have increased.

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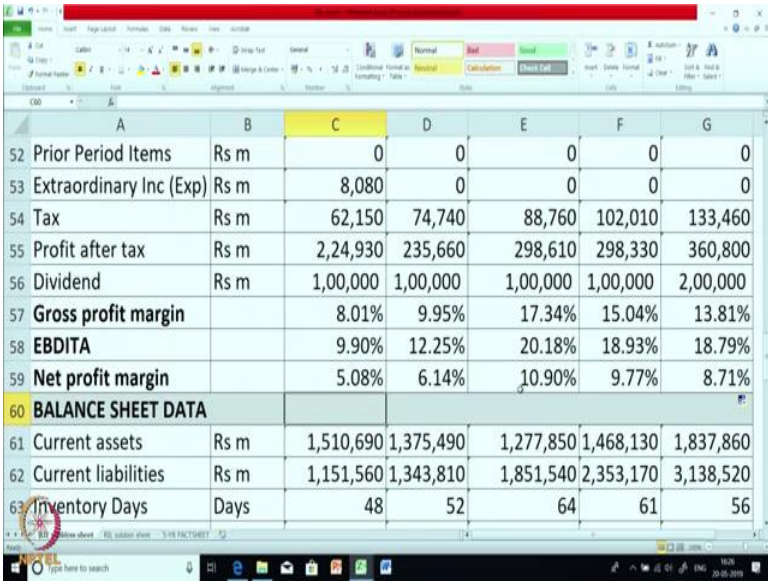
	A	B	C	D	E	F	G
49 Interest	Rs m	38,360	33,160	36,910	38,490	80,520	
50 Profit before tax	Rs m	279,550	311,140	385,010	401,420	493,670	
51 Minority Interest	Rs m	-550	-740	2,360	-1,080	590	
52 Prior Period Items	Rs m	0	0	0	0	0	
53 Extraordinary Inc (Exp)	Rs m	8,080	0	0	0	0	
54 Tax	Rs m	62,150	74,740	88,760	102,010	133,460	
55 Profit after tax	Rs m	224,930	235,660	298,610	298,330	360,800	
56 Dividend	Rs m	295	295	325	325	310	
57 Gross profit margin							
58 EBDITA							
59 Net profit margin							
60 BALANCE SHEET DATA							

And the profit after tax has also increased more or less consistently; the dividend figures are given over last some years some ok.

So, profit after tax and we have taken estimated figures of dividend for all the years just for our calculation sake. So, this is their income data, now using this we can calculate certain important ratios the first one is gross margin ratio. So, what is the formula, do you remember? It is gross profit divided by sales. So, it is 8 percent for March 14 please calculate it with me for all the years. So, it becomes 8, then 9 then 17, 15 and 13. So, you can see that in March 16, they were sorry in March yeah March 16 they were able to significantly increase their gross profit margin. Overall they have a good margin although it is changing over a period of time they are into several businesses, but mainly in oil refining. So, may be the changes in the oil prices could be responsible for changes in the gross margin.

The next is EBDITA. Now what is a full form of EBDITA? Earning Before Depreciation Interest Tax and Amortization; this is a cash operating profit. Now we have been given gross profit which is almost like a operating profit and we have also been given profit before tax. So, in profit before tax, let us add interest and depreciation to get EBDITA. PBT add interest add depreciation this is the EBDITA, we will divide it by net sales.

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	A	B	C	D	E	F	G
52	Prior Period Items	Rs m	0	0	0	0	0
53	Extraordinary Inc (Exp)	Rs m	8,080	0	0	0	0
54	Tax	Rs m	62,150	74,740	88,760	102,010	133,460
55	Profit after tax	Rs m	2,24,930	235,660	298,610	298,330	360,800
56	Dividend	Rs m	1,00,000	1,00,000	1,00,000	1,00,000	2,00,000
57	Gross profit margin		8.01%	9.95%	17.34%	15.04%	13.81%
58	EBDITA		9.90%	12.25%	20.18%	18.93%	18.79%
59	Net profit margin		5.08%	6.14%	10.90%	9.77%	8.71%
60	BALANCE SHEET DATA						
61	Current assets	Rs m	1,510,690	1,375,490	1,277,850	1,468,130	1,837,860
62	Current liabilities	Rs m	1,151,560	1,343,810	1,851,540	2,353,170	3,138,520
63	Inventory Days	Days	48	52	64	61	56

So, it is about 10 percent in March 14 over a period of time, it has increased slowly from 9 to 20 and then it is more or less stagnant slightly it has gone down.

