Financial Statements Analysis and Reporting
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Lecture - 50
Valuation or Capital Market Ratios Part-I

Welcome students. So, we are in the process of ratio analysis and with the help of ratio analysis we are trying to analyze the financial statements, and so far we have discussed different types of the ratios different sets of the ratios, and the we talked about say RoI ratios, we talked about solvency ratios, we talked about the liquidity ratios, we talked about turn over ratios, that is the resource sufficiency that we talked about the profitability ratios, du point ratios, and in this discussion in this lecture will be talking about the capital market ratios, or the valuation ratios. Because capital market is very (Refer Time: 01:02) capital market position of the firm is very very important; whatever the book value of the firm is if that is not reflected in the capital market then it is really very difficult for the firm to generate funds for expansion and growth, and to have a better image in the market. So, for that reason the capital market ratios are very very important.

In my previous lecture I discussed with you that what are the important capital market ratios, and we had we identified that the there are six ratios which can be considered as a capital market or the valuation ratios, these ratios were earning per share. Then we had other five ratios earning per share we have already calculated and we know that how to calculate the earning per share, then we had another ratio that is the price earning ratio we talked about how to calculate the price earning ratio, and that for that we need the closing market price, that is the market price of the last day of the accounting period; and then we had the say other you can call it as other I say ratios that is another ratio is in NAV net asset value which we have already calculated, and we had now the next ratio that is the market price to NAV, we have to calculate compare the market price with a NAV then we have the market capitalization ratio and finally, the yield to investors. Yield to investor we discussed in my previous lecture also that we consider in two ways one is the dividend, and second is the appreciation in the market price.

So, normally there is a appreciation or depreciation in the market price, so if somebody buys the share, because in the sundry market it is not on the basis of say at the performance of the company, maybe it is directly or indirectly linked to the performance; for people on the people's perceptions, people investors behaviour is more important and relevant there that is the fees that the company's overall reputation is good, and if you buy the share today because of the improved financial position or the better financial position of the company, if somebody can buy this share from you or from somebody else tomorrow at the higher price. So, may be within a month or too somebody can earn or good investment return or the return on his investment. So, there the return and means the gain and loss is normally on the perceptional values on the perceptional prices not on the book value, not on the physical value, but you see that perceptional value is also to a larger extent is affected by the book value.

Now, for example, there is very good perception about the reliance industries, and it is dream share for anybody that if reliance industry shares are available any company in the reliance group. If there shares are available people are all to buy the shares even if it is IPO, then people are ready to buy the those shares at say at very high premium, may be some times the 10 rupees share can be sold for 1000 rupees. So, you see that how much premium people are ready to pay; they are not expecting that they will be getting dividend on that share and they are waiting for that dividend, nobody is waiting till the dividend is declared by company right from the beginning of the year and till the end of the year, when the profit and loss and income statements are prepared, and the dividend is declared in between that say 12 months period of time, share changes number of hands.

So, people are only earning by on the basis of; but see that market value is also based up on the actual value of the company, and note is 10 rupees 1000, but you see this will the company very good and their investment is safe and that investment is growing because company itself is growing. Similarly we talk about the Infosys industries, if you get the Infosys share today there is no issue that nobody will you buying it from you and anybody can buy it from you, buy it today and tomorrow you will sell it off in the market you can earn a good return; because Infosys overall financial position is good. So, these are the companies who have been able to raise the funds not in India, but globally in the say US markets also these companies are listed and they are raising the funds there.

So, it is not the perceptional of the people in India only, is the perception of people globally that these companies are the best performers and there both the values are closely linked one side it is the book value other side it is the market value, and by looking at both the values, then both the things go hand in hand if there is a growth in the physical process there is a growth in the market process. If there is a growth in the physical profits actual profits of the company there is a growth in the market share of the company say share price of the company in the market.

So, it is directly linked. So, we will see that what is the book value of the company, and what is the market value of the company. Now there is the one ratio we will be calculating, and if we calculate that ratio that is called as the capitalization ratio market capitalization ratio. So, market capitalization ratio is basically how we calculate, we take the market price of the share there is the closing market price of the share.

