

**Financial Statements Analysis and Reporting**  
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**Lecture – 51**  
**Valuation or Capital Market Ratios Part – II**

Welcome students. So, we are now in the say verge of closing the discussion on the ratio analysis. This is my last lecture on the ratio analysis and say with reference to Grasim industries and their performance, if we what we could find out so far I was discussing with the last part of discussion that here we are finding that the dividend paid by the Grasim industries seems to be low and this could be the one reason that the market price has not appreciated, but if people are looking or the potential or existing investors. If they are looking from this prospective then it means they are totally financially illiterate I would say. They do not know how to analyze the over performance of the company and their financial outcomes. Because you see that one important indicator which you also as a financial analyst tomorrow has to see that if you look at the situation that is the reserve and surplus position here then it is 6138.35.

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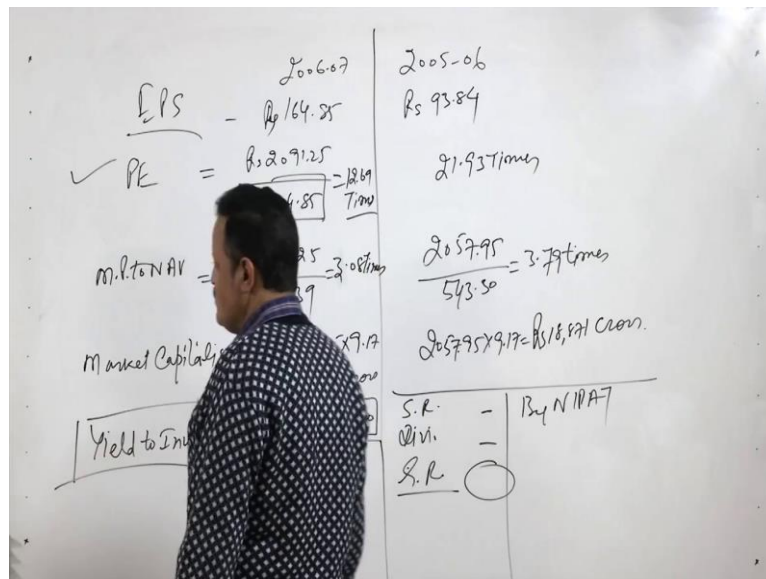
GRASIM INDUSTRIES LIMITED				
Balance Sheet				
AS ON 31 <sup>st</sup> March 2007				
	Schedule		Current Year	Previous Year
<b>SOURCES OF FUNDS</b>				
<b>Shareholders' Funds</b>				
Share Capital	1	91.69		91.69
Reserve and Surplus	2	6,138.35		4,890.39
			6,230.04	4,982.08
<b>Loan Funds</b>				
Secured 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
<b>TOTAL</b>			<b>9,764.15</b>	<b>7,546.13</b>
<b>APPLICATION OF FUNDS</b>				
<b>Fixed Assets</b>				
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 if you talk about the debt equity ratio we have seen that the debt equity ratio in this company where it should have been 2 is to 1 or more than that it is less than half. You can call it as 0.47 is to 1, if you remember then it is less than half it means they have not

at all exhausted their borrowing capacity. Reason was that most of the fund this firm has generated internally that is reserve and surplus means they are starting the business with initial capitals. So, far was a capital issue you talk about that is 90 about 92 [FL] and remaining capital is coming from the reserve and surplus it means how a company builds up the reserve and surplus, how a company builds up the reserve and surplus.

When we prepare the profit and loss appropriation account, you if you recall it if you know or we have discussed the profit and loss appropriation account and if you know that and if you recall the profit and loss appropriation accounts preparation.

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In this case you can see that we have a buy net profit after tax and here you have the appropriations and when you talk about the appropriations, in case of the appropriations you see that we are first of all creating specific reserves and then we are paying the dividends and then the amount is remaining amount is going to the general reserve. It means the firm is creating very less amount of the specific reserve very small amount is little amount they are paying as a dividend and larger part of the investment is means that profits is going to be reinvested back in the business.