Now, this is a very important figure to know the cash generated from their operating profits. Now the next one is net profit margin you all know the formula net profit upon sales. But here instead of sales we would take the total revenues. So, net profit was 5 percent went up to 10 percent is now 8.71 percent as we know mainly because of gross margins, but it also takes into account other income and other figures.

Now, let us go to balance sheet data.

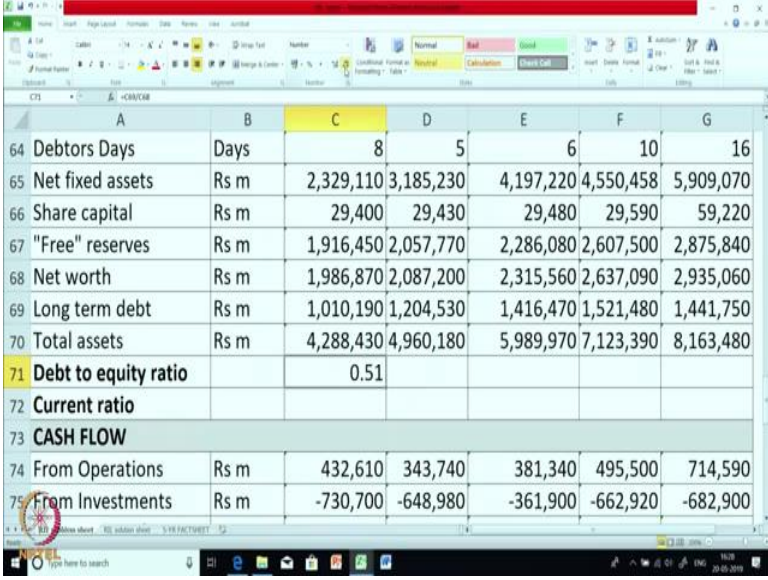
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	A	B	C	D	E	F	G
58	EBDITA		9.90%	12.25%	20.18%	18.93%	18.79%
59	Net profit margin		5.08%	6.14%	10.90%	9.77%	8.71%
60	BALANCE SHEET DATA						
61	Current assets	Rs m	1,510,690	1,375,490	1,277,850	1,468,130	1,837,860
62	Current liabilities	Rs m	1,151,560	1,343,810	1,851,540	2,353,170	3,138,520
63	Inventory Days	Days	48	52	64	61	56
64	Debtors Days	Days	8	5	6	10	16
65	Net fixed assets	Rs m	2,329,110	3,185,230	4,197,220	4,550,458	5,909,070
66	Share capital	Rs m	29,400	29,430	29,480	29,590	59,220
67	"Free" reserves	Rs m	1,916,450	2,057,770	2,286,080	2,607,500	2,875,840
68	Net worth	Rs m	1,986,870	2,087,200	2,315,560	2,637,090	2,935,060
69	Long term debt	Rs m	1,010,190	1,204,530	1,416,470	1,521,480	1,441,750

Now, last time we had studied TCS, but this is important and more interesting because this is a manufacturing company which is which has more figures because it invest in variety of types of assets. Now you can see that their current assets which actually went down and again have gone up current liabilities are pretty high. If you look at the ratio you will realize that their current liabilities are much higher than current assets in March 18. Inventory as a days because being a manufacturing company has to maintain lot of inventory, it has increased from 48 to 64 and again it went down to 56.

Debtors are very low 8, 5, 6, 10 and 16 this is in number of days. So, you will realize that their credit policies are very strict, they are selling almost on cash basis or with a very minimum credit, but slightly it has gone up to 16 days now.

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	A	B	C	D	E	F	G
64 Debtors Days	Days		8	5	6	10	16
65 Net fixed assets	Rs m		2,329,110	3,185,230	4,197,220	4,550,458	5,909,070
66 Share capital	Rs m		29,400	29,430	29,480	29,590	59,220
67 "Free" reserves	Rs m		1,916,450	2,057,770	2,286,080	2,607,500	2,875,840
68 Net worth	Rs m		1,986,870	2,087,200	2,315,560	2,637,090	2,935,060
69 Long term debt	Rs m		1,010,190	1,204,530	1,416,470	1,521,480	1,441,750
70 Total assets	Rs m		4,288,430	4,960,180	5,989,970	7,123,390	8,163,480
71 Debt to equity ratio			0.51				
72 Current ratio							
73 CASH FLOW							
74 From Operations	Rs m		432,610	343,740	381,340	495,500	714,590
75 From Investments	Rs m		-730,700	-648,980	-361,900	-662,920	-682,900

