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Original Research Article

Ratio Analysis: A Study on Financial Performance of Eicher Motors

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Abstract

Financial analysis is the process of reviewing the financial position of the company. Ratio analysis is extensively used by companies as a tool to predict the profitability and survival in the competitive environment. This study aims at analysing the financial soundness of Eicher Motors using ratios. The primary objective of this study is to evaluate the performance of Eicher motors over the last decade. The reference period used for the study is 11 years starting from 2008 to 2018. Ratios calculated for this purpose are Return on capital employed, net worth, Debt to Equity, Gross profit Margin, asset turnover, Interest Coverage Ratio, Earnings Per share. EBIDTA/Turnover. Secondary data was collected from Annual reports of Eicher Motors to derive relevant information. OPM has indirect relation with company's financials. The results reveal that the company has performed reasonably well in the last decade. The company has earned high returns as return on capital employed was highest in the year 2016 to 78.64 per cent from 15.9 per cent in 2008. Increasing EPS shows that the company is earning huge profits and thereby benefitting their equity shareholders. Declining debt to equity has a positive impact on the firm's performance as it depicts that company is using less debt to meet its financial obligations. It also reveals that they will be able to pay off all their debts in the future.
Keywords: EPS, Financial, EBIDTA, Shareholders.

INTRODUCTION

Financial ratios provide a better way to analyse and predict the future of the company. These ratios are often used to check the financial position of an enterprise in the global arena. Financial ratios are broadly classified as leverage, profitability, valuation, turnover and liquidity ratios. Ratios are calculated by using certain figures that are drawn from the financial statements of the respective companies. Liquidity ratio measures the availability of cash that can be used to pay short term loans and advances. Profitability ratios measure how efficiently the firm is able to utilize their assets to realize the maximum profits. Debt ratios give insight on the efficiency of the firm to pay its long term liabilities. Activity ratio measures the ability to convert non-cash assets into liquid form. Ratios are useless if not compared with some pre-established standards. Therefore, it is mandatory to compare obtained results with past records so as to have a better idea of the financial performance of the company.

RESEARCH OBJECTIVE

- To analyse the financial position of the company.
- To compare the Impact of ratios on the performance of company.

LITERATURE REVIEW

Kangari, Farid & Elgharib [1], the research emphasis is on to determine the various attributes leading to downfall of the U.S cement industry. So as to overcome such business failure, author developed a quantitative model based on financial ratios to assess the financial performance, category of a construction company, and its chances of business survival. Nissim & Penman [2] distinguishes the leverage out of financing activities from leverage arising out of operating activities and further concluded that items in balance sheet are priced differently in both financing and operating liabilities. This study also explained the differences in current and future rates of return and price-to-book ratios. Feng & Wang [3] in this paper tries to develop a performance evaluation procedure for highway buses with the implementation of financial ratios. In results, it was evident that financial ratios are more comprehensive when taken into consideration for the purpose of performance evaluation. Pandya [4] evaluated the performance of Tata steel ltd by considering the data of past 10 years using the financial ratios. The study revealed that Tata steel has performed well in terms of returns available to all investors. It stated that debt policy of the company was very rigid so as to avoid solvency and financial risk.

Delen, Kuzey, & Uyar [5] pertained to define the relationship between the financial ratios and financial performance of the company using the statistical tools. It stated that how financial ratios impact the performance of a company. Results of the study showed that earnings before Tax-to-Equity Ratio and Net Profit Margin were the two most important variables for determining the given relationship using decision tree algorithms further Borhan, Mohamed & Azmi [6] examined the impact of financial ratios on the financial performance of a chemical company. It stated that liquidity ratios, leverage ratios and profitability ratios were used to assess the reasons of negative performance of the company during the period of crisis. The Company improved its performance by determining the positive and negative relationship between various ratios.

RESEARCH METHODOLOGY

This study includes the secondary data collected from Eicher motors annual reports of the past 11 Years. The research is descriptive in nature. Descriptive statistics is used to draw charts in Excel.