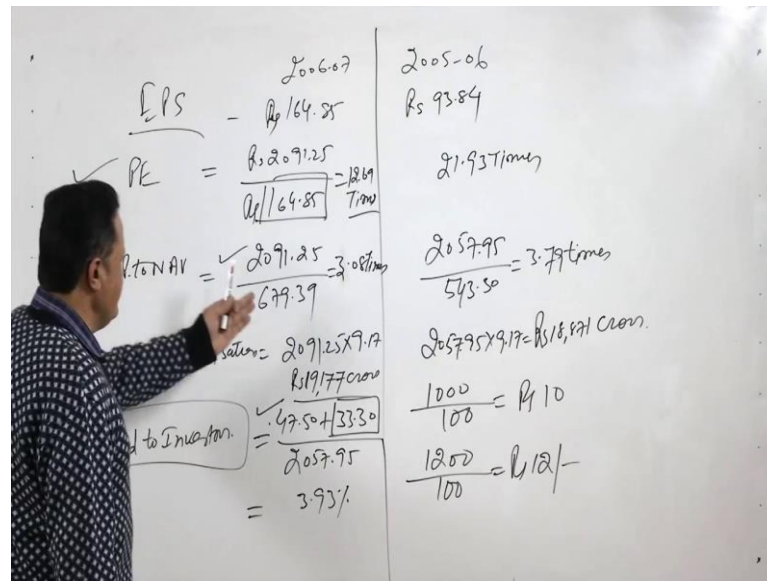
It means the money reinvested back in the firm, is it not the share holders money, is it not the share holders fund means if you talk about the earning per share earning per share is growing because if you talk about the total dividend or the total return of this it is seriously growing that earning per share it was 94 rupees, now it is 165 rupees, it has

grown by 70 rupees this year, it is 65 rupees and it was 94. So, 60 to 71 rupees growth is there. It is not a small growth and for example, the company is not paying any dividend, can you say that the company's yield to invest is very poor? Yield; dividend is not the criteria because people who are thinking of getting the dividend and comparing the return on the investment on the basis of the dividend then they are the poor investors. Because in the market from the beginning of the year till the end of the year when the dividend is declared in the market.

It changes hands in say to the number of peoples it changes number of hands. So, it means if you are talking about the dividend is low that is why the share price has not gone up we cannot draw their conclusion because finally, that is also the share holders money and reserve and surplus also goes to the equity shareholders. So, it means and we have the different kind of the remedies available, remedies here is that for example, somebody is not happy with the company's shares that the company share is not growing; market price is not growing and the dividend is also not being paid by the company means right amount of the dividend is also not being paid by the company.

In that case they do not want to continue as the share holder of the company there is no issue at all. They can sell the share in the country market and they can get rid of the company shares it is quite possible now for example, you talk about there is for example, some company's share capital is 1,000 rupees and number of shares are 10.

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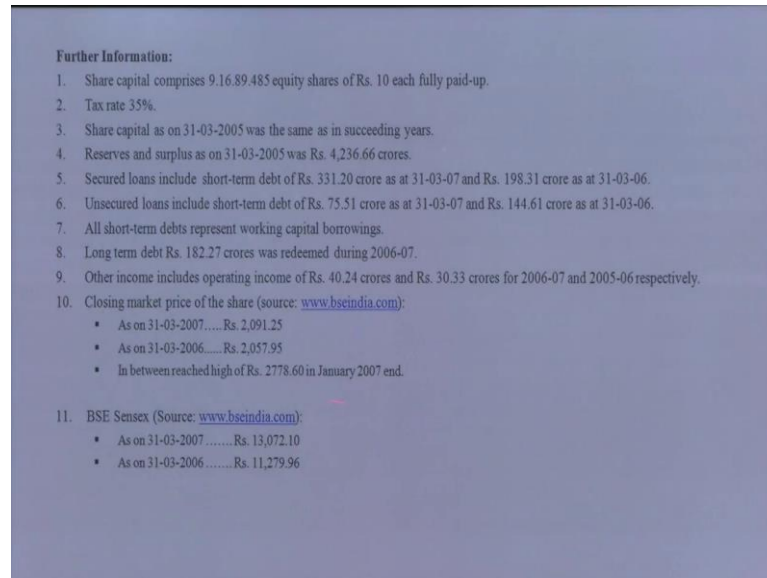
So, what is the odd number of shares are 100. What is the total market price of the share that is the or the book value of the share? You can call it as 10 rupees per share, but now what are the; company earned a profit of say 2 rupees or 200 rupees and they did not declare any dividend and they reinvested the entire amount back in the business.

