Financial Statements Analysis and Reporting
Dr. Anil Kumar Sharma
Department of Management Studies
Indian Institute of Technology, Roorkee

Lecture – 39
Different Sets of Ratios Part-II

Welcome students. So, we were talking about the ratio analysis and we learnt that how to calculate different types of the resource and we discussed something about the three set of ratios that is return on investment ratios then we talked about the solvency ratios and then we talked about the liquidity ratios. So, three sets of ratios we talked about and ROI was the first set which we discussed that how to calculate the return on investment and as I told you that this is the broader concept as compared to the simple profitability. Profitability ratios I will be talking later on and till now what we discussed that is the ROI and then the solvency ratios and then the liquidity ratios.

We will first calculate these ratios it means we will discuss a case of one existing form that is Grasim Industries Limited and Grasim industries is a firm which is working in the textile sector and that is a really very good performing form and we will discuss this case.

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GRASIM INDUSTRIES LIMITED
Profit and Loss Account for the year ended
AS ON 31st March 2007

	Schedule	Current Year	Previous Year
INCOME			
Gross Sales		9,607.97	7,638.41
Less: Excise Duty		1,004.38	985.80
Net Sales		8,603.59	6,652.61
Interest and Dividend Income	13	113.27	67.53
Other Income	14	168.49	152.41
Increase/(Decrease) in stocks	15	(16.44)	(43.48)
		8,868.91	6,829.07
EXPENDITURE			
Raw materials consumed	16	2,219.32	1,822.69
Manufacturing Expenses	17	1,744.33	1,580.34
Purchases of Finished and Other Products		321.16	240.15
Payments to and Provisions for Employees	18	459.40	407.64
Selling, Distribution, Administration and Other Expenses	19	1,505.69	1,181.33
Interest	20	111.84	103.38
Depreciation and Amortisation		317.91	301.64

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Fixed Assets held for disposal			14.33	12.76
Investments	6		4,274.70	3,481.71
Current Assets, Loans and Advances				
Interest accrued on Investments		0.70		1.46
Inventories	7	824.14		750.73
Sundry Debtors	8	576.48		413.45
Cash and Bank Balances	9	116.38		155.58
Loans and Advances	10	824.69		705.54
		2,342.39		2,026.76
Less:				
Current Liabilities and Provisions				
Liabilities	11	1,266.86		969.15
Provisions	12	183.20		304.22
		1,450.06		1,273.37
Net Current Assets			892.33	753.39
TOTAL			9,764.15	7,546.13

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GRASIM INDUSTRIES LIMITED
Balance Sheet
AS ON 31st March 2007

	Schedule		Current Year	Previous Year
SOURCES OF FUNDS				
Shareholders' Funds				
Share Capital	1	91.69		91.69
Reserve and Surplus	2	6,138.35		4,890.39
			6,230.04	4,982.08
Loan Funds				
Secured Loans	3	2,291.00		1,386.12
Unsecured Loans	4	660.56		593.55
			2,951.56	1,979.67
Deferred Tax Liabilities			582.55	584.38
TOTAL			9,764.15	7,546.13
APPLICATION OF FUNDS				
Fixed Assets				
Gross Block	5	6,770.97		6,114.12
Less: Depreciation/Amortization		3,380.53		3,109.49
Net Block		3,390.44		3,004.63
Capital Work-in-Progress		1,192.35		293.64
			4,582.79	3,298.27

And what we have discussed so far about the ratios that are the three sets of ratios, we will calculate these three sets of ratios for the Grasim industries and then we will proceed further knowing about the other ratios. So, that you get to know that how to calculate these ratios and how to interpret the ratios.

So, more important is not simply the calculating the figures anybody can do it or even the systems do it for us these days and even there are some standard data basis as I talked to you about the (Refer Time: 02:15) centre for monitoring Indian economy if you look at their database that is (Refer Time: 02:20) that is having say financial statements of more than 11500 companies. And, most of the part of these financial statements is analyzed also and they have already calculated the ratios.

