

## **Chapter 5**

### **Financial Analysis of Companies**

- Balance sheet**
- Profit & Loss A/C**
- Cash Flow Statement**
- Key Financial Ratio Analysis**
- Du Pont Chart Analysis**

## **FINANCIAL STATEMENTS**

Financial statements are summaries of the operating, financing, and investment activities of a business. Financial statements should provide information useful to both investors and creditors in making credit, investment, and other business decisions<sup>80</sup>. And this usefulness means that investors and creditors can use these statements to predict, compare, and evaluate the amount, timing, and uncertainty of potential cash flows. In other words, financial statements provide the information needed to assess a company's future earnings and therefore the cash flows expected to result from those earnings.

## **ACCOUNTING PRINCIPLES AND ASSUMPTIONS**

The accounting data in financial statements are prepared by the firm's management according to a set of standards, referred to as generally accepted accounting principles (GAAP). The financial statements of a company whose stock is publicly traded must, by law, be audited at least annually by independent public accountants (i.e., accountants who are not employees of the firm). In such an audit, the accountants examine the financial statements and the data from which these statements are prepared and attest—through the published auditor's opinion—that these statements have been prepared according to GAAP. The auditor's opinion focuses on whether the statements conform to GAAP and that there is adequate disclosure of any material change in accounting principles.

The financial statements are created using several assumptions that affect how we use and interpret the financial data:

Transactions are recorded at historical cost. Therefore, the values shown in the statements are not market or replacement values, but rather reflect the original cost (adjusted for depreciation, in the case of depreciable assets).

80. Agarwal, J.D., and Aman Agarwal, *Literature in Finance: Specialised Finance* (VOL. IV)

The appropriate unit of measurement is the dollar. While this seems logical, the effects of inflation, combined with the practice of recording values at historical cost, may cause problems in using and interpreting these values.

The statements are recorded for predefined periods of time. Generally, statements are produced to cover a chosen fiscal year or quarter, with the income statement and the statement of cash flows spanning a period's time and the balance sheet and statement of shareholders' equity as of the end of the specified period. But because the end of the fiscal year is generally chosen to coincide with the low point of activity in the firm's operating cycle, the annual balance sheet and statement of shareholders' equity may not be representative of values for the year.

Statements are prepared using accrual accounting and the matching principle. Most businesses use accrual accounting, where income and revenues are matched in timing such that income is recorded in the period in which it is earned and expenses are reported in the period in which they are incurred to generate revenues. The result of the use of accrual accounting is that reported income does not necessarily coincide with cash flows. Because the financial analyst is concerned ultimately with cash flows, he or she often must understand how reported income relates to a company's cash flows.

It is assumed that the business will continue as a going concern. The assumption that the business enterprise will continue indefinitely justifies the appropriateness of using historical costs instead of current market values because these assets are expected to be used up over time instead of sold.

Full disclosure requires providing information beyond the financial statements. The requirement that there be full disclosure means that, in addition to the accounting numbers for such accounting items as revenues, expenses, and assets, narrative and additional numerical disclosures are provided in

notes accompanying the financial statements. An analysis of financial statements is therefore not complete without this additional information.

Statements are prepared assuming conservatism. In cases in which more than one interpretation of an event is possible, statements are prepared using the most conservative interpretation.

The financial statements and the auditors' findings are published in the firm's annual and quarterly reports sent to shareholders and the SEBI. Also included in the reports, among other items, is a discussion by management, providing an overview of company events. The annual reports are much more detailed and disclose more financial information than the quarterly reports.

**There are three basic financial statements:**

Balance sheet

Income statement

Cash Flow statement

**THE BALANCE SHEET<sup>81</sup>**

The balance sheet is a summary of the assets, liabilities, and equity of a business at a particular point in time—usually the end of the firm's fiscal year. The balance sheet is also known as the statement of financial condition or the statement of financial position. The values shown for the different accounts on the balance sheet are not purported to reflect current market values; rather, they reflect historical costs.

**Assets** are the resources of the business enterprise, such as plant and equipment that are used to generate future benefits. If a company owns plant and equipment that will be used to produce goods for sale in the future, the company can expect these assets (the plant and equipment) to generate cash inflows in the future.

81. [www.moneycontrol.com](http://www.moneycontrol.com)

**Liabilities** are obligations of the business. They represent commitments to creditors in the form of future cash outflows. When a firm borrows, say, by issuing a long-term bond, it becomes obligated to pay interest and principal on this bond as promised. Equity, also called shareholders' equity or stockholders' equity, reflects ownership. The equity of a firm represents the part of its value that is not owed to creditors and therefore is left over for the owners. In the most basic accounting terms, equity is the difference between what the firm owns—its assets—and what it owes its creditors—its liabilities.

## **ASSETS**

There are two major categories of assets: current assets and noncurrent assets, where noncurrent assets include plant assets, intangibles, and investments. Assets that do not fit neatly into these categories may be recorded as either other assets, deferred charges, or other noncurrent assets.

## **CURRENT ASSETS**

Current assets (also referred to as circulating capital and working assets) are assets that could reasonably be converted into cash within one operating cycle or one year, whichever takes longer. An operating cycle begins when the firm invests cash in the raw materials used to produce its goods or services and ends with the collection of cash for the sale of those same goods or services. For example, if Fictitious manufactures and sells candy products, its operating cycle begins when it purchases the raw materials for the products (e.g., sugar) and ends when it receives cash for selling the candy to retailers. Because the operating cycle of most businesses is less than one year, we tend to think of current assets as those assets that can be converted into cash in one year. Current assets consist of cash, marketable securities, accounts receivable, and inventories. Cash comprises both currency—bills and coins—and assets that are immediately transformable into cash, such as deposits in bank accounts. Marketable securities are securities that can be readily sold when cash is needed. Every company needs to have a certain amount of cash to fulfill immediate

needs, and any cash in excess of immediate needs is usually invested temporarily in marketable securities.

Investments in marketable securities are simply viewed as a short term place to store funds; marketable securities do not include those investments in other companies' stock that are intended to be long term. Some financial reports combine cash and marketable securities into one account referred to as cash and cash equivalents or cash and marketable securities. Accounts receivable are amounts due from customers who have purchased the firm's goods or services but haven't yet paid for them. To encourage sales, many firms allow their customers to —buy now and pay later,<sup>82</sup> perhaps at the end of the month or within 30 days of the sale. Accounts receivable therefore represents money that the firm expects to collect soon. Because not all accounts are ultimately collected, the gross amount of accounts receivable is adjusted by an estimate of the uncollectible accounts, the allowance for doubtful accounts, resulting in a net accounts receivable figure. Inventories represent the total value of the firm's raw materials, work-in-process, and finished (but as yet unsold) goods. A manufacturer of toy trucks would likely have plastic and steel on hand as raw materials, work-in-process consisting of truck parts and partly completed trucks, and finished goods consisting of trucks packaged and ready for shipping. There are three basic methods of accounting for inventory, including<sup>82</sup>:

- FIFO (first in, first out), which assumes that the first items purchased are the first items sold,
- LIFO (last in, first out), which assumes that the last items purchased are the first items sold, and
- Average cost, which assumes that the cost of items sold, is the average of the cost of all items purchased.

82. Swamy, Narayan, Financial Accounting, pg.267

asset's cost is allocated over the life of the asset; the reported value is the original cost of the asset, less whatever has been amortized. The number of years over which an intangible asset is amortized depends on the particular asset and its perceived useful life. For example, a **patent** is the exclusive right to produce and sell a particular, uniquely defined good and has a legal life of 17 years, though the useful life of a patent—the period in which it adds value to the company—may be much less than 17 years. Therefore the company may choose to amortize a patent's cost over a period less than 17 years. As another example, a **copyright** is the exclusive right to publish and sell a literary, artistic, or musical composition, and is granted for 50 years beyond the author's life, though its useful life in terms of generating income for the company may be much less than 50 years. More challenging is determining the appropriate amortization period for goodwill. **Goodwill** was created when one company buys another company at a price that exceeds the acquired company's fair market value of its assets.