Net fixed assets they are having vast quantum of fixed assets and there is a consistent increase in the fixed assets which is 5909 now. Share capital has been constant more or less, but in the last year it has gone up. Free reserves are pretty high amount free reserves are high because consistently they are making good amount of profits. Net worth is also reasonably high. Long term debt being a manufacturing company it is not a zero debt company like TCS, they have a high long term debt although the debt equity ratio is not very high, we will just calculate the ratio now..

Total assets they are nearly doubled over a period of 5 years. Now let us calculate two important ratios that is debt equity and current ratio. So, you know the formula in debt equity it is debt upon equity. So, long term debt divided by net worth 0.50; either it can be expressed as a percent or just as a fraction this time. Let us just keep it as a fraction. So, its 0.51, signifying that for one rupee of equity 50 paise is an amount of long term debt. If you compare all the 5 years, then debt equity ratio increase the bit to 0.61 it has again gone down now till March 18.

Now, current ratio you know it is current assets divided by current liabilities.

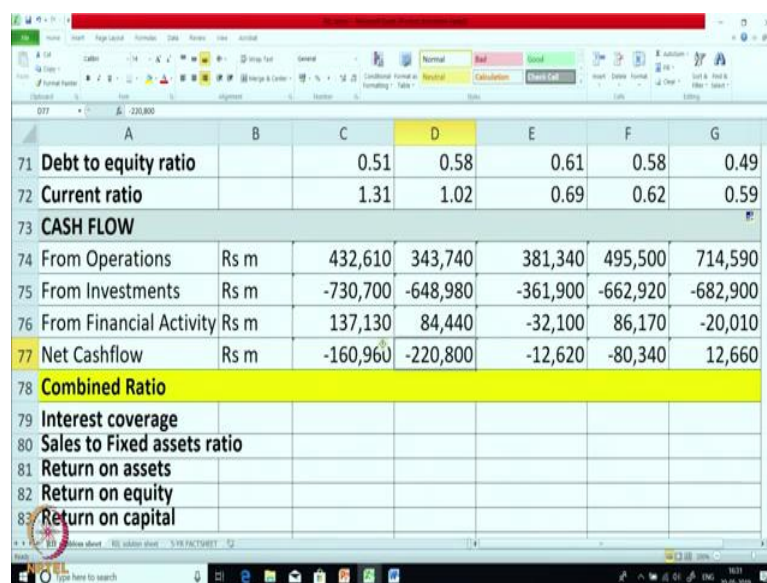
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	A	B	C	D	E	F	G
62	Current liabilities	Rs m	1,151,560	1,343,810	1,851,540	2,353,170	3,138,520
63	Inventory Days	Days	48	52	64	61	56
64	Debtors Days	Days	8	5	6	10	16
65	Net fixed assets	Rs m	2,329,110	3,185,230	4,197,220	4,550,458	5,909,070
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69	Long term debt	Rs m	1,010,190	1,204,530	1,416,470	1,521,480	1,441,750
70	Total assets	Rs m	4,288,430	4,960,180	5,989,970	7,123,390	8,163,480
71	Debt to equity ratio		0.51	0.58	0.61	0.58	0.49
72	Current ratio		1.31	1.02	0.69	0.62	0.59
73	CASH FLOW						

It was pretty high 1.31 and now has decrease substantially to 0.59. Particularly you will see that because of rise in the current liabilities, the current ratio is falling. Now if you remember we had discussed of standard ratio of 2 is to 1 reliance industry has much lesser current ratio than the standard ratio. This could be a bit of problematic as far as the liquidity is concerned although it is a very big company with a high credit rating. So, they are able to manage even with lesser current assets.

Particularly in the last years there is last 2 years, there is a remarkable increase in current liabilities maybe that needs to be further studied.