Switched on the question of calculating the ratios and the values; values and ratios anybody can calculate. They can be easily calculated, but interpretation is the most important thing. As a financial analyst we should be knowing that how to interpret those values, what is the meaning of those values and how to draw the meaningful inferences about that. That is the really intelligent part as for as the financial statements are concerned.

So, in this part we will be learning how to calculate different sets of ratios and then we will interpret those ratios. And once we complete that calculation and interpretation of the three sets of ratios discussed the so far; that is return on investment ratios, solvency ratios, and liquidity ratios, we will proceed further to learn about the other four sets of ratios, but first we will talk about the Grasim industries. We will analyze the financial statements of Grasim Industries Limited.

If you look at this you know that you must have heard about the name of this company that is a textile unit, a textile company working in the textile sector. And if you look at the balance sheet of these companies, really a wonderful balance sheet is really very interesting balance sheet. And if you look at the ROI, many we will calculate you will really want be wondering that really having a very good return on investment, this solvency is also very good and they maintaining a quite good amount of the liquidity also.

So, in this part we are going to learn about the Grasim industries. So, look at this case say Grasim industries whose balance sheet is given to us as on 31st March 2007. And if you look at that important parts here; if you look at the important things here you will see that it is a very good balance sheet, because solvency structure of the form is really very good very very strong format is. And if you look at this to see that they are running the show largely from say internal funds and internal funds they invested initially share capital of 91.69 [FL] and if you say look at the return on investment maybe the profit they have earned and reinvested back in the business.

Now, the larger expansion of the firm has been done on the basis of these internal funds. And you look at this and reserve and surplus figure which is 6138.35 [FL] and which was 4890.39 [FL] previous year. So, you see that how much profit has been added here and the capital has appreciated from the above 5000 [FL] to the 6000 [FL]. So, it is a very good appreciation in 1 year as compared to the previous year; and when you talk about the loan funds. So the loan component is very very less here their secured loans of 2291 [FL] which was 1386.12 [FL] in the previous year. So, they have gone up by about say 1000 [FL] and unsecured loans are 660 [FL] which was 593.55 [FL] in the previous year.

So the loans have also gone up, but not to that extent as it should have been. In the real sense as I talk you in my previous lectures that the debt equity ratio of the firm which is at the acceptable level is 2 is to 1. So, if you look at the debt equity ratio here it is I think it is reverse it is one-third is to 1.33 is to 1, if you look at the total quantum of the loans which is about say 3000 [FL]; and if you look at the share capital which is appreciation plus the initial share capital and that is more than 6000 [FL]. So, they have share capital internal funds more than the external funds; it means the intention of the management, intention of the initial promoters is very clear that they want to grow with the firm, they want to work hard, they want to really expand this firm, and they are largely depending upon the say internal funds. And they are making use of the external funds also.

But maybe half of the external funds half of the internal funds. So, this is the credibility of the firm, this is the solvency of the firm. And if you look at here the you calculate any solvency ratios maybe it is nab or it is debt equity ratio or it is interest coverage ratio or the say debt service coverage ratio, all the ratios are really very good or will be very good when we will be calculating. And they have really a very good say structure of their finances or the sources of the funds they are generating.

Now here come to the lower part here. If you look at the assets, they are justifying their total investment and they have the gross block of assets that is 670 [FL] and then the after depreciation it is a half that is 3390.44 [FL] in the 2007. And it has come down because of the depreciation. Then they have some capital work in progress.

And then you talk about the other things, they have quite a good amount of investments also which they have made outside the firm and then they have say- if you look at the other incomes also they are about say 70 lakhs; 0.70 [FL], and similarly the other assets.

If you talk about the current liabilities, then the current liabilities are also really good. Means, current liabilities are largely the part of spontaneous finance; that is the suppliers credit, bills payable, and then some expense credits, so they have also been able to generate sufficient amount from the spontaneous source is also. So, they are making proper use of all the three sources long term funds. Largely the long term funds are from the internal sources that is share capital plus reserves and surplus. And they have made the use of external long term sources, but half of the say internal investment and then they have made use of the short term funds also and then the spontaneous finance also because current liabilities amount is very very high here.