So, now the capital has become 1,200 rupees, number of shares is again 100. So, what is now the price of the share? 12 rupees per share it means share value is growing share value is appreciating in the market its growing in the market. So, there is no point that we when we talk about the yield to investors that they are paying very low amount of the dividend and that dividend was somewhere how much was the entire dividend they paid was is very less that the company paid the entire dividend this year is only 252 [FL].

If you talk about the total profitability, profit after tax is 1,535 and only 250 [FL] is being declared as a dividend which is very less amount it means larger parts of the fund are being reinvested back into the business and with that also equity share holders base is growing because the number of share holders is number of shares in the market is same. So, company when they are not increasing the number of shares, but they are reinvesting back the funds in business the total capital base is growing and when the total capital base is growing that capital also ultimately belongs to equity share holder. If somebody is not satisfied with the dividend; somebody is not satisfied with appreciation in the market price because it is a temporary trend company like this people have misconceived

the company; people have misconceived the growth of the company and company is like this, cannot have the growth in the market share only by 33 rupees, it would have been certainly this price which was in the month of January.

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**Further Information:**

1. Share capital comprises 9.16.89.485 equity shares of Rs. 10 each fully paid-up.
2. Tax rate 35%.
3. Share capital as on 31-03-2005 was the same as in succeeding years.
4. Reserves and surplus as on 31-03-2005 was Rs. 4,236.66 crores.
5. Secured loans include short-term debt of Rs. 331.20 crore as at 31-03-07 and Rs. 198.31 crore as at 31-03-06.
6. Unsecured loans include short-term debt of Rs. 75.51 crore as at 31-03-07 and Rs. 144.61 crore as at 31-03-06.
7. All short-term debts represent working capital borrowings.
8. Long term debt Rs. 182.27 crores was redeemed during 2006-07.
9. Other income includes operating income of Rs. 40.24 crores and Rs. 30.33 crores for 2006-07 and 2005-06 respectively.
10. Closing market price of the share (source: [www.bseindia.com](http://www.bseindia.com)):
  - As on 31-03-2007.....Rs. 2,091.25
  - As on 31-03-2006.....Rs. 2,057.95
  - In between, reached high of Rs. 2778.60 in January 2007 end.
11. BSE Sensex (Source: [www.bseindia.com](http://www.bseindia.com)):
  - As on 31-03-2007.....Rs. 13,072.10
  - As on 31-03-2006.....Rs. 11,279.96

In the month of January, this price was 2,778 had or 79. So, this the real prize of the company's share maybe somewhere from January to March, there might be some bad news or wrong news about the company, misconception about the company and its performance in the market that is why it has not been measure the share price has not gone up to that extent. So, it means you as a true analyst financial analyst you have to look at the balance sheet, you have to look at the profit and loss account you have to look at the overall performance of the company because now you will call back just when you talk about if you take the total say snapshot of all the ratios we calculated. So, far we have seen that return on investment was how much. Return on net worth this year is 27 percent roughly, 26 point something that is 27 percent.