A company may have additional noncurrent assets, depending on their particular circumstances. A company may have a noncurrent asset referred to as **investments**, which are assets that are purchased with the intention of holding them for a long term, but which do not generate revenue or are not used to manufacture a product. Examples of investments include equity securities of another company and real estate that is held for speculative purposes. Other noncurrent assets include **long term prepaid expenses**, arising from prepayment for which a benefit is received over an extended period of time, and **deferred tax assets**, arising from timing differences between reported income and tax income, whereby reported income exceeds taxable income.

Long-term investment in securities of other companies may be recorded at cost or market value, depending on the type of investment; investments held to maturity are recorded at cost, whereas investments held as trading securities or available for sale are recorded at market value. Whether the unrealized gains or losses affect earnings on the income statement depend on

whether the securities are deemed trading securities or available for sale.

## **LIABILITIES**

**Liabilities**, a firm's obligations to its creditors, are made up of current liabilities, long-term liabilities, and deferred taxes.

### **Current Liabilities**

Current liabilities are obligations that must be paid within one operating cycle or one year, whichever is longer. Current liabilities include<sup>83</sup>:

**Accounts payable**, which are obligations to pay suppliers. They arise from goods and services that have been purchased but not yet paid.

**Accrued expenses**, which are obligations such as wages and salaries payable to the employees of the business, rent, and insurance.

**Current portion of long-term debt or the current portion of capital leases**. Any portion of long-term indebtedness—obligations extending beyond one year—due within the year.

Short-term loans from a bank or notes payable within a year.

The reliance on short-term liabilities and the type of current liabilities depends, in part, on the industry in which the firm operates.

## **LONG TERM LIABILITIES**

**Long-term liabilities** are obligations that must be paid over a period beyond one year. They include notes, bonds, capital lease obligations, and pension obligations. Notes and bonds both represent loans on which the borrower promises to pay interest periodically and to repay the principal amount of the loan.

A **lease** obligates the lessee—the one leasing and using the leased asset—to pay specified rental payments for a period of time. Whether the lease obligation is recorded as a liability or is expensed as lease payments made depends on whether the lease is a capital lease or an operating lease.

83. Pandey, I.M., Financial Management, pg.568



A company's pension and post-retirement benefit obligations may give rise to long-term liabilities. The pension benefits are commitments by the company to pay specific retirement benefits, whereas post-retirement benefits include any other retirement benefit besides pensions, such as health care.

Basically, if the fair value of the pension plan's assets exceeds the **projected benefit obligation** (the estimated present value of projected pension costs), the difference is recorded as a long-term asset. If, on the other hand, the plan's assets are less than the projected benefit obligation, the difference is recorded as a long-term liability. In a similar manner, the company may have an asset or a liability corresponding to post-retirement benefits.

### **DEFERRED TAXES**

Along with long-term liabilities, the analyst may encounter another account, deferred taxes. **Deferred taxes** are taxes that will have to be paid to the federal and state governments based on accounting income, but are not due yet. Deferred taxes arise when different methods of accounting are used for financial statements and for tax purposes. These differences are temporary and are the result of different timing of revenue or expense recognition for financial statement reporting and tax purposes. The deferred tax liability arises when the actual tax liability is less than the tax liability shown for financial reporting purposes (meaning that the firm will be paying the difference in the future), whereas the deferred tax asset, mentioned earlier, arises when the actual tax liability is greater than the tax liability shown for reporting purposes.

### **EQUITY**

Equity is the owner's interest in the company. For a corporation, ownership is represented by common stock and preferred stock. Shareholders' equity is also referred to as the **book value of equity**, since this is the value of equity according to the records in the accounting books. The value of the ownership interest of preferred stock is represented in financial statements as its **par value**, which is also the dollar value on which dividends are figured. For example, if you own a share of

preferred stock that has a \$100 par value and a 9% dividend rate, you receive \$9 in dividends each year.

Further, your ownership share of the company is \$100. Preferred shareholders' equity is the product of the number of preferred shares outstanding and the par value of the stock; it is shown that way on the balance sheet. The remainder of the equity belongs to the common shareholders. It consists of three parts: **common stock outstanding** (listed at par or at stated value), additional paid-in capital, and retained earnings. The par value of common stock is an arbitrary figure; it has no relation to market value or to dividends paid on common stock. Some stock has no par value, but may have an arbitrary-value, or **stated value**, per share. Nonetheless, the total par value or stated value of all outstanding common shares is usually entitled —capital stock or —common stock. Then, to inject reality into the equity part of the balance sheet, an entry called **additional paid-in capital** is added; this is the amount received by the corporation for its common stock in excess of the par or stated value.

## THE INCOME STATEMENT<sup>84</sup>

An **income statement** is a summary of the revenues and expenses of a business over a period of time, usually one month, three months, or one year. This statement is also referred to as the **profit and loss statement**. It shows the results of the firm's operating and financing decisions during that time.

The operating decisions of the company—those that apply to production and marketing—generate **sales or revenues** and incur the **cost of goods sold** (also referred to as the **cost of sales** or the **cost of products sold**). The difference between sales and cost of goods sold is **gross profit**. Operating decisions also result in administrative and general expenses, such as advertising fees and office salaries. Deducting these expenses from gross profit leaves **operating profit**, which is also referred to as **earnings before interest and taxes (EBIT)**, **operating income**, or **operating earnings**.

84. Khan and Jain, Financial Management, pg. 345

The results of financing decisions are reflected in the remainder of the income statement. When interest expenses and taxes, which are both influenced by financing decisions, are subtracted from EBIT, the result is net income. Net income is, in a sense, the amount available to owners of the firm. If the firm has preferred stock, the preferred stock dividends are deducted from net income to arrive at **earnings available to common shareholders**. If the firm does not have preferred stock (as is the case with Fictitious and most non-fictitious corporations), net income is equivalent to earnings available for common shareholders. The board of directors may then distribute all or part of this as common stock dividends, retaining the remainder to help finance the firm.

Companies must report comprehensive income prominently within their financial statements. **Comprehensive income** is a net income amount that includes all revenues, expenses, gains, and losses items and is based on the idea that all results of the firm—whether operating or non-operating should be reflected in the earnings of the company. This is referred to as the **all-inclusive income concept**. The all-inclusive income concept requires that these items be recognized in the financial statements as part of comprehensive income.

It is important to note that net income does not represent the actual cash flow from operations and financing. Rather, it is a summary of operating performance measured over a given time period, using specific accounting procedures. Depending on these accounting procedures, net income may or may not correspond to cash flow.

### **CASH FLOW STATEMENT**

It is a statement, which measures inflows and outflows of cash on account of any type of business activity. The cash flow statement also explains reasons for such inflows and outflows of cash so it is a report on a company's cash flow activities, particularly its operating, investing and financing activities.

## FINANCIAL ANALYSIS

Financial analysis is a tool of financial management. It consists of the evaluation of the financial condition and operating performance of a business firm, an industry, or even the economy, and the forecasting of its future condition and performance. It is, in other words, a means for examining risk and expected return. Data for financial analysis may come from other areas within the firm, such as marketing and production departments, from the firm's own accounting data, or from financial information vendors such as Bloomberg Financial Markets, Moody's Investors Service, Standard & Poor's Corporation, Fitch Ratings, and Value Line, as well as from government publications, such as the Federal Reserve Bulletin. Financial publications such as Business Week, Forbes, Fortune, and the Wall Street Journal also publish financial data (concerning individual firms) and economic data (concerning industries, markets, and economies), much of which is now also available on the Internet.