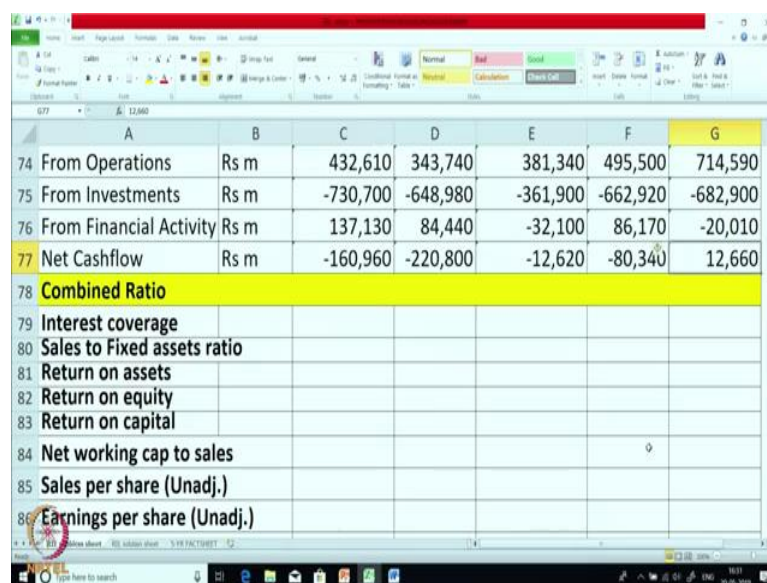
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	A	B	C	D	E	F	G
71 Debt to equity ratio			0.51	0.58	0.61	0.58	0.49
72 Current ratio			1.31	1.02	0.69	0.62	0.59
73 CASH FLOW							
74 From Operations	Rs m	432,610	343,740	381,340	495,500	714,590	
75 From Investments	Rs m	-730,700	-648,980	-361,900	-662,920	-682,900	
76 From Financial Activity	Rs m	137,130	84,440	-32,100	86,170	-20,010	
77 Net Cashflow	Rs m	-160,960	-220,800	-12,620	-80,340	12,660	
78 Combined Ratio							
79 Interest coverage							
80 Sales to Fixed assets ratio							
81 Return on assets							
82 Return on equity							
83 Return on capital							

Now, in the third part cash flow is given, you can see in the last year there is a significant increase in the cash from operations, cash from investments is more or less maintained although in the March 15. It was significantly negative which is a positive sign, but in most of the years a RI has been able to make some or other investment. Financial activity related cash flow also has been more or less constant though there are few fluctuations, but compared to the total size. It is not very high and the net cash flow was minus 160, then it became minus 220 and in the last year it is 12660.

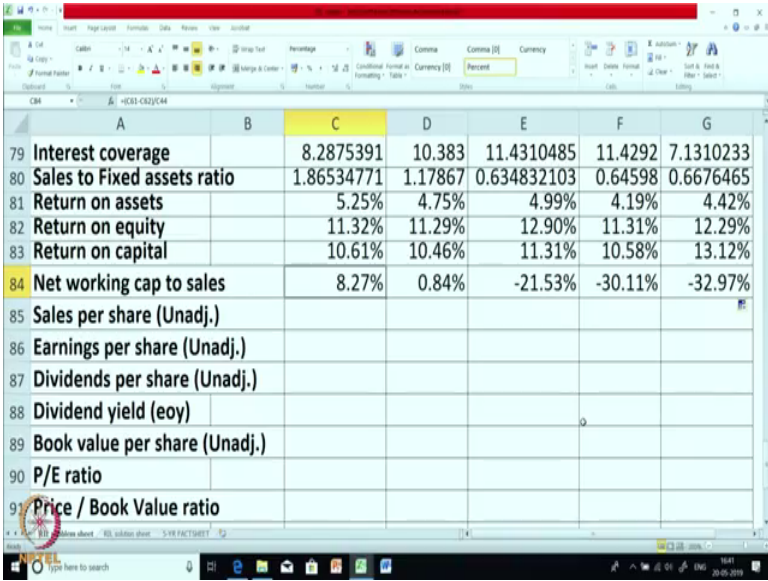
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	A	B	C	D	E	F	G
74 From Operations	Rs m	432,610	343,740	381,340	495,500	714,590	
75 From Investments	Rs m	-730,700	-648,980	-361,900	-662,920	-682,900	
76 From Financial Activity	Rs m	137,130	84,440	-32,100	86,170	-20,010	
77 Net Cashflow	Rs m	-160,960	-220,800	-12,620	-80,340	12,660	
78 Combined Ratio							
79 Interest coverage							
80 Sales to Fixed assets ratio							
81 Return on assets							
82 Return on equity							
83 Return on capital							
84 Net working cap to sales							
85 Sales per share (Unadj.)							
86 Earnings per share (Unadj.)							