Similarly if you talk about the solvency position of the firm, solvency position of the firm is very very good, where we have calculated the net asset value and if you look at the net asset value here it is 679.39 rupees per this share and similarly if you talk about the say your other issues that is interest coverage ratio, how many times 20 times, similarly you talk about the debt service coverage ratio of the company that was about 6-7 times or 8 times, look at the solvency position of the firm. Then we went through the

liquidity analysis and when you look at the liquidity ratios firm is not maintaining any high amount of current assets or investment in the current assets it means if the inventory level is low sundry debtors are very less low about 10 percent we have seen the sundry debtors. So, it means if the company because production process is continuous when the company is continuously producing in the market and their sales are also going to the market then they are continuously producing and sales are going to the market because level of inventory is very very low and most of the sales ninety percent of the company sale are on cash. Only 10 percent are on credit and the amount of the bad debt is also not very high if you look at; let us check the bad debts.

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GRASIM INDUSTRIES LIMITED			
Profit and Loss Account for the year ended			
AS ON 31 <sup>st</sup> March 2007			
	Schedule	Current Year	Previous Year
<b>INCOME</b>			
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
<b>EXPENDITURE</b>			
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		117.01	701.64

If you look at the bad debts components, I do not think that the company has any high amount of the bad debts here; we do not have any bad debts components material manufacturing expenses purchases then all interest depreciation.

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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		<u>37.10</u>	<u>-----</u>
<b>Profit before Tax</b>		2,226.36	1,206.03
Provision for Current Tax		(692.38)	(369.82)
Deferred Tax		<u>1.83</u>	<u>27.00</u>
<b>Profit after Tax</b>		1,535.81	863.21
Debt 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		<u>878.37</u>	<u>815.35</u>
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		<u>965.33</u>	<u>878.37</u>
		2,452.79	1,687.43
Basic and diluted earnings per share (In Rs.)		167.50	94.14

And if you look at the say bad debts component surplus then write back of the provision for diminution, then provision for current tax, deferred tax, means there is no bad debt at all. It means whatever the credit sales they are making, they are making to the very good quality of the buyers. So, it means look at the liquidity, liquidity does not means only that whether the firm has the sufficient cash available or not or the firm is able to pay off its obligations or not that is not the case.

While studying the liquidity ratios, you have to look it into the total perspective; how much inventory firm has how much debtors this firm has how much say cash firm has and how much other assets they are not having even a single prepaid amount they have paid anything as a prepaid no advance payments nothing. So, they have rather given the loans and advances to the different interest groups. So, it means the liquidity position if you will talk about the current ratio excellent 1.26 times if you talk about the quick ratio that is one is to one almost and if you talk over the super quick ratio it was only eight percent. So, where is the problem in the company?

So, there is 2 financial analyst you can easily make out that this company is not a bad performer. So, if you look at this yield and you finally, draw the conclusion on the basis of this yield then we are not the good financial analyst similarly you talk about the turn over issues turn over. So, this company is a highly capital intensive industry its working in a highly capital industry intensive industry where the capital the asset base is very

very high physical assets if you talk about it is a very high amount of the physical assets how much physical assets we had if you look at the physical assets we have the level of the gross block of the asset is 6,770 [FL] which is net, if you talk about 3,390 [FL]. Still if you talk about the net worth turn over it was really wonderful if you talk about the fixed asset turn over it was really wonderful. So, it means their sales are 2-3 times of the very high amount of the investments in the fixed assets. So, despite being a capital intensive industry they are having sufficient sales and the sales are growing at a spectacular rate it means another indicator says the company is a good performer in the market.

Similarly, when you talk about the other ratios like profitability ratios I discussed that length with you what is the meaning of the gross profit and what is the meaning of net profit operating means you have to look it at as a true financial analyst that you look it at the operation structure of the firm and you look at the financial structure of the firm. If it is a manufacturing sector firm I told you in my say in my previous lectures also that if the firms is a operating structure is good financial structure is not that good do not worry it will improve, but in this case we have found. Operating structure is excellent, gross profit is 50 percent and financial structure is also well within control very good very strong and the net profit is you can see it is a very good amount it is a sizable amount. So, when the profitability is improving profitability is going up while the market price is not going up which means there is a mismatch wrong perceptions about the company people are not able to analyze the overall performance of the company and overall working of the company that is why the good performance has not been there or that has not reflected in the market price.