Within the firm, financial analysis may be used not only to evaluate the performance of the firm, but also its divisions or departments and its product lines. Analyses may be performed both periodically and as needed, not only to ensure informed investing and financing decisions, but also as an aid in implementing personnel policies and rewards systems. Outside the firm, financial analysis may be used to determine the creditworthiness of a new customer, to evaluate the ability of a supplier to hold to the conditions of a long-term contract, and to evaluate the market performance of competitors.

Firms and investors that do not have the expertise, the time, or the resources to perform financial analysis on their own may purchase analyses from companies that specialize in providing this service. Such companies can provide reports ranging from detailed written analyses to simple creditworthiness ratings for businesses. As an example, Dun & Bradstreet, a financial services firm, evaluates the creditworthiness of many firms, from small local businesses to major corporations. As another example, three companies—Moody's Investors Service,

Standard & Poor's, and Fitch—evaluate the credit quality of debt obligations issued by corporations and express these views in the form of a rating that is published in the reports available from these three organizations.

### **(A) FINANCIAL RATIO ANALYSIS<sup>85</sup>**

Ratio analysis is such a significant technique for financial analysis. It indicates relation of two mathematical expressions and the relationship between two or more things. **Financial ratio** is a ratio of selected values on an enterprise's financial statement. There are many standard ratios used to evaluate the overall financial condition of a corporation or other organization. Financial ratios are used by managers within a firm, by current and potential stockholders of a firm, and by a firm's creditor. Financial analysts use financial ratios to compare the strengths and weaknesses in various companies.

#### **Essence of ratio analysis**

Financial ratio analysis helps us to understand how profitable a business is, if it has enough money to pay debts and we can even tell whether its shareholders could be happy or not. Financial ratios allow for comparisons:

1. between companies
2. between industries
3. between different time periods for one company
4. between a single company and its industry average

To evaluate the performance of one firm, its current ratios will be compared with its past ratios. When financial ratios over a period of time are compared, it is called time series or trend analysis. It gives an indication of changes and reflects whether the firm's financial performance has improved or deteriorated or remained the same over that period of time. It is not the simply changes that has to be determined, but more importantly it must be recognized that why those ratios have changed. Because those changes might be result of changes in the accounting polices without material change in the firm's performances.

85. Ratio analysis is the main part of the study and so read from many places like books, journals, magazines, websites, projects etc.

Another method is to compare ratios of one firm with another firm in the same industry at the same point in time. This comparison is known as the cross sectional analysis.

It might be more useful to select some competitors which have similar operations and compare their ratios with the firm's. This comparison shows the relative financial position and performance of the firm. Since it is so easy to find the financial statements of similar firms through publications or Medias this type of analysis can be performed so easily.

To determine the financial condition and performance of a firm, its ratios may be compared with average ratios of the industry to which the firm belongs. This method is known as the industry analysis that helps to ascertain the financial standing and capability of the firm in the industry to which it belongs.

Industry ratios are important standards in view of the fact that each industry has its own characteristics, which influence the financial and operating relationships. But there are certain practical difficulties for this method. First finding average ratios for the industries is such a headache and difficult. Second, industries include companies of weak and strong so the averages include them also. Sometimes spread may be so wide that the average may be little utility. Third, the average may be meaningless and the comparison not possible if the firms with in the same industry widely differ in their accounting policies and practices. However if it can be standardized and extremely strong and extremely weak firms be eliminated then the industry ratios will be very useful.

#### **Use of Ratio by stakeholders**

As before mentioned there are varieties of people interested to know and read these information and analyses, however different people for different needs. And it is because each of these groups has different type of questions that could be answered by a specific number and ratio.

Therefore we can say there are different ratios for different groups, these groups with the ratio that suits them is listed below:

1. **Investors:** These are people who already have shares in the business or they are willing to be part of it. So they need to determine whether they should buy shares in the business, hold on to the shares they already have or sell the shares they already own. They also want to assess the ability of the business to pay dividends. As a result the Return on Capital Employed Ratio is the one for this group.
2. **Lenders:** This group consists of people who have given loans to the company so they want to be sure that their loans and also the interests will be paid and on the due time. Gearing Ratios will suit this group.
3. **Managers:** Managers might need segmental and total information to see how they fit into the overall picture of the company which they are ruling. And Profitability Ratios can show them what they need to know.
4. **Employees:** The employees are always concerned about the ability of the business to provide remuneration, retirement benefits and employment opportunities for them, therefore these information must be find out from the stability and profitability of their employers who are responsible to provide the employees their need. Return on Capital Employed Ratio is the measurement that can help them.
5. **Suppliers and other trade creditors:** Businesses supplying goods and materials to other businesses will definitely read their accounts to see that they don't have problems; after all, any supplier wants to know if his customers are going to pay them back and they will study the Liquidity Ratio of the companies.
6. **Customers:** are interested to know the Profitability Ratio of the business with which they are going to have a long term involvement and are dependent on the continuance of presence of that.
7. **Governments and their agencies:** are concerned with the allocation of resources and, the activities of businesses. To regulate the activities of them, determine taxation policies and as the basis for national income and similar statistics, they calculate the Profitability Ratio of businesses.
8. **Local community:** Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the business and the range of

its activities as they affect their area so they are interested in lots of ratios.

9. **Financial analysts:** they need to know various matters, for example, the accounting concepts employed for inventories, depreciation, bad debts and so on. Therefore they are interested in possibly all the ratios.

10. **Researchers:** researchers' demands cover a very wide range of lines of enquiry ranging from detailed statistical analysis of the income statement and balance sheet data extending over many years to the qualitative analysis of the wording of the statements depending on their nature of research.

### **Classification of Ratios**

In isolation, a financial ratio is a useless piece of information. In context, however, a financial ratio can give a financial analyst an excellent picture of a company's situation and the trends that are developing. A ratio gains utility by comparison to other data and standards.

Financial ratios quantify many aspects of a business and are an integral part of financial statement analysis. Financial ratios are categorized according to the financial aspect of the business which the ratio measures. Although these categories are not fixed in all over the world however there are almost the same, just with different names:

1. **Profitability ratios** which use margin analysis and show the return on sales and capital employed.

2. **Rate of Return Ratio (ROR) or Overall Profitability Ratio:** The rate of return ratios are thought to be the most important ratios by some accountants and analysts. One reason why the rate of return ratios is so important is that they are the ratios that we use to tell if the managing director is doing their job properly.

3. **Liquidity ratios** measure the availability of cash to pay debt, which give a picture of a company's short term financial situation.

4. **Solvency or Gearing ratios** measures the percentage of capital employed that is financed by debt and long term finance. The higher the gearing, the higher the dependence on borrowing and long term financing. The lower the gearing ratio, the higher



the dependence on equity financing. Traditionally, the higher the level of gearing, the higher the level of financial risk due to the increase volatility of profits. It should be noted that the term —Leverage is used in some texts.

5. **Turn over Ratios or activity group** ratios indicate efficiency of organization to various kinds of assets by converting them to the form of sales.

6. **Investors ratios** usually interested by investors.

### **(B) COMMON SIZE STATEMENT ANALYSIS<sup>86</sup>**

Vertical analysis of financial statements is a technique in which the relationship between items in the same financial statement is identified by expressing all amounts as a percentage a total amount. This method compares different items to a single item in the same accounting period. The financial statements prepared by using this technique are known as common size financial statements.

This analysis is performed on the income statement as well as the balance sheet.

- **Balance Sheet:** When applying this method on the balance sheet, all of the three major categories accounts are compared to the total assets. All of the balance sheet items are presented as a proportion of the total assets. These percentages are shown along with the absolute currency amounts.
- **Income Statement:** And when applying this technique to the income statement, each of the expense is compared to the total sales revenue. The expenses are presented as a proportion of total sales revenue along with the absolute amounts. The main advantage of using vertical analysis of financial statements is that income statements and balance sheets of companies of different sizes can be compared. Comparison of absolute amounts of companies of different sizes does not provide useful conclusions about their financial performance and financial position.