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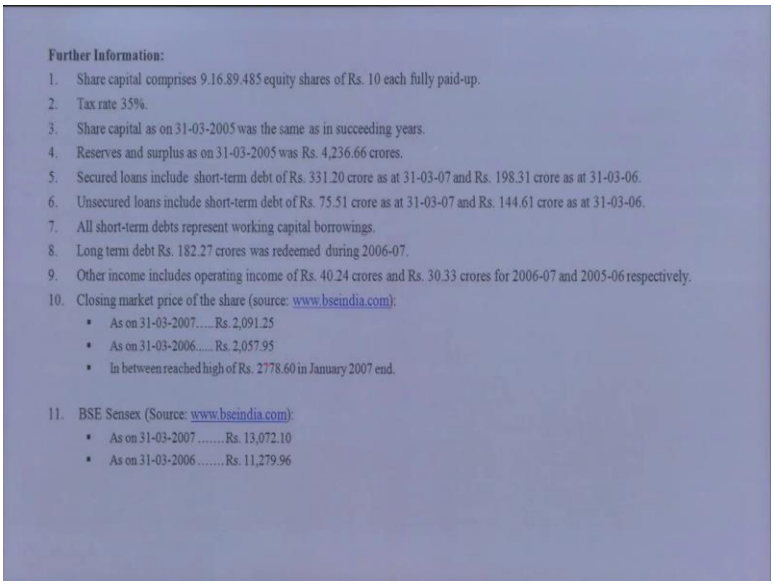

And in this case we will talk about the year 2007 closing market price is 2091 and 35 paisa; and number of shares are 9.17 [FL] in this case the Grasim industries. If you multiply you will find the market capitalization of company in somewhere around 19000 [FL] and if you look at the book value of the company.

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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

If you look at the total asset size of the company then the total assets side of the company is how much 9764.15 [FL].

So, it means that is more than double market capitalization is. So, the market value of the firm is more than double. So, it means one price companies say fetch for their physical growth, other price they fetch for goodwill in the market. So, goodwill price is very very high in the market, and that is the reflected in the share price in the market and you can see that 10 rupees share of the Grasim industries because selling in 2007 for 2000 rupees. And somewhere in January it had gone up to 2778.6. So, this is the perceptional value, but linked directly or indirectly with the physical value.

So, now we will be calculating these six ratios, and then will analyze that how the Grasim industries is market performance is, how people proceed this firm in market and how we can say that what is the market rating of the firm.

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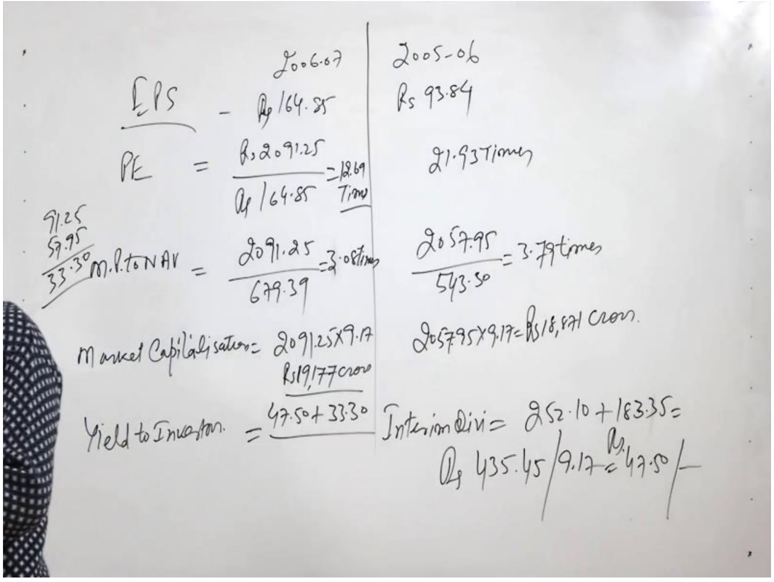

So, we talk about the EPS; if you talk about EPS we have already calculated earning per share, and the earning per share of the company is already there with us we have already calculated and for the year 2006 and 7, and then it is the year 2005 and 6. So, earning per share rate is 164.85 rupees, and then we have the earning per share is 93 rupees 93.84 rupees.

So, means in 2005 and 6 earning per share was 93.84 rupees, which is grown up to 14.85 rupees per share, it means it is a good amount of earning per share the company is earning that is really good. So, it is already calculated it is with us, and now we calculate the PE ratio we calculate the PE ratio, and if you calculate PE ratio we have to calculated how the closing market price and earning per share. So, closing market price; closing market price is how much? If you look at the closed market price of the company it is given here 2091.25, 2000 rupees 2091.25 and earning per share that is the price earning price to earning ratio. So, price is 2091.25 and earning is 164.85, that is rupees 164.85.