Then we talk about the; this is the profit and loss account of the Grasim industries. And if you look at the total income here that is in terms of sales that is about say 9607 about say 10000 [FL] more than 9500 [FL] which has significantly gone up from the previous year. And if you look at the net sales here that is also quite a good amount that is after the excise duty, because excise duty goes to the government; so just not the firm's income. So, after say subtracting this excise duty from the gross sales, the net sales left are very good handsome amount that is more than 8500 [FL]. And then they have some other incomes also. They have made investment as we have seen the investment figure. In the asset side of the balance sheet, so because of the investments they earning the good amount of interest that is 113.27 [FL] which has grown up significantly from the previous year, and they have say given some loans also. So, they are getting both the incomes interest and dividend incomes.

Then we have here the other incomes are also quite good. And then they have say when using the stock also; what about the stock was there with them may be of any kind raw material work in process or the finished goods they have also been able to reduce that stock also. So, it means they are selling the quite good amount of the say- production in the market. And here it is the lower part which is talking about the cost part for generating these sales. Larger chunk of the cost is for the same material, then is the manufacturing expenses and then they have purchase some finished goods as also without say any further processing they are selling that in the market. And then there were the other expensive like selling and distribution expenses.

Yes they have borrowed money that is 111 [FL] of the interest for almost 112 [FL] of interest they are paying. So, it means they have the loans about 3000 [FL] of the loans are there, so on that they are paying the interest. For the interest is also at the very manageable level, and then there is amortization of amount; and depreciation and amortization.

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Profit before Tax & Exceptional Items		2,189.26	1,201.90
Surplus on pre-payment of sales tax loan			4.13
Write back of provision for diminution		37.10	-----
Profit before Tax		2,226.36	1,206.03
Provision for Current Tax		(692.38)	(369.82)
Deferred Tax		1.83	27.00
Profit after Tax		1,535.81	863.21
Debenture Redemption Reserve No Longer Required		38.56	8.62
Investment Allowance Reserve No Longer Required		0.05	0.25
Balance brought forward from Previous year		878.37	815.35
Profit available for Appropriation		2,452.79	1,687.43
Appropriations:			
Interim Dividend		252.10	-
Proposed Dividend			183.15
Corporate Dividend Tax		35.36	25.71
General Reserve		1,200.00	600.00
Balance carried to Balance Sheet		965.33	878.37
		2,452.79	1,687.43
Basic and diluted earnings per share (In Rs.)		167.50	94.14

Then we have the: if you look at here the profit of the firm which is really very very interesting figure. If you profit before tax here is that is 2000 plus [FL], which was 1200 [FL] earlier in the previous year; this year the profit has increased by 1000 [FL] you can say from the 1200 [FL] to the 2226.36 [FL]. So, there is a very good increase almost profit is gone up by say 100 percent, almost 100 percent as compared to the previous year. So, that is again a very very good achievement.

And then they have a say a profit after tax. And the profit after tax figure is also a very good figure, which was 863 [FL] previous year and now this year it has gone up to 1535.81 [FL]. So, again the net profit also has become double that is a profit after tax. And then they have talked about the other components there in the profit and loss account. And they have a say creditor some reserves and some dividends they have paid. So, interim dividend they have paid, they have propose the final dividend also, and then they are talking about the tax part. And look at the general reserve figure. General figure has also become double this year; 600 [FL] of the general reserve that is the reserve and surplus work there for any a contingency or any future unspecified purpose. And this general reserve has become 1200 [FL] almost gone double not almost.

But, yes it has gone double here 1200 [FL]; 1200 [FL] of the reserves we have created. And then they have taken the balance sheet name is the profit to be taken to the balance sheet is also quite a good amount close to 1000 [FL]. So, it means if you look at the overall financial position of this firm and the profitability of this firm even without any kind of analysis if you look at the row balance sheet; without any kind of analysis, without ratio analysis, without preparing cash flow statement or anything you will be able to find it out that this is the very good firm having a very good financial structure, and having a very good say financial position also.