<sup>86</sup> Financial analysis is the main part of the study and so read from many places like books, journals, magazines, websites, projects etc.

Usually the vertical analysis is performed for a single accounting period to see the relative proportions of different account balances. But it is also useful to perform vertical analysis over a number of periods to identify changes in accounts over time.

### **(C) CASH FLOW AND FUND FLOW ANALYSIS<sup>87</sup>**

Cash flow is essentially the movement of money into and out of your business; it's the cycle of cash inflows and cash outflows that determine your business' solvency.

Cash flow analysis is the study of the cycle of the business' cash inflows and outflows, with the purpose of maintaining an adequate cash flow for the business, and to provide the basis for cash flow management.

Cash flow analysis involves examining the components of the business that affect cash flow, such as accounts receivable, inventory, accounts payable, and credit terms. By performing a cash flow analysis on these separate components, one is able to more easily identify cash flow problems and find ways to improve your cash flow.

A quick and easy way to perform a cash flow analysis is to compare the total unpaid purchases to the total sales due at the end of each month. If the total unpaid purchases are greater than the total sales due, there is need to spend more cash than what is received in the next month, indicating a potential cash flow problem.

A fund flow statement, also called a statement of changes in capital and statement of changes in financial position, is a financial statement that represents how an organization has been financed, the sources of funds and how they have been used within a specific period of time.

87. Financial analysis is the main part of the study and so read from many places like books, journals, magazines, websites, projects etc.

Author Roy A. Foulke, writing in the book, "The Commercial Market Paper," defines a fund flow statement as a "statement of sources and application of funds is a technical device designed to analyze the changes in the financial condition of a business enterprise between two dates." Simply put, a fund flow statement highlights the flow of funds (sources and uses) between two dates.

A fund flow statement is a financial analysis tool that helps managers makes decisions. It highlights the changes in the financial position of a company. Unlike other financial statements, such as an income statement and balance sheet that provide only a static view of an organization's financial operations, a fund flow statement is dynamic and depicts the flow of funds and how they have been allocated between various business activities. It provides complete information to financial managers on the effectiveness of fund allocation and reveals an organization's fund-generating strengths and weaknesses. A fund flow statement also throws light on the financial position of a firm at a given point in time and highlights the financial consequences of major business operations, allowing managers to take corrective actions if required. Funds flow statements allow financial managers to plan on how to improve the rate of return on assets, manage the effects of insufficient funds and cash balance and plan how to pay interest to creditors and dividends to shareholders.

#### **(D) DUPONT ANALYSIS<sup>88</sup>:**

It is believed that measuring assets at gross book value removes the incentive to avoid investing in new assets. New asset avoidance can occur as financial accounting depreciation methods artificially produce lower ROEs in the initial years that an asset is placed into service. If ROE is unsatisfactory, the DuPont analysis helps locate the part of the business that is underperforming.

<sup>88</sup>. Financial analysis is the main part of the study and so read from many places like books, journals, magazines, websites, projects etc.

This method of performance measurement was started by the DuPont Corporation in the 1920s. With this method, assets are measured at their gross book value rather than at net book value in order to produce a higher return on equity (ROE). It is also known as "DuPont identity".

DuPont analysis tells us that ROE is affected by three things:

- Operating efficiency, which is measured by profit margin
- Asset use efficiency, which is measured by total asset turnover
- Financial leverage, which is measured by the equity multiplier

## 5.1 FINANCIAL ANALYSIS OF THE COMPANIES<sup>89</sup>

### 1. Financial Analysis of Tata Motors Ltd.

#### Key Financial Ratio analysis:

1. In the year 2009-10 Debt Equity ratio is increasing and the main reason is increased in Current Liability. This can be proved with the use of almost stable long term debt equity ratio and decreasing current ratio in the same years.
2. In the year 2009 the sales turnover of the company has gone down. As from 2008 to 2010 there was a period of recession for India, almost all the organization faced the problem regarding the sales and Tata Motors is also one of them. Because of decreased sales, all turnover ratios like Fixed assets, Inventory, Debtors are showing the downward trend.
3. For the same reason cited above the profitability of the organization is also not increasing with good rate.
4. The main reason which affects not only this company but overall all companies of India is the world crisis. As in the period of 2008-09 the fall down of Lehman Brothers affected the UK and US economy, this affected the other country economy also. On the same time, India adopted the stringent monetary policy which created liquidity problems in the market. These multiple problems affected the company in decreased profitability and increased liability.
5. The above reasons cited have affected different profitability ratios of the organization.
6. The interest coverage ratio in the year 2009-10 has decreased a lot the main reason is decrease in the profitability and increase in the liability.

#### Balance sheet analysis:

1. The equity share capital of the company has drastically gone down in the year 2009-10 and the main reason is that the company has paid up the preference capital in these years.

89. The financial analysis of the companies selected is 100% done on own and no references are taken for it.

2. The capital reserve is also increased from the year 2009 to 2010, which is also one of the reasons in reduction in equity capital.
3. Tata motors has issued Share warrants in the year 2011, that increases the capital of the company.
4. There are many changes in the capital structure of the company as company has issued the convertible debenture in the year 2009 while in the years 2009 and 2010 company has paid up the term loans and unsecured loans.
5. In case of the gross block there is less change, as the sales have not increased in last 2009 and 2010 so use of assets are bit less. And so the sundry debtors have also decreased in the year 2009 to 2010 from 635.98 crore to 434.83 crores.
6. While there is a reverse trend in terms of sundry creditors as it has gone up from 3243.42 crore to 4046.25 crore because of the cash crisis in the organization. The cash crisis of the organization can be seen in the cash flow analysis.

**Income statement analysis:**

1. As already discussed above the sales turnover of the organization is not increasing with good rate and there is a cash crisis in the organization as the cash from operating activities have drastically decreased.
2. Tata motors has sold many of its investments and that created cash flow to the organization.
3. In case of the manufacturing and operating expenses there is no big change and the main reason is the not so increasing sales, leads to no big increase in the production.
4. Debenture interest of the company is going up and down as company has converted the debentures as well as the debentures are paid back also.
5. Depreciation is in increasing trend for the organization as the assets got purchased and so in the initial years the depreciation is high.
6. In the year 2010 the dividend has decreased by 50% that from 160 to 80, which shows cash problems with the organization in the year 2009-10.

**Cash flow analysis:**

1. Net cash from operating activities in the year 2010 has gone down one fifth which is very much alarming.
2. There are many changes in the working capital of the company from last three years, as in case of inventory, the investment is high and in case of trade payables, payments are more.
3. In case of the net cash used in financing activities, it has gone down in last three years because of cash crisis and less cash flow from operating activities.
4. As discussed above the company has paid debentures and long term liabilities in last three years, the cash flow are getting down.
5. Compare to the profit earned the interest paid is more and so it also creates the problem for the cash flow of the organization.

**Du Pont Analysis:**

1. After analysing the key ratios, if in brief the important ratios to be analysed the Du Pont Analysis is very useful. The Du Pont chart covers the important ratios like PBDIT to Sales ratio, Sales to Net Asset ratio, PBDIT to Net Asset ratio, PAT to PBDIT ratio, Net Asset to Net Worth ratio and all this lead to the final Return on Equity (ROE) of the organization.
2. As we can see from the Du Pont Ratios from the table given above all the ratios described have gone down from the year 2007 to 2011. And in particular, in the year 2009 it is at lowest.
3. The reasons are already discussed and remain the same, which because of the slowdown in the world market, the effect of it to the Indian economy. The problems faced by different companies because of this effect as well as the Indian financial problems, companies have faced a lot.

4. Especially the ROE of the Tata Motors have gone down drastically from 30.98% in 2007 to 5.34% in 2009 and again 10.37% in 2011.