I share with you that good companies who are the real companies or who have the good intentions to grow in the market and to sustain in the market, to compete in the market on the long term basis we have this kind of strategy financial strategy you would call it as that they will not declare very high amount of dividend they do not declare. Take the case of Reliance industries.

Reliance industries hardly declare any dividend maybe today they are declaring, but in the past we will talk about the 70s and 80s when Dhiru Bhai Ambani was the chairman of the company. He was of the philosophy that do not pay much dividend to the people rather whatever the profits are available you reinvest back those profits to the business



and you generate more funds for the growth diversification or any kind of vertical or horizontal diversification and growth you generate funds internally because if you generate funds internally you have many other advantages also. Number one, companies attract many incentives from the government, second advantage is that when you have less amount of the external debt; borrowed debt or the borrowed investment in the company, company's threat for means any kind of the external threat from the company is not there, but when the extent of the borrowed, capital borrowed money borrowed, funds increases in the company in that case there is a problem. So, if you look at this company that equity ratio is very very low, it means the external claim on the company because financial institutions and lenders did not wait for much longer.

If the company's performance does not come up to the expectations even for a year, they will they will start say issuing the notices for to the company. So, it means not having sufficient amount or not having a high amount of an external debt another feature of the company and Dheeru Bhai Ambani followed the policy that most of the funds should be generated internally. So, it means this is the second advantage.

Third advantage is when you are declaring the dividend it is taxable at 2 places number one is firms profit is taxable first. So, firm is paying the firm is paying the tax on its profits which either way it has to be paid, but second thing is when the dividend is being paid by the firm to the shareholders it is under the category of capital gain it is again taxable at the hands of the share holder also. So, double taxation is there. So, when the more dividend is not being declared in that case what is happening the company is paying only corporate tax to the government and when the company is not paying any dividend or the dividend amount is very low major chunk of the funds are being reinvested back in the business it means the dividend tax can also be avoided.

So, number of advantages are there Reliance has followed this strategy financial strategy for generating internal funds maximum and I think Grasim is also the one who have been also following the same strategy that is of the Reliance group and they have also invested the major chunk of the funds internally and the dividend declaration dividend payment is very very low, very very less. So, it means in this case you can make out that finally, you can understand that not paying the dividend as a true financial analyst is not a bad thing.

So, do not say analyze a company from the angle of say yield to investors yield to investors already I told you that when the company is reinvesting the funds back in the business whose funds are these are again the equity share holders funds. But irony is in this company in this particular year is there that has not that reinvestment and high amount of the reserve surpluses have not reflected in the market share that is the that is the some misnomer must be there in the market some rumors or some bad say news must be there in the market about this company means by the end of the year because the share price had gone up to 2,700 plus and the say month of January, but means by reaching to the month of march it has seriously gone down it means there is something fishy about the company which is not true.

So, as a true financial analyst you should not be driven by this change in the share price from this to this you should analyze your company yourself when we invest in the company what are our objectives our objective, first objective is that my investment should be safe and second investment objective is my investment must be growing and in this case both objectives have been met your investment is highly safe and the second thing is your investment is growing probably this year it has not grown at the desired rate. But in the coming years it will grow and it is a rule in this stock market that if you want to earn the good returns you have to wait for the longer durations stock market is not a place that you make good returns and you go out of it, it is not possible.

There you can make good gains also and then you can earn good money, but you can good loses also you can have a high amount of losses also that it may not be possible that you are buying and if you do not have the time to stay in the stock market do not move to the stock market if you want to move to the stock market you have sufficient funds and you should have sufficient funds and if you should have sufficient time. If you have sufficient time see the Grasim industry share has not gone up this here it has only gone up from by thirty 3 rupees, but you can expect a very good growth or you might have seen we do not have the information beyond 2007, but in the other years it must have done very well. So, overall the performance of the company is wonderful excellent though it is not reflected sometimes in the market ratios or the market capitalization or in the capital market ratios or if you, but still you cannot say that the value of the company is going down or the value of the company is not up to the mark or company is not up to the expectations.