Let us talk about one more figure here that is we talk about the cash and bank balances. Cash and bank balances it has this which was 150 [FL] previous year, this figure has come down they have reduce the cash level to 116 [FL]. It means this is good development, because function not keep large amount of the cash and the current assets. They should keep nominal means optimum amount of the current assets, because as I told you cash in hand or cash at bank does not on anything for the firms. It is only kept for meeting day to day expenses. So, if you keep large amount of the cash in that case it is not going to serve a good purpose; means any purpose and it is going to cause as the cost.

So, the cash should be kept as the optimum as possible so that is sufficient for making the payment, firm is not making any default in making the payment is not technically insolvent. And there fulfilling all the requirements. And they are not losing any income also by keeping extra amount of the cash. So, if you look at the total sales level which is total quality; means total assets level if you look at which is about say 9000 [FL] of the assets and out of that they are keeping only 10 percent if you say roughly 10 percent they are keeping as cash which is a very optimum amount. And we can expect that they are maintaining the quite a good amount of the liquidity also; not more not less. So, it is a optimum amount of the liquidity they are maintaining. And they we will be able to say use this liquidity for paying their short term liabilities; current liabilities.

Apart from their balance sheet and profit and loss account we find here that the firm has some extra information also.

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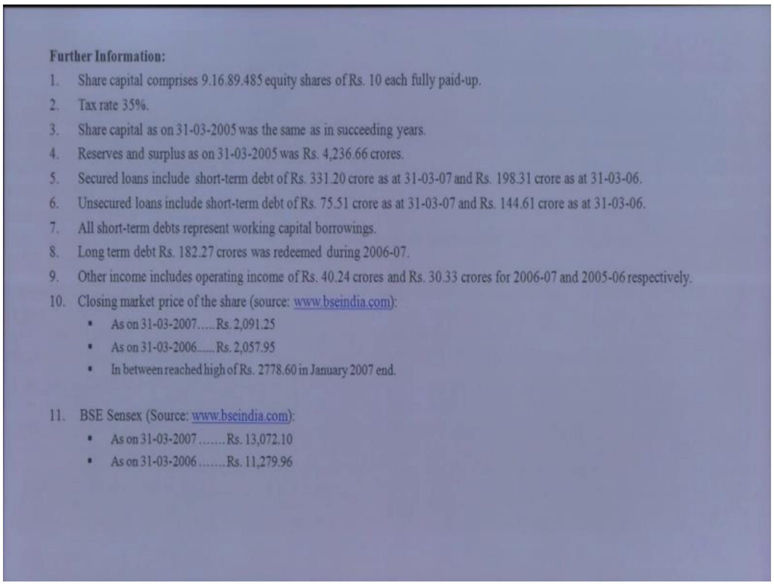

This industry, this firm has say share capital of say if you look at this is 9,16,89,485 equity shares and 1 share is of the 10 rupees and they are fully paid. Tax rate is 35 percent and then the share capital on as on 31st March 2005 was the same as in the succeeding here. It means they have not issued any new shares in the market, they have been running the show with the initial amount of the share capital that is 91.69 [FL]. And if you talk about the reserve and surplus figure; so reserve and surplus figure was 4236 and currently if we look at the reserve and surplus then this figure is really very good. Reserve and surplus they have risen up to the level of; if you look at this figure of the current year that is 6000 [FL], so quite a good amount of increase in the reserve and surplus.

And as you know that reserve and surplus is are created from the profits. So, if you are earning the profits after paying all the say creating specific resolves, paying the dividend and miss making all kind of the provisions we have amount to be passed on to the reserve and surplus and which was 4236 [FL] or 7 [FL] in 2005, in 2007 it has become about 6000 [FL]. So, it means it is a quiet increase good increasing the reserve and surplus also. And here we have to; if you look at this information then you see that we have certain other items also.

And if you look at the other items then these items are like this is the figure of secured loans. So, secured loans include a short term debt of 331.20 [FL] and 198, so it is a short term. Short term information is not given to us in the balance sheet, it is only given us the secured loans. So, in that secured loans; we are talking about this analysis of the balance sheet and the information given here. So, we are talking about this balance sheet and it is better to understand the balance sheet thoroughly before starting calculating the ratios. It is very important, because if you start calculating the ratios and if you have not look at the total information of first what is given to us in the statements, this sometime we can miss out some information and we may not be able to calculate all the ratios properly.