## **2. Financial Analysis of Mahindra & Mahindra Ltd.**

### **Key Financial Ratio analysis:**

1. In the year 2007 the debt equity ratio of the company was 0.39 while it has gone up to 0.69 in the year 2009 while again it has gone down to 0.29 in the year 2011. The main reason of this up and down is in the year 2007 the secured loan amount was 106.65 crore which has gone up to 981 crore in 2009 and the same happened with the debentures also. In the year 2007 it was 5.51 crore which has increased to 600.01 crore in the year 2009. But, again up till the year 2011 both the items gone down as company has paid their most to the liabilities.
2. If we take the turnover ratios, all the ratios like asset turn over, inventory turnover and debtors turnover has gone down and the main reason behind it is there is drastic change and decrease in the sales turnover of the company.
3. In case of the interest coverage ratio from the year 2007 to 2009 it has gone down. The main reason behind it is the interest is going up because of more debt and sales and profitability of the organization is going down. It is not a good sign for any company. But as discussed above, again till year 2011 company has paid most of the debt and profit and sales have also increased, the interest coverage ratio started going up.
4. All the profitability ratios like, PBIDTM (%), PBITM (%), CPM (%), APATM (%) and RONW (%) had shown the same change.

That is from the year 2007 to 2009 it is going down because of the reasons discussed above and then it has started going up.

5. The overall ratio analysis can tell that from the year 2007 to 2009 the financial situation of the company was not very sound because of the world economy situation and its effect on the Indian economy. But then after as we know that Indian economy has started recovering, companies also started making good profits.

**Balance Sheet Analysis:**

1. The analysis of the capital structure of the company focuses on certain important facts.
2. Like, there is negligible change on the equity capital of the company but the debt has very much up and down in the figures.
3. The main reason of this variation is that, company was not making good sales and profit in the year 2009-10 which created cash scarcity in the organization. And in the same period because of the markets were falling down and investors not having trust in the market, company would not be able to issue new equity and thus, it has to rely more on the debt funds.
4. In case of the total reserves of the organization, the reserves have gone up after 2009, up till that it was stable. The main reason of increase in the reserves is the increase in the Profit and Loss account balance. The main reason for this balance increase is

increased sales, profitability and of course the decrease in the interest paid.

5. After the sources of funds, if we analyse the application of funds it shows good use of the money by the company.
6. Because, in last five years company have invested a lot in the assets and it increase the gross block of the organization. In the same way company has invested a lot in the government securities as well as in the equity market. It shows the foresightedness of the company as in the slowdown period at less rates it has invested money which will be giving them good return in the later years.
7. The total assets of the organization have gone up in last five years while the liabilities are slowly going down which is a good trend for the company.

**Income Statement Analysis:**

1. Analysis of the profit and loss account of the company shows a negligible increase in the sales turnover from 2007 to 2009 and after that the growth is quite ok.
2. In the same manner company's operating income shows less rate of growth but seeing to the figures, one thing is interpreted that the operating expenses of the company is less compare to the other automobile companies. And the main reason for it is that the Mahindra motors rely more on the auto components and they make the cars thus, the operating expenses are less.



3. The equity dividend of the company in the year 2007 was 115 which have gone down to 100 in the year 2009, which has gone up to 230 in the year 2011. It shows the effect of world economy in the year 2009 -10 and then after the increase in the dividend because of increase in the profitability and good market condition.

**Cash Flow statement Analysis:**

1. The cash flow statement of Mahindra shows drastic decrease in the year 2008 from the past year. In the year 2008 it was 1168.94 crore which has gone down to 825.83 crore. The main reason is the falling world market, increased rate of the automobile parts and the problems faced by the Indian monetary policy and the market this scenario was almost everywhere.
2. As already discussed above with the balance sheet analysis that the company has taken more debt in the year 2009-10 the interest paid was also very high. This shows less profitability because of less income and high fixed charges.
3. In case of the cash generated from the investment activities are high, because company has invested a lot in the last five years but with the same internal investments are also high in the form of fixed assets. It gives the mixed results in case of the cash generation.

**Du Pont Analysis:**

- 1.As the above statement analysis shows, the same is reflected from the Du Pont Analysis as well.
- 2.It shows decrease in the PBDIT to Sales (%), Sales to Net Assets (%), PBDIT to Net Assets (%) from the year 2007 to 2009 because of the same reasons discussed above.
- 3.The company also shows decrease in the Return on equity from the year 2007 to 2009 which proves the above discussed reasons correct. The ROE was 33.2% in the year 2007 which has gone down to 18.1% in the year 2009.
- 4.But as the scenario changed it has again gone up to 31.96% in the year 2010 and 29.39% in the year 2011. Same with the case of Return on Capital Employed as in the year 2007 it was 32.25% which has gone down to 14.83% in 2009 but again rose up to 30.68% in the year 2011.

### **3. Financial analysis of Cipla Ltd.:**

#### **Key financial ratio analysis:**

1. The debt equity ratio was 0.11 in the year 2007 which has gone down to 0.1 in 2008 which has again gone up to 0.18 in the year 2009 and again going down in the year 2010 and 2011. This up and down trend is because of the secured and unsecured loans coming and going in the balance sheet. The other main reason for it is the use of packing credit, cash credit and bills.
2. Except the year 2009, the current ratio of the company is above two which is more than the norms. And again the main reason is the trade credit, packing credit, bills receivables and other current assets of the organization.
3. In case of the turnover ratios all ratios are almost stable like fixed assets, inventory, and debtors.
4. The interest coverage ratio of the company has continuously increasing because the sales and profit of the company is going up year over year and the interest charges are almost stable.
5. The profitability ratios are affected negatively in the year 2009 not mainly because of the internal reasons but because of the slowing down market reasons.
6. Mainly the Return on Capital Employed and Return on Net Worth is little slowing down because of the decreasing sales and profitability.

**Balance Sheet Analysis:**

- 1.The equity capital of the company is stable in all last five years as company has not issued any new equity in last five years.
- 2.Reserves of the company increased year over year as the profit and loss account balance of the company has increased.
- 3.In case of the assets, it has increased year over year in last five years and so as the investments of the company.
- 4.Company also increased the research and development activities and so investment into that has also gone up.
- 5.Company has invested more in the current assets in last five years while current liabilities have gone down, which can be seen from the balance sheet as well as the ratios.

**Income Statement Analysis:**

- 1.Looking to the Profit and Loss account of Cipla, the sales turnover is increasing with almost 15% from 2007 to 2008, 23% from 2008 to 2009 but then it drop down to 7% in 2010 and then again it rose up to 12% in 2011. So it shows a normal increasing trend. Only in 2009-10 it gone down drastically because of the world market situation, increasing inflation and other economy effects.
- 2.Analysis of the operating income, operating expenses and operating profit shows that almost 67% of operating expenses are there year over year means the operating profit is around 23% every year.

3.Dividend paid by Cipla was stable i.e. 100% from the year 2007 to 2010 and it gone up to 140% in the year 2011 which shows good trend and it can attract the long term investors.

**Cash Flow Statement Analysis:**

- 1.Cash flow from operating activities from the year 2007 to 2009 was almost stable i.t. near to 350 crores every year which all of a sudden rose to 1041 crore in 2010 and 987 crore in the year 2011. It shows the growing trend for the company.
- 2.Company is not having very high debt on it thus; fixed income charges are very less. It is a boon for any company.
- 3.Year over Year Company is increasing the investments which can be seen from the cash used in investment activities. In year 2007 the investment was 485 crore which has gone up to 1136 crore in the year 2011, means almost three fold.
- 4.Because company has taken less money in terms of debt the internal use of funds is high, and company has also given some money to other companies which can be seen from the financing activities.

**Du Pont Analysis:**

- 1.The analysis of Du Pont table shows decrease in almost all ratios from year 2007 to 2009 and then increase till 2011.
- 2.PBDIT to sales ratio has decreased from 26.11% in year 2007 to 22.01% in the year 2009 and again gone up to d28.06% in the year 2010.