Value of the company is very much up to the mark, it is very much up to the expectations and you have to read this company as a very good company does not get illusion by these ratios.

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Sr. No.	Ratios	2006-07		2005-06	
		Grasim	Industry	Grasim	Industry
1.	RONW	26.97	29.12	18.49	18.44
2.	D/E	0.45	0.52	0.35	0.47
3.	ICR	19.97	11.90	14.48	8.29
4.	CR	1.26	0.96	1.25	0.96
5.	IHP	70	65	74	58
6.	DCP	22	31	20	34
7.	FA T/O	2.54	1.59	2.21	1.45
8.	Net Profit	17.57	13.97	12.98	10.52

Now, we talk about one more angle, from one more angle we try to look at the ratios and when you talk about the ratios and one more angle you try to look at the ratios we see that you compare the performance of Grasim industries with the industry we have the industry averages also for the different indicators for the different things and if you compare it the Grasim industry's performance with the industry as a whole with the industry average you would able to make out where the Grasim lies and it is rated means how the Grasim is rated.

Let us look at these indicators; we have return on net worth for the industry. It is in the year 2007 the return or network in the industry was more than the Grasim industries, it is 29 percent where as it was 20 almost 27 percent. So, in the Grasim, it was 2 percent less as compared to the industry as a whole. But you see in the previous year 2005 and 6, the growth was more the return on invest or return on net worth was more in the Grasim as compared to the industry it means in 2007 there is something seriously wrong with the company means not with the company, but with the about the perception of the company in the minds of the people.

So, only perceptual change not the physical change not the material change only perceptual change and perceptual change is only momentary then you talk about the debt equity ratio we can make out that the overall debt in the industry is low other firms in the industry are also not borrowing much money in the market, but still we see that that Grasim's borrowing is much less as compared to the industry's borrowing. Industry's debt equity ratio is 0.5 to 0.52:1 whereas, the borrowing by the or the debt equity ratio of the Grasim is 0.45 only and in this case you look at industries previous year also the industry's borrowing was more than the Grasim. So, it means that debt component in the Grasim is much less as compared to industry even overall it is less, but as compared to industry also it is much less. So, it means this is the reason that if the company's fixed asset basis is so high 6,000 [FL] or 6,600 [FL], but borrowing is very low in the; from the market it means most of the funds are being generated internally. So, it means most of the profit is being reinvested back internally and the declaration of the dividend is low.

Consequently it has to be low because company needs more funds for its growth and they are generating more funds internally and that is why they are declaring less amount of the dividend which is not at all a bad indicator then we talk about the interest coverage ratio it is about 20 times for Grasim and how much it is only 12 times for the industry how much time more solvent the firm is look at the solvency of the firm how solvent the Grasim is how strengthful powerful the Grasim is. So, again another indicator interest coverage ratio which is 20 times it is only 12 times for the industry and it is in the previous year you look at it was about fourteen and half times and here it is only eight times. So, almost it is double almost it is double in case of the Grasim industry. So, it means average firm in the industry is having the interest coverage ratio that is only 12 times previous year it was only 80 times, but the Grasim is the leader here they have four fourteen and half times and about 20 times and about 20 times.

So, it means this is the interest coverage position of the firm now come back to the liquidity position yes in the liquidity position may be when you talk about the working capital approaches we have 3 approaches in the working capital current ratio maintaining the current ratio one is the say aggressive approach another is the hedging approach another is the conservative approach. So, aggressive approach means the current asset level is very low as compared to current liabilities hedging approach is when the current

assets are equal to current liabilities and say conservative approach is that when the current assets are much more than the current liability. So, Grasim seems to be somewhere between the hedging and the say conservative approach, but giving say sufficient amount of the current asset is not bad because they here also they are keeping more cash and the cash ability because their ICR is high.