So, that is why I am explaining it to you that, because it keeps in idea also that what kind of the balance sheet it is, what kind of the financial statements are these. And if you look at even the naked or with the naked eyes also your balance sheets and your say profit and loss account you can easily make out that how the overall financial position of the company. So, it means in case of the Grasim industries if you look at the overall financial statements of the company you will be able to make out or take a decision that without even any kind of analysis this company is a very good firm, very good organization. And similarly if you talk about here, we were talking about the figures of say you can call it as a different types of the loans and the part of your figures given in the secured loans.

So, if you talk about the figures given the secured loans, here secured loans have short term debt of 331.20 [FL] out of the total debt of the 3000 [FL] and out of the total unsecured debt of about 600 [FL] 75.71 [FL] in 2007 is on account of the short term debt. So, short term debt is basically the current liability. We will have to add it up in the current liabilities while calculating the liquidity ratios. So, there you will be directly you are given the current liabilities and in the current liabilities you have to add the short term debt and then total will be of these two will become the denominator for calculating the liquidity ratios. So, we should be very clear.

And one more important thing is: you need this information of the long term and short term debt for calculating the interest coverage ratio and then the debt service coverage ratio. So, interest coverage ratio as we have seen in the numerator; that is a profit after tax then which takes noncash charges and then we take the interest on the long term loans. So, if you know because interest figure maybe it has been given as a total figure of the interest. So, how much is the interest on the short term debt, how much is the interest on the long term debt? We will have to calculate for that. And for calculating the interest coverage ratio and the debts service coverage ratio we will have to take only the interest on the long term debt, we will not have to take the interest on the short term debts. So, interest component we have to know and for that it is very important to know the extent of for the magnitude of the long term and the short term loans.

So, that is why I was discussing with you. Then we have the same other items like your working capital; all short term debt represents working capital borrowings. And then we have the say long term debt is 182.27 [FL] was redeemed during the year. It was redeemed means it may it was paid back, it was returned by the company during the year. So, look at that how much surplus they have, how much profits they have; their able to pay a quite a good amount of the say interest out of the profits. And interest payment is only possible if you have the liquidity, if you have the good amount on the profits you have the sufficient cash available liquid amount of the cash available then only the interest can be paid. And then the loan part can be paid. So, here if you look at the long term debt; long term debt 182.27 [FL] has been paid back.

And then we talk about the other incomes that include operating income of 40.24 [FL] and 30.33 [FL] which was in the two years. This and then we have the some important information about the say- market price of the share of the company. You see that closing market price of the share as on 31st March 2007 was 2091 rupees. And as on 2006 it was 2057.95 rupees. It means as compared to 2006, in 2007 the share price market value of the share of the company has gone up; it has not been remaining static it has gone up, and when it has increase means you see what is the price of the share of the company.

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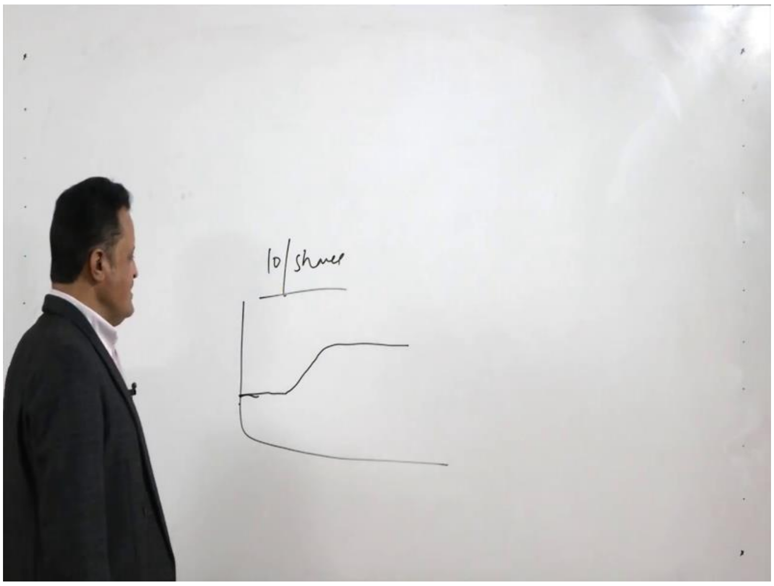

If you talk about the book value of the shares of the company the book value of the shares is how much, rupees 10 per share is the book value of the company. And it 10 rupees share which was originally issued by the company long back it has now the market value of 2000 plus [FL] and sorry, 2000 rupees more than 2000 rupees.