3. In the same manner the ratio like sales to net assets have gone down to 0.88 from 1.05 from the year 2007 to 2011.
4. As the income statement shows positive results but ROE says very different story. In the year 2007 the ROE of Cipla was 25.69% while it has gone down to 15.36% in the year 2011, which is very near to almost half, means the sales turnover is increasing but with it the profit margin is decreasing and the reason can be operating expenses and other manufacturing expenses. As we know that in last 2-3 years inflation has gone up, leads to increase in the prices and it increases the different expenses of the organizations.

#### **4. Financial Analysis of Sun Pharmaceuticals Ltd.:**

##### **Key Financial Ratio Analysis:**

1. The Debt Equity ratio of the company was 0.72 in the year 2007 which has become 0 in the year 2010 and 0.01 in the year 2011. This means company has become almost unlevered and relying fully on the equity. This situation can be taken in two ways i.e. becoming unlevered means no fixed financial charges which will give benefit to the shareholders when company is growing but the problematic side is that they will not be getting the benefit of trading on equity.
2. Company has also worked better in case of the current ratio as in the year 2007 it was 4.62 which is very high, and it has gone down to 2.71 in the year 2011, which is very near to the required norms. It shows that earlier company was keeping more money in the Current Assets which might not give them proper return and the money will be kept idle. But to reduce this ratio means enough investment in current asset, less idle money and more money put into the long term investment which will increase overall return of the company.
3. When the above two ratios shows very good trend on the other side the turnover ratios are decreasing where the first is decrease in the fixed asset turnover ratio. The analysis of balance sheet shows negligible increase in the fixed assets but the sales turnover is also not increasing and so this ratio is going down.

4. The good sign is decrease in the debtors and so there is decrease in the ratio. It means that the company must have made the credit policy more stringent, but it might affect the sales also.
5. All the profitability ratios show increase year over year, it is a good sign for the company.

**Balance Sheet Analysis:**

1. The capital structure of the organization is very easy to analyse as there is no change in the equity and other funds in last five years. So as with the debt funds that company has very less debt funds and in recent years that became almost zero.
2. In case of the reserves of the organization, it is increasing year over year and the main reason is increase in the profit and loss account n balance. As the sale is going up in last five years and profitability is also increasing with good rate the reserves are reflecting the same.
3. Sun is continuously investing in the new technology year over year which increases the gross block of the organization.
4. Sun Pharma also shows good increase in the investment part as year over year the investment has increased. In the year 2007 it was 1057.49 crore which has gone up to 3601.42 crore in the year 2011 means three fold in last five years.
5. In case of the current assets company has decreased it or kept stable, the reasons already discussed above in the thesis and in case of the current liabilities it is almost in the down trend.

### **Income Statement Analysis:**

1. Sales turnover of the company is almost same and in certain years it is going up and down, this shows the general trend of pharma sector.
2. As the company has increasing investments in last five years, the income from interest is also increasing year over year.
3. Total expenditure compare to the income earned is less than half and this gives good operating profit to the company, the main reason for this situation is decreasing raw material cost which is the important part of the manufacturing expenses.
4. Company has not spent any money on advertisement and marketing in last five years but still the sale is going up. There are two main reasons to it; one that the drugs are in too much of demand and compulsory purchased on requirement and the second reason is that this market is highly influenced by the doctors so promotional campaigns don't give any results.
5. The equity dividend (%) is increasing year over year. In the year 2007 it was 135% which has gone up to 350% in the year 2011, but on the other side the EPS is almost stable but still increased dividend is very good for the shareholders.

### **Cash Flow Statement Analysis:**

1. Cash flow from the operating activities have shown very varies trend as in the year 2007 it was 450 crore which has gone up to 626 crore in 2008 and again 1262 crore in 2009. But all of a sudden it gone down to 646 crore in the year 2010 and again

gone up to 1230 crore in the year 2011. The main reason for it could be fluctuating sales, manufacturing and other operating expenses.

2. Sun Pharma has increased the investment in last five years, which can be seen in the cash flow used in the investment activities. In the year 2007 it was 112 crore which has gone up to 1105 crore in the year 2011 which is almost ten times high.
3. Sun Pharma has also given money to other companies for finances because it can be seen from the cash flow from the financing activities in last five years.

#### **Du Pont Analysis:**

1. The analysis of the Du Pont table gives an idea that in last five years almost all the profitability ratios have gone up but on the same time the ROE has gone down.
2. In the year 2007 the PBDIT to sales ratio was 30.21% which increased to 48.10% in the year 2011 in the same manner PBDIT to Net asset was 0.2 in the year 2007 while it gone up to 0.23 in the year 2011.
3. Same with the case of PAT to PBIDT, that it was 0.41% in the year 2007 which has increased to 91.11% in the year 2011 but the Sales to Net asset ratio has decreased in the same time duration.
4. In the year 2007 it was 0.65 which has decreased to 0.47 in the year 2011, this all shows that the company has invested money

into the assets but the utilization of assets is not efficient and so it is not reflecting into sales.

5. The ROE in the year 2007 was 32.15% which has gone down to 22.32% and it can be interpreted the same way that the money put into the business is not utilized properly and thus it is not earning proper return. The different market factors are also affecting the company results.

## 5. Financial Analysis of Ambuja Cement Ltd.

### Key Financial Ratio Analysis:

1. The Debt Equity ratio of the company was 0.35 in the year 2006 while it has gone down to 0.02 in the year 2010 which is almost near to 0 and it is because of the decrease in the debt while the equity was stable in last five years.
2. Current ratio of the company was near to 1 in last five years which shows that the company has not invested much in the current assets and neither in the current liabilities as well.
3. In case of the turnover ratios, the Fixed assets, inventory and debtors shows the down trend and the main reason is the change in fixed assets is very negligible and so as in the debtors. And in the same way the sales turnover also shows negligible change and so the ratios are little bit decreasing in last five years.
4. In case of the interest coverage ratio, it has gone up from the year 2006 to the year 2010. In the year 2006 it was 17.26 which have gone up to 81.4 in the year 2009 which shows that the profitability of the company is continuously increasing and it is more able to cover the interest to be paid.
5. The profitability ratio of the company is showing the mix trend as in certain years the ratios are increasing and in some it is decreasing. The main ratio i.e. ROCE was 34.1% in the year 2006 which has gone up to 42.49% in 2007, again 30.75% in 2008 and finally 24.39% in the year 2010. But overall company has earned good rate of return in last five years.

**Balance Sheet Analysis:**

1. Ambuja has not changed much the capital structure of it as the equity remains the same in last five years, no new equity capital is issued and in case of the debt in the year 2006 the debentures issued were of 220 crores but then after it has gone down to 100 crores for three years. In the year 2010 company has paid all the debentures.
2. Company's reserves have increased twofold in last five years which shows that company has earned good amount of money and with that they have also kept good amount back in the organization.
3. In case of the assets of Ambuja, that also increased twofold in last five years which shows good amount of investment in the internal assets of the company. As in last ten years the infrastructure market is in boom it is understandable to invest more in the assets to earn more.
4. As far as current assets and specifically inventories are concerned it has also increased in last five years from 408 crore to 901 crore which shows growth in the production and use of different type of inventories.
5. Because that the company is not having much amount of debtors, the liquidity of Ambuja is good which can be seen from the ratios also.



### **Income Statement Analysis:**

1. The sales turnover of the company has increased twofold in last five years, from 4677 crore to 8257 crore in the year 2010, which depicts the growth in the infrastructure in India and no substitute of cement.
2. Looking at the profit and loss account one interesting fact is coming in the notice, that in last five years the dividend income is reducing while the interest income is going up which shows the trend of the market. As in last few years the equity market is going down the debt market is safe to invest money.
3. In all last five years the operating expenses compare to total expense is almost half as the inflation is going up, market is going down and the prices of crude and all other material is continuously increasing.
4. Company has sold big amount of assets in the year 2007 as it has gone for some modernization in the year 2007.
5. In all last five years company has not only paid dividend but also interim dividend which shows good profitability and liquidity of the organization.