So, if you calculate the ratio, this ratio works out as it is 12 this is equal to 12.69 times, 12.69 times and in this case if you calculate the ratio, this work out as 21.93 times. So, that the price earning ratio has come down, if you look at the absolute growth in the price it has gone up; in 2006 it was 2057, and in 2007 it has become 2091 there is a growth, but if you compare the earning per share it is more in the year 2006 and 7. So, it means in that case because of increased profitability, the price earning ratio in the year 2007 is down that is the denominator has improved the significantly, earning per share has improved significantly, but market price of share has not improved.

So, this is some you can call it has (Refer Time: 10:04) that when the earning is increasing, earning per share is increasing that is from 93 to 164 rupees, but the price is not increasing. So, it means we will discuss that how it can be possible, and what is the effect of it; and but could be the possible reasons for not growing the price earning ratio then we have the next ratio is market price to market price to NAV. Market price to the NAV that is the market price to the net asset value, market price to the net asset value is the closing market price that is again 2091, 2091.25 and NAV is 679.39 this is the NAV value, and if you calculate this ratio NAV market price to NAV, this works out as 3.08 times, 3.08 times this is NAV market price to NAV value 3.08 times this is NAV.

And then we have the NAV value for this. So, the price is 2057.95 and 543.30. So, it is how much it is 3.79 times, 3.79 times is the market price to NAV. So, again there is decline in this ratio also. So, both the ratio that is price earning and the market price to net asset value is decline in. So, that is the meaning of this declined, what is the say ultimate means reflection of this declined, what could be the reason, will discuss it later on let us calculate first all the ratios.

Then we have the market capitalization. Look at the market capitalization what is the closing market price? 2091 into 25 into 9.17 and how much it is; it works out as rupees 19,177 [FL] and in this case if you calculate it is 2057.95 into again 9.17. So, the market capitalization here is rupees 18,871[FL]. So, you can make out the market capitalization of the firm and finally, we have the ratio that is the yield to investors and in case of the yield to investors you have two kind of the things: one is dividend, and second is the appreciation in the market price.

So, what is the dividend let us check the dividend value, we will have to check the dividend value how much dividend is being paid by this firm, and if you look at dividend we paid per share. So, we will have to see that how dividend is being paid will have to calculate this dividend. So, let us see how much is the amount of dividend paid in this year.

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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	291.64
		6,679.65	5,627.17

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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

So, if you look at the amount of dividend being declared by the company it is the; first you will have to take into account the number one is interim dividend, let us calculate it interim dividend, how much is interim dividend is paid this year?

Let us check the interim dividend payment yes, interim dividend is 252.10 [FL], that is the interim dividend paid during the year dividend paid during the year 0.10[FL] plus what is the closing dividend which was declared previous year, but paid this year that dividend we will have to calculate means look for. So, let us check the dividend here all short term debts will (Refer Time: 13:56) working capital long, term debt is this much other incomes include this much, and closing market price is this much and this is the case.

Now, is there any other information letting to dividend will have to look for secured loans, this much unsecured short term debt working capital will let us check a final dividend here, what was the final dividend paid. The say when we talk about the current year dividend which will you paid this year, there is no final dividend proposed dividend that is only the interim dividend has been paid that is 252.10 [FL], but proposed dividend here is 183.15, that is that is dividend proposed in the previous year which will be paid in this year. So, it will consider has the dividend for the current year. So, it is 183.15; 183.15. So, this becomes total of this because how much? This total dividend becomes 250.10 [FL] plus 183.35 [FL].

So, this is the closing dividend and if you look at this dividend total amount of this is that is rupees total works out has how much? 435.45 [FL] and if you divided by how much number of shares? 1.9 per 17 [FL] shares this works out has the dividend income is in the current year dividend income is 47.50 rupees per share, which I had written here already 47.50 rupees plus, but in the appreciation in the market price? The market price has gone up if you look at the market price of 2005 was 57.95 and it is 91.25. So, there is appreciation in the price. So, it is 91.25 and it is 57.95, 57.95.