Now, let us calculate some of the combined ratios. The first one is interest coverage ratio now what is a formula do you remember? We see how better the interest is covered. So, how many times they have earning to pay interest? Interest in the denominator and profits in the numerator. So, you will take which profit in the numerator? Will you take PAT? No because we have to take profit before interest and taxes from that amount we can pay interest.

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	A	B	C	D	E	F	G
79 Interest coverage			8.2875391	10.383	11.4310485	11.4292	7.1310233
80 Sales to Fixed assets ratio			1.86534771	1.17867	0.634832103	0.64598	0.6676465
81 Return on assets			5.25%	4.75%	4.99%	4.19%	4.42%
82 Return on equity			11.32%	11.29%	12.90%	11.31%	12.29%
83 Return on capital			10.61%	10.46%	11.31%	10.58%	13.12%
84 Net working cap to sales			8.27%	0.84%	-21.53%	-30.11%	-32.97%
85 Sales per share (Unadj.)							
86 Earnings per share (Unadj.)							
87 Dividends per share (Unadj.)							
88 Dividend yield (eoy)							
89 Book value per share (Unadj.)							
90 P/E ratio							
91 Price / Book Value ratio							

So, let us calculate PBIT, we have been given PBT add interest to that we will get PBIT; this is the profit available for paying interest divided by interest. So, you get 8.28. So, there is a fair coverage although they have got lot of interest payments since their profitability is very high, it is covered 8 times the coverage increased now it has slightly gone down.

The next one are the efficiency related ratios? We have just considered one ratio here that is sales to fixed assets ratio. So, it shows how efficiently you are utilizing your fixed assets to generate sales. So, sales divided by fixed assets. Since this is operating related we are mainly considering only net sales and not taking total revenue. So, what do you see here? There is a serious fall in the ratio. It was 1.81 the ratio has fallen particularly from March 16 and then it has become stagnant, its 0.66. If you look carefully their fixed assets have increased substantially without much increase in the sales in fact, sales went down and now the sales are steadily rising.

But its a very complex company. So, we cannot directly know anything, they might be constructing new fixed assets, but the current data as of available right now shows that the efficiency of utilization has somewhat gone down. Now return on assets popularly known as ROA where we will try to calculate how the total assets are used to generate profits. So, we will take PAT upon total assets. $\text{PAT} \div \text{total assets}$. So, you get 0.52. So, you can see 0.05 and if you convert it in percentage then it is more meaningful.

So, 5 percent was the return it has gone down to 4.42, it is not a much of a fall, but slight fall in the return on total assets the next one is return on equity. So, equity means owners funds and what profits they are able to generate? So, PAT upon net worth. So, 11.32 percent was the return and now it has more or less stagnant it has become 12.29. So, if you remember TCS this return on equity is somewhat lower for reliance.

Now, the next one is return on capital popularly known as ROCE or sometimes called as ROI where we will take the total return and in the denominator take the total funds debt plus equity. So, do you remember formula? In the numerator we will take PBT add back interest divide it by long term debt plus equity. So, 10.61 percent; in case of TCS it was almost zero debt company very low debt, but reliance being a manufacturing company has a reasonable quantum of debt. So, you can see the return on capital is slightly lower and now over a period of time the return has gone up to 13 percent. Keep in mind that it is interesting to study manufacturing because you get debt plus equity and we have discussed about capital structure. If you know your capital structure there is a higher quantum of debt the return tends to increase which is known as trading on equity.

Now, you can see here that company has somewhat been able to improve their return on capital by going for some level of debt ok, but in case of TCS if you remember, the return on capital was much higher because of the effect of tax. Now the next is net working capital to total sales. So, working capital is CA minus CL divided by sales 0.08, you can also take it as a percentage; that means, about 8 percent of the capital of the sales is the net working capital..

You can see this is very interesting it has moved from 8 percent to minus 32 percent now what could be the reason? Because their current liabilities have increased substantially. So, look at the current assets and liabilities, now the current liabilities are much more

than current assets. So, they are into a negative working capital scenario, that is a reason why the ratio has turned negative in last 3 years.

So, really interesting ratio it was 8 percent then became less than 1 percent and its negative in last 3 years. If you look at current ratio you will see it was from 1.31 to 0.59 the same impact was in terms of sales if you look at, you can get it from this ratio getting it?

So, we will stop here in the next session. We will continue with the calculation of the remaining ratios. Namaste.