### **Cash Flow Analysis:**

1. Net cash from operating activities shows a bit fluctuating trend in last five years, as the sales are increasing but the expenses are also increasing because of the above discussed reasons.
2. In certain years company has also received money as foreign exchange transactions.

3. In case of the cash used in the investment activities, it increased YOY, in the year 2006 it was 632 crore which has gone up to 1194 crore in the year 2009. Majority of this money is invested in the purchase of fixed assets.
4. As discussed earlier also the interest income has increased a lot in last five years as company has invested money in the debt market instead of equity market.
5. In case of the cash used in financing activities, has gone down in last five years which shows that the company is not investing money into the financing activities as not required also.

**Du Pont Analysis:**

1. The PBDIT to Sales ratio has gone down in last five years from 32.51% to 25.41% as the sales is increasing but the operating expenses are increasing and thus company has decreased operating income.
2. But in case of the sales to net asset ratio, it is almost stagnant in last five years, as in the year 2006 it was 1.61 which is now 1.12, which shows the effective use of the assets.
3. In case of PAT to PBDIT the ratio is fluctuating as in the year 2006 it was 65.9% which has gone down to 57.4% in the year 2009 and again increased in the year 2010 to 60.24%. But overall the ratio is good because of the company sales and profit.
4. Last but important ratios is ROE which was 35.36% in the year 2006 which has continuously gone down and reached to 18.31%

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in the year 2010 which depicts the market situation to the company.

## **6. Financial Analysis of UltraTech Cement Ltd.:**

### **Key Financial Ratio Analysis:**

1. Debt equity ratio of UltraTech is continuously decreasing from the year 2007. It was 1.08 in the year 2007 which has gone down to 0.38 in the year 2011. It is good for the organization as the debt is decreasing and equity is increasing but it may not benefit much to the equity shareholders as they will not be getting the benefit of trading on equity.
2. The current ratio of the company is stable in last five years and it is less than one. In the year 2007 it was 0.7 and in the year 2011 it was 0.69 which shows that company is not keeping idle money in the current assets and not having much of current liabilities also which is good.
3. In case of the turnover ratios almost all the ratios are going down except debtors turnover ratio. The debtors turnover ratio was 30.8 in the year 2007 which has gone up to 36.32 in the year 2011 while the inventory turnover ratio has gone down to 10.7 from 13.49.
4. The interest coverage ratio of the company has gone down from 14.43 in the year 2007 to 7.44 in the year 2011 which is not a good sign as this ratio shows the interest covered by the profit.
5. The profitability ratios of the company have gone down drastically and the main reason is increasing expenses. The sales turnover of the company has increased twofold in last five years but the operating expenses are half of the total expense

and the total expenses are also increasing which is affecting the profitability negatively.

**Balance Sheet Analysis:**

1. In last five years there is no big change in the capital structure except the issue of equity capital in the year 2011. Company has issued equity capital of 150 crore in the year 2011.
2. As far as the reserves are concerned, there is all of a sudden increase in the year 2011 and the main reason is issued equity funds and almost doubled sales turnover compare to last year. In the year 2010 it was 4482 crore which has gone up to 10387 crore in the year 2011.
3. In case of the debt funds, in the year 2011 company has issued non-convertible debentures of 1037 crore. It shows that the company is in the expansion phase as it is increasing the capital to invest.
4. In the same line it has also taken term loan of 450 crores in the same year.
5. In the year 2011 company has also invested a lot in the assets to use the taken money from the market and use it for the expansion purpose.
6. As far as inventories are concerned in the year 2011 it has increased more than double compare to last year, all these figures interpreting the growth in the company. And the main reason of such growth is infrastructural development.

### **Income Statement Analysis:**

1. Sales turnover of the company was 5484 crore in the year 2007 which has gone up to 14,858 crore in the year 2011. Means in last five years it has grown more than 100%. But the main change has come from the year 2010 to 2011. As in the year 2010 the sales was 7729 crore which has become 14,858 crore in the year 2011, which is almost double.
2. With this the total expense also increased. It was 4939 crore in the year 2007 which has gone up to 13,558 crore in the year 2011. It shows that with sales, expenses are also increases. Means the profitability will not be having very positive growth.
3. The equity dividend of the company has gone up from 49.79 crore in the year 2007 to 164.42 crore in the year 2011, it shows the increase but if we consider the percentages, it was 40% in the year 2007, 50% in the year 2009, and 60% in both the year 2010 and 2011.

### **Cash Flow Analysis:**

1. Net cash from the operating activities shows increase year over year as in the year 2007 it was 1113 crore which has gone up to 2074 crore in the year 2011.
2. As the profit and loss account shows increase in sales turnover the cash has to be increased but it doesn't shows the same growth rate because the expenses are also increasing with the same pace.

3. Net cash used in the investment activities have gone down as company is investing more into the assets and especially in the year 2011 it has gone up drastically.
4. In the year 2011 company has also issued loans to subsidiary company as in the same year company has taken money from the market.
5. Net cash used in the financing activities, were less from the year 2007 to 2009 but it increased in the year 2010 and 2011 as company has given loan to its subsidiary and also some other financing activities.

**Du Pont Analysis:**

1. PBDIT to Sales ratio of the company has gone down from 26.97% in the year 2007 to 19.03% in the year 2011. As discussed earlier the sales have gone up but with the same the expenses have also increased and so the profitability of the organization is not showing much positive growth.
2. Same is the case with sales to net assets and PBDIT to net asset. The company has invested a lot into the assets and sales have also gone up but still because of less profitability the ratios are going down.
3. The company looks in the expansion stage as the equity, assets and sales everything is increasing but because of market situations and effect of different economic factors the ROE has gone down drastically. In the year 2007 it was 55.84% which has gone down to 18.39% in the year 2011.

## **7. Financial Analysis of Steel Authority of India Ltd. (SAIL):**

### **Key Financial Ratio Analysis:**

1. The debt equity ratio of the company has increased year over year. In the year 2007 it was 0.28 which has gone up to 0.52 in the year 2011. The main reason behind this is increase in debt. In last three years company has taken high amount of term loan and also issued non-convertible debentures.
2. Current ratio of the company was 1.36 in the year 2007 which has gone up to 1.7 in the year 2011, which is minor change.
3. The inventory and debtor turnover ratios have decreased year over year and it is because of the market conditions.
4. The interest coverage ratio of SAIL has gone down almost to half. In the year 2007 it was 29.37 and in the year 2011 it was 16.15. As discussed earlier the debt has increased a lot in last three to five years and so as the interest expenses. Because of this reason the interest coverage ratio has decreased which is not good for any company. But because it is a government company the investors need not to worry.
5. In case of the profitability ratios, all ratios are on the down going side and the main reason is the recession in the world market and its impact on the India economy and companies.

### **Balance Sheet Analysis:**

1. The share capital of the company is stagnant in the last five years, being the government company; there is no change in the share capital as expected.



2. In the reserves also, there is no big change as the only contributor in the reserves is profit and no capital addition.
3. As other government organizations, SAIL has also issued debentures and it amounted to 6411 crore in the year 2011.
4. SAIL has also taken term loan in last three years and that has also increased year over year. The term loan was 800 crore in the year 2009 which has gone up to 5318 crore in the year 2011; it is a very big rise in the debt of the company.
5. Looking to the other side, assets of the SAIL has not increased much in last five years. It was 29,912 crore in the year 2007 which has gone up to 38,263 crore in the year 2011.
6. In case of the current assets, it is also rising at moderate rate. The main contributor in the current asset is inventory which was 6814 crore in the year 2007 which has gone up to 11,470 in the year 2011.