DATA ANALYSIS

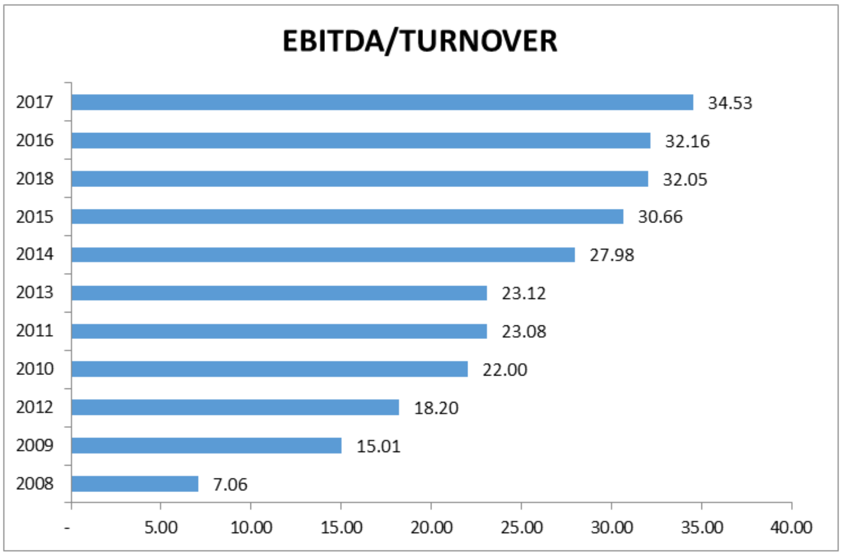

Chart-1:

The above chart clearly depicts that EBIT/Turnover has increased from 7.6% in 2008-2009 to 32.05 in 2017-2018 which shows significant jump in the earnings turnover. The average EBITDA/turnover ratio calculated as 26.58%. EBITDA/turnover increased significantly during initial years due to increased demand.

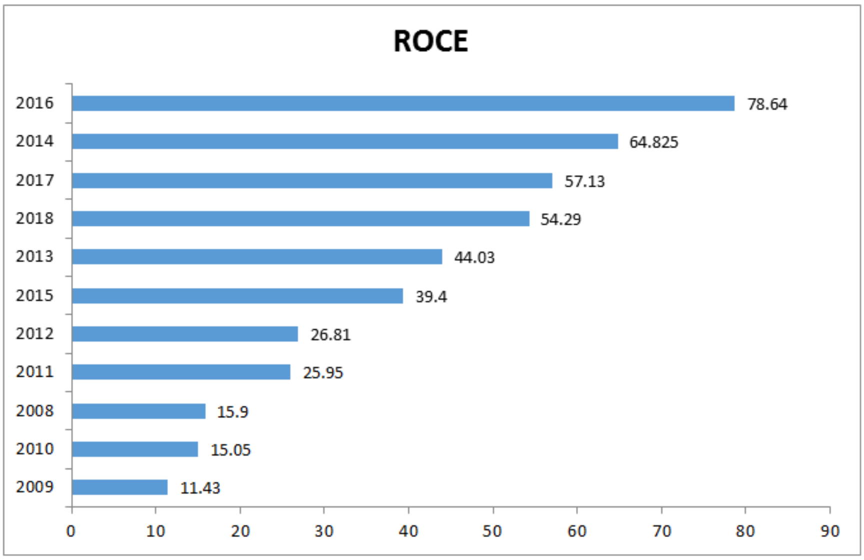

Chart-2:

Return on average capital employed increased from 11.43% in 2008-2009 to 78.64% in 2015-16 showing an impressive growth in the returns earned on deployed capital. Average of return on capital employed worked out to be 39.40%. In the year 2014-16 there has been increase in the values.