If we take this 0, then it is the 3, then it is the 10 minus 7 is 3, and it is 8 minus 5 is 3. So, 33.3 is the appreciation in the market price. 33.3 is the appreciation in the market price. These are two changes in the market say two sources of the yield to investment, and initial investment is how much? People are buying the share previous year this much 257.2057; 2057 point how much it is? 250, 2057.95. So, it means what is the yield investors in this year that is finally, it is 3.93 percent, and this cannot be calculated for this year because it is we do not have the interim dividend, we do not have the final dividend position here. So, from the previous year 2005 what was the position that is not given to us so that cannot be calculated. So, yield to investor in the previous year cannot be calculated; however, the yield for the current year is 3.93 percent. So, these are the six ratios it is nil, or not calculated or we can call it as not available.

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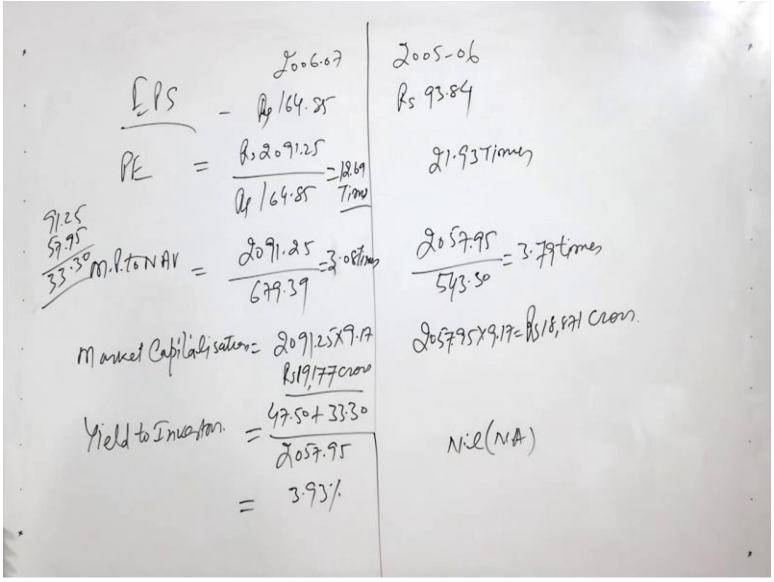

So, if you look at capital market ratios and you draw the; you should analyze these ratios I want to draw some meaning full conclusion about it. So, let us start talking about ratios one by one; and if talk about the these ratio these ratios one by one we will see that 2006-7 and 2005-6 if we talk about earning per share, it has seriously significantly improved from the 93 yeah 94 rupees 2, 165. So, it means there is a in case of 6 and then it is 5, 71 rupees. So, this earning per share has improved seriously significantly by 71 rupees, but the market has not changed to in that proportion or to that extent.

Now, what could be the reason, market price has only changed from how much; that is the 33 rupees increase in the market price. 2005-2006 and propose the price and what is the price in 2007 if you compare these two prices, then you see that the change in the market price is not much, now there could be different reasons may be there is some wrong news about Grasim industries in the market in that that time, that the company is passing through very difficult phase company is going to be taken over, company is not performing well, company's financial position or the operating position is not good. So, because of any reasons because of any you can call it as the misnomers or the misperceptions in the market, sure price is get affected because.

Finally what is the share price? It is the perceptional value; it is only the perceptional value nothing else. So, when the perception of the people changes then actually it is affecting the share price. So, if you see physically company is doing very well, when we started analyzing the ratios with the help of this company or in case of this company Grasim industries, we found it that this company even without going for any kind of analysis reflects it is all balance sheet and profit and loss account reflects that this company is a wonderful organization, very nicely properly managed firm, but and that that situation we have really found in ratios also, but if you look at the market price then it is not big change and that is only the reason that you are in this case price to earning ratio if you talk about a earning is improving in a big way, and the price is not improving that is why the PE ratio is declining.

So, it means PE ratio which was 921.93 times about 22 times previous year, this year it has come down to 13 times almost 12.69 points, it means there is a decline because market price is not improved. But you see market price is you cannot say that market price is not improved at all, market price has improved in January look at this there is January marked price of the company share was 2778.6.

So, we compare here and you compare here there is the difference of out 700 rupees in the market price. At the end of the 2007 had this been January price could be the closing price, this ratio would have been much more compared to what it was in previous year. So, if in January if there is the share price can become about 2007 hundred rupees, but it is come down in march it means there is something perceptionally wrong, not actually physically wrong, perceptionally there was something wrong and which was taken in a wrong since by the people or by the potential investors and that is why the price has not changed. So, there is nothing wrong with the company, EPS is good and price earning ratio in this case is misguiding, if people look at the price earning ratio then they would be wondering that if the earning is increasing why the price is not increasing, and it is only because the precipitation of the people is moving in the different direction. Then you talk about this ratio that is marked price to NAV net asset value.