**Income Statement Analysis:**

1. Sales turnover of the company has increased year over year with a moderate rate. In the year 2007 it was 39,481 crore which has gone up to 47,008 crore in the year 2011.
2. The interest income received by SAIL is high compare to dividend received in last five years. The main reason is being the government company it needs to invest in other government company bonds and debentures and so the interest income is high.
3. Compare to total revenue, total expenditure is also high and thus company is not earning very huge profit. Total expenditure in the year 2007 was 25,123 crore which has gone up to 37,219

crore in the year 2011. Thus, the profit has increased by only 1000 crore from 2007 to 2010 and rather decreases by 1000 crore in the year 2011.

4. Despite of less profits or decreasing profits SAIL has paid very good interim and regular dividend.
5. But looking to the dividend rate, it is fluctuating. In the year 2007 it was 31% which has gone down to 27% in the year 2009 and again gone down to 24% in the year 2011, in the same time it has reached to 37% in the year 2008 and again 33% in the year 2010.

#### **Cash Flow Analysis:**

1. Cash flow from operating activities shows very fluctuating scenario as in the year 2007 it was 5632 crore which has gone up to 8378 crore in the year 2009 and then after it is continuously decreasing and reached to 2156 crore in the year 2011.
2. Year over year the investment is rising in SAIL, either internal or external. As company has invested in the assets also and in the other government funds also, the amount was 587 crore in the year 2007 which has gone up to 8933 crore in the year 2011.
3. As far as the financing activities are concerned, SAIL is continuously financing different government agencies and its own business as well. The cash used in the financing activities was 1608 crore in the year 2007, 3088 crore in the year 2009 and so on.

**Du Pont Analysis:**

1. All the profitability ratios are going down year over year and the main reason is the effect of world market, recession and its impact on Indian economy.
2. The PBDIT to sales ratio was 27.78% in the year 2007 which has gone down to 19.48% in the year 2011.
3. In the same manner all the profitability ratios, importantly PAT to PBDIT has gone down to 53.57% from 56.56%. But compare to other steel companies it is very good.
4. In case of ROE it has gone down drastically as in the year 2007 it was 41.47% which has gone down to 13.94% which is even less than half.
5. Looking at overall performance, SAIL is doing well but because of the world market conditions, and recession it got affected in certain years.

## 8. Financial Performance of Tata Steel Ltd.

### Key Financial ratio Analysis:

1. The debt equity ratio of the company was increased from the year 2008 to 2010 and then it's gone down, and the main reason is increasing debt. The ratio was 0.51 in the year 2007 which has gone up to 0.78 in the year 2010 again it decreased to 0.64 in 2011.
2. Current ratio of the company is almost stable from last five years, and it is near about 1.3 which is good for the company.
3. Turnover ratios shows increasing trend as fixed assets turnover ratio was 1.26 in the year 2007 which has gone up to 1.41 in the year 2011. The inventory turnover ratio has increased from 8.77 to 9.07 and same with the case of debtors turnover ratio was 33.75, which has gone up to 73.95.
4. In case of the interest coverage ratio, it has gone down from 25.92 to 6.8 which is very good for the company. Company's profitability has gone up and it is good for the investors.
5. The profitability ratios of the company are almost stable as only 1 to 2% of rise or fall is seen. Mainly the ROCE shows more down trend, as in the year 2007 it was 36.63% which has gone down to 16.68% in the year 2011.
6. Same with the case of RONW, as in the year 2007 it was 35.4% and it gone down to 16.36% in the year 2011. Basically this down drop is because of the world market situations and its impact on the Indian economy.

**Balance Sheet Analysis:**

- 1.The share capital of the company was stable from the year 2007 to 2010 and then after company has issued new equity, thus there rise in the equity share capital.
- 2.As far as the reserves are concerned in last five years it has increased almost threefold from 13,368 crore in 2007 to 45,807 crore in 2011, which shows that company is in the growing mode and it is putting money into reserves for future expansions.
- 3.In last five years company has not issued a very big amount of debentures but it has taken big amount of term loan in last five years.
- 4.In case of the assets, there is more than threefold increase as in the year 2007 it was 23,741 crore which has gone up to 75,246 crore in the year 2011.
- 5.Current assets and current liabilities of the company are not showing big change and it can also be concluded from the current ratio as it is almost stable in last five years and near to 1.3.

**Income Statement Analysis:**

- 1.Sales turnover of the company has increased at a moderate rate in last five years, in the year 2007 it was 19,762 crore which has increased to 31,902 crore in the year 2011.
- 2.In last three years company has sold many of its investments and through it gained money. Looking to the market scenario it was

- a good decision to sale certain investments which are not providing positive returns.
3. In last five years total income of the company has increased almost twofold. In the year 2007 it was 18,109 crore which has gone up to 30,746 crore.
  4. Looking to the expenses side in last five years selling and advertisement expenses are continuously on rise which shows the impact of competition.
  5. From 2007 to 2009 the dividend paid is rising and then after in gone down. In the year 2007 it was 943 crore which has gone up to 1168 crore in 2008 and 2009 but again it gone down to 709 crore in 2010 and then increased in the year 2011 to 1151 crore. It shows very fluctuating trend and the main reason behind it is the world market situation and its impact on Indian market.

**Cash Flow Statement Analysis:**

1. Net cash from operating activities have increased from 4896 crore in the year 2007 to 8542 crore in the year 2011 which shows increase in the sales revenue.
2. Company has invested more money in last five years but it is on fluctuating basis. In the year 2007 it was 5429 crore which gone up to 29,318 crore in 2008 and again in the year 2009 it gone down to 9580 crore which again gone down to 5254 crore and 13,288 crore in the year 2011.
3. As already discussed earlier company has invested in fixed assets in last five years and the same can be analysed from the cash flow statement.

**Du Pont Analysis:**

1. The PBDIT to sales ratio was almost stable in last five years. In the year 2007 it was 37.1% which was 39.52% in the year 2011. This shows the stable growth in the company and facing the competition well.
2. Same is the case with the sales to net asset ratio. In the year 2007 it was 0.84 and then after from 2008 to 2011 it was near to 0.40.
3. The PAT to PBDIT ratio was 57.58 which was 54.45 in the year 2011 and it also not showing big fluctuations.
4. As the above all discussed ratios showing almost the stable trend the ROE is showing decreasing trend. It was 35.4% in the year 2007 which has gone down to 25.97% in 2008, 21.885 in 2009, 14.19% in the year 2010 and 16.36% in the year 2011.

### **9. Financial analysis of State Bank of India:**

1. Current ratio of the bank is 3.09 right now which is very high compare to the standard ratio but in the bank it is understandable that the requirement of current assets is high and so the current ratio of any bank must be high.
2. Same is the case with the quick ratio, it is 9.07 which is quite high because of the above discussed reason.
3. EPS of the bank is very high compare to past. Right now it is 144.37 which is good. Shareholders of the bank are getting good return on their investments.
4. The balance sheet of the bank shows good amount of assets but the biggest problem is of the NPA. Because SBI is a government bank the credit policy is strict but the collection efforts are not so very high and so the NPA is high.
5. The profitability of the bank is very high and the main reason is very large customer base of the bank.

### **10. Financial Analysis of ICICI Bank:**

1. The current ratio of the bank is only 0.020 which is very low and it indicates underutilization of the current assets which is not good.
2. But the bank like ICICI, the liquidity is good because of high capitalization and deposits.
3. The EPS of the bank is continuously increasing from last five years because of increased profitability and relatively less increase in the number of shares.
4. It also shows the effective utilization of capital and efficient use of the loan funds instead of owners fund.
5. Due to huge increase in the net profit and capital employed increase the return on capital employed is has gone up and it is a good sign for any entity.