It means there is a good appreciation. And everybody would like to buy the shares of this kind of the companies, because they can expect a very good increase that if you buy the shares of Grasim industries today and you sell it after our some days you will be able to get a good return on that; is nothing going to be a say any kind of a loss making situation, it is a profit making situation.

But a point of caution here is that is not there blind fully you buy the shares of this kind of the companies because, the appreciation which has to be there in the share it has already gone up to the saturation level. Now further more increase is not expect much more increase in the share price of this company because if you look at the previous year's price that was 20 sorry, 2057.95 means 2058 rupees and now it has become 2091 rupees.

So, how much increases there? About 33 rupees increases there. The share prices increase as compared to previous year this year the share prices gone by 33 rupees, because the reason is the company is very good their earning very good profits, their performance is also very good. But, it has already gone up to a level which you call it as a level of the saturation. If I draw a line, you can say that normally the share price sometimes say is moving like this and then it goes up started going up and then it reaches at the saturation level. So, when it is reaching at the saturation level it means you cannot expect. So, it is going up also; in case of the Grasim industries the share price is going up its increasing, but not at a very faster rate.

So, only 33 rupees increase we have seen in the current year. So, it which was maybe in the beginning it was going like this, now it is something like this and it is moving like this. So, not a very good increases there. So, ups and downs some increases are there. But finally, at the end of the year it has shown the increased by 33 rupees. So, we are not going to make any loss making investment if we buy the shares of this kind of companies, it can be bought. And if you look at the same time the SENSEX value on this date 31st March the SENSEX was 13000 at the 13072 rupees which has also gone up as compared to 2006. And you see one more important thing here is that in between the share of this company had reached up to 20778 also or 79 also in January 2007.

So it means, if somebody has bought the shares and if you wanted to sell generally would have been the better month that if you do not keep on waiting till March, if you sell it of in January you are earning a good amount, because you have that share you bought in 2006 for 2000 rupees 2057 rupees or 58 rupees, and now in advance point of time in January it has risen up to 20778 or 79 rupees. So, somebody had sold these shares in the market in January he would have earned a good amount of return or a good amount of the say return on his investment.

Finally, if you look at the overall performance of the company is really without even calculating any kind of the ratios you can make out that, yes this company is a very good organization, is very nicely managed company, properly managed company and without even any kind of the ratios you will be able to find out that seems to be that their overall financial position is very good, their profitability is very good, their share price is going up, and they are getting huge amount of the reserves also, there paying quite a good amount of dividend to their shareholders also. So, overall very good companies very well banish company. And whatever the investment may has a shareholder I make as a lender I give funds or anybody gives funds to this company or is a supplier somebody gives the material to this company is not going to make any loss making proposition, is going to deal with a very good firm, very good organization and no loss only gain as a win-win situation for all the stakeholders.

After this we will start calculating the ratios. Why I picked up this kind of the case because it is really good to make analysis of the companies who are itself showing a very good financial position. And we want to confirm that the financial position which we are finding out from the raw financial statements without any kind of analysis is the same thing is coming out while we are making the analysis or there is some different.

Because, financial analysis add sum value as for as the firms over all information is concerned, and then we want to make sure that yes what has seen here with the naked eyes or maybe as a raw balance sheet on the profit and loss account same think you will find when you will calculate the relevant ratios for the Grasim industries and you can substantiate your observations about the company with the ratios which we are calculating. And with the help of the ratios we can convince the shareholders, we can convince the bankers, we can convince other financial institutions and we can convince the suppliers.

So, now next part will be that is we will start calculating the ratios; three sets of ratios: that is the ROI ratios, then this solvency ratio, and the liquidity ratios for the Grasim industries. And that I will start doing in the next part of discussion.

Thank you very much.