Now, this is the interesting ratio; as a financial analyst you must be knowing that this is a comparison typical comparison of the two things: one is the market value of firm that is the market price, and NAV is the book value of the firm, net asset value is what it is the book value of the firm. So, when you calculate the NAV net asset value of the firm, and you try to compare with the say market value of the firm, it means in that case we are going to find out that comparison of the market value to the book value or the market value to the book value this is the book value in NAV is the book value of the firm this is physical value of the firm, you can easily check it up net asset value is; you can easily find it out that this is the physical value book value of the firm, physically it can be if the firm is sold in the market we can get this much of the price.

But actual market price is this much which is perceptional, and if you talk about the market price of the firm as compare to the net asset value, it is 3.0 at times, which has also come down from the 3.79 times to the 3.08 times, because over all this year as compared to 2006 in 2007 overall companies market performance is not good you can say, but that is only perceptional difference you can call intelligence of financial analyst, he can easily find out that what (Refer Time: 22:29) is looking at company like; you should not look at company like this.

Because you know that what is here in these financial statements, and if it is here in the financial statements if you are a clever financial analyst, if you are intelligent financial analyst you must be either buying the share yourself or must be say advising your well wishers that you go and buy the share of this company, and I can guaranty your share will have it a better return. So, because market analysis showing that this company is performance is declining; what was in 2006 and what is in 2007 is really declining, but it should not taken be taken like that and here what you talk about that the market price and the net asset value is 3.08 times, and when you talk about the market capitalization it is physically the book value of the firm is 9700 [FL], but it is 19000 [FL] it is almost going to be say more than two times.

So, you can say the physical value the book value of the firm is something and the market value of the firm something, but if you look at and you look at the market capitalization here, then form the previous year the market capitalization is gone up, but not seriously significantly. Had it been 2778.6 has the share price, you would have seen the company is growing at a remarkable rate, but that could not be sustained that would not kept going till the end of the year, and then yield to investors. Yield to investors is a not very good 3.93 you cannot say that it is very good yield. So, it means is not the case that this yield it has two parts: one is the dividend company is declaring, and the second thing is the appreciation in the market price.

So, yield has come down not because of the dividend, but because of the not sufficient appreciation in the market price, because market price has gone up from is by 33 rupees only over two years period of time. So, for example, you see the person who has bought the share in the beginning of 2006, and he is holding the share till end of 2007 it means he must be badly depressed that I made so much of investment in this company, but finally, the growth in the share price is not big so my yield is low. He must be must not be satisfied by this yield this year has specially which it is low, but you see here I could like to share one important component that when you talking about the company Grasim industry limited, we have seen that company has raised most of the funds from it is internal sources and here the basic investment in the form of share capital was only 91.69 [FL].

And now by adding this reserve and surplus by 6138.35 [FL] they have reason up to this level of 6230, and the external debt on the company is very very less. So, it could be that this share price or the dividend is you say that only 47 rupees, you cannot say that it is very good amount of the dividend. So, if somebody buying a share say 2000 rupees, and if it is getting a dividend of 47 rupees you can say you can make out how much dividend he is getting, what percentage of dividend he is getting. So, when he is not getting the right sufficient amount of the dividend, it means there could be different reasons also why he is not getting and what could be the philosophy of the company. So, that reasons and the philosophy of the company that you can say as a true financial analyst you can find out that the dividend is 47.5 and the market appreciation is 33.30; why this low growth is there expressed the yield to investors is concerned not very good growth.

There are different kind of the financial policies of the companies, and may be the Grasim is also following this policy, and the if you look at this policy here in this case you can make out that may be the company's policy is different, and share holders who want dividend immediate return on their investment, dividend on their investment or dividend on the share they have purchased, I think Grasim may not be the good company for him.

But is it right for a company to declare the dividend or not to declare the dividend, and are there any other companies following the similar kind of the system or the approach as the Grasim industry is following all this discussion I will be doing with you, and why the loan amount of the dividend has been declared to solve I will be talking to you and discussing with you in the next part of discussion.

Thank you very much.