So, normally they have a negative working capability we look at the current ratio of the industry, industry has a negative working capital they are running the show with the negative working capital by keeping the current ratio means level of current assets is point 0.96 as compared to the liabilities it is the same in both the years, but it is 1.26 and 1.25 in case of the Grasim. So, Grasim more prudent Grasim is more like unlikely Grasim is quite unlikely to default in making the payments of the current liabilities whereas, the other firms average firm in the industry is more proven to the default in the making the means paying the liabilities or when the liability will become due its quite likely that the other firms in the industry may become technically solvent.

So, there also means keeping high current ratio is not a bad indicator, it is a good indicator and it means the Grasim is able to maintain that then inventory holding period inventory in case of industry it is fifty eight days and sixty five days where as it is about 70 days; 70-74 days. In case of the Grasim, it will be little more, they are converting their inventory into cash and a period of about 70 days industry is converting a little early. So, yes there may be, but it is not very significant difference it is a nominal period it is a nominal amount of time.

Similarly you talk about the debt conversion period or the debts collection period credit sales collection period its really excellent its really excellent their credit sales are number one very low as compared to total sales their credit sales are very low and if you talk about the debt collection period it is further much lower as compared to the industry the here it is 44 days for industry and they have 20 day 31 and 22 days, it means they are very good performers whose product is salable on cash on the market and if it is the credit very low amount of the credit and credit is collectival as quickly as possible whose product is efficient enough in the market then people buy it either on cash and if they expect credit then the credit is for a only normal period of time 20 days to 22 days against the normal market credit rate in the Indian scenario is 45 to 60 days.

In this industry, we have seen that it is almost one month, but the Grasim is only giving 20 days 10 days less than the one month their fixed asset turnover ratio fixed asset turnover ratio is very very high in this company. So, it means the numb amount of sales as compared to the fixed assets is very high. So, average is 1.45 times whereas, in case of Grasim, it was 2.21 times and it is 2.54 times in case of Grasim as compared to the industry is 1.45, it has little gone up from 1.45; 1.59 times. But in case of the Grasim, it has gone up that it is really there is a much seriously big difference despite being a capital intensive industry their sales liable is very very high and it is say 2.21 times and it is going up it has become 2.54 times. And finally, we come to the last indicator and that is a net profit ratio net profit here is the industry means overall profit in a industry is low that if the industry average you look at it is 10.52 percent and 13.97 percent and so in the previous year also it was more than industry and in the current year also it is almost eighteen percent it is more than industry.

So, where Grasim industry is not doing well, whatever we are finding here its only all perceptional value, perceptional position, perceptional things, and you should not get misguided by the perceptional things that the capital market ratios or not good or the company is not a good performer in the market because is the issue of the behavioral finance. Behaviorally people may do something actually the things may be different, but actually we have to look it at as a true financial analyst we have not to get influenced by the behavioral aspects of the people or investors this is only temporary this is permanent this is temporary this is permanent and looking at the overall say financial position of the company if we look at the overall financial position of the company, company is really wonderful, it is doing well. It is doing exceedingly well. I would say in almost all the indicatives see here what the Grasim industry is doing as against the industry average or as against the industry performance you can easily make out how they are doing how they are performing and how you can proceed their performance.

It is really a wonderful organization beautiful organization very nicely very effectively managed firm and I think if we have this kind of firms in the industry you can say that yes overall performance is good all the stake holders are safe investors are safe, lenders are safe, suppliers are safe, customers are safe and every everybody is getting very good products very good profits very good returns and temporarily this year 2007 this position is not very good, but this is very good we have to believe in this not in this.

So, with this I end up the discussion on the ratio analysis or ratio analysis as a tool of financial analysis. You have to believe in the ratios only quality of a good financial analyst is to identify which ratios are important for me and what is my objective of analysis which ratios I choose, which ratios I should calculate and how should I; it is a million dollar question how should I interpret the information being worked out with the help of ratios.

With this I complete discussion on the ratio analysis and in the next part of discussion, I start talking about the next technique of the financial analysis that is by preparing the cash flow statement. Meaning importance and the purpose of preparing the cash flow statement and how it is a useful tool of the financial analysis I will be talking to you in the next part of discussion till then.

Thank you very much.