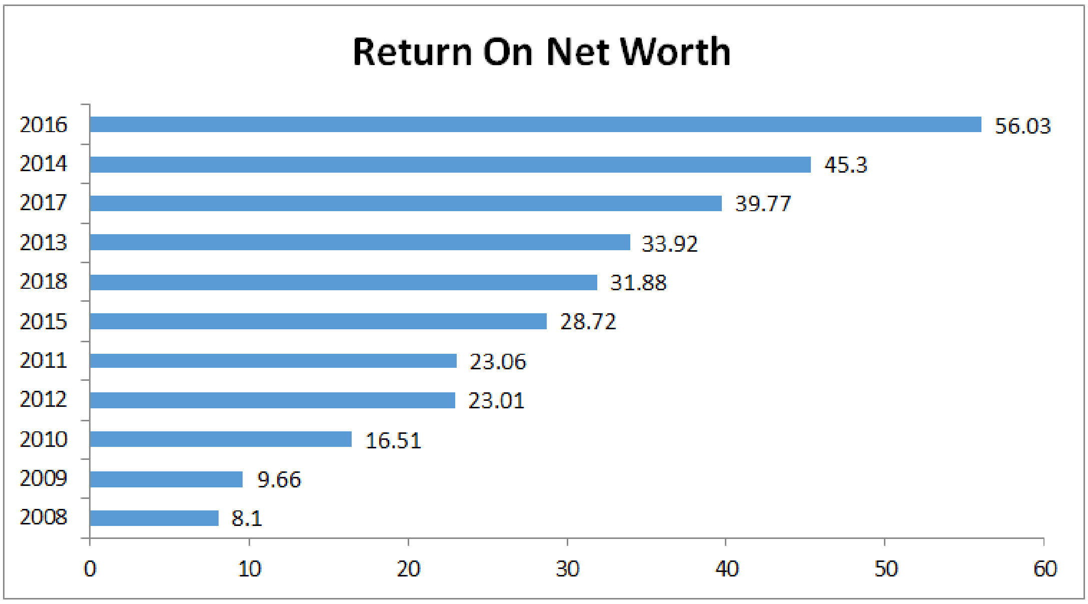

Chart-3:

In the year 2007-2008, the return on net worth was 8.1% which is very low in comparison to subsequent years return on net worth i.e. an average of 28.7 % which is almost double from the initial year. It states that company has been more efficient in generating the profit out of shareholder's equity. It depicts a significant increase over the period of 11 years.

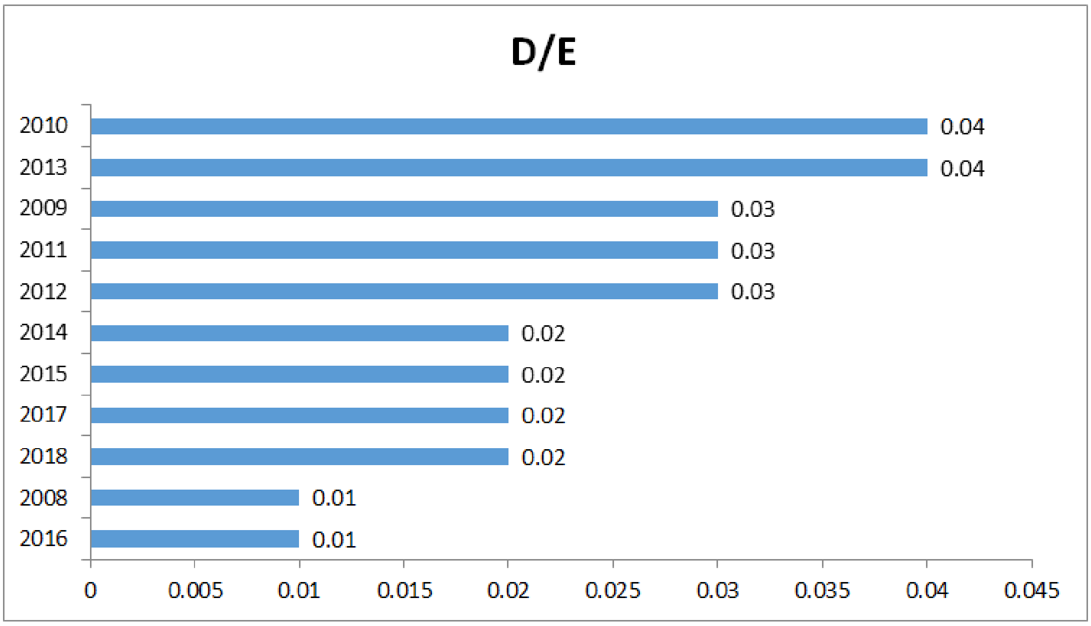

Chart-4:

As shown in the chart, the debt to equity ratio is lower in the year 2007-08 indicating the lower degree of financial leverage and potential risk in comparison to 2017-2018. Although there is no significant difference found in the past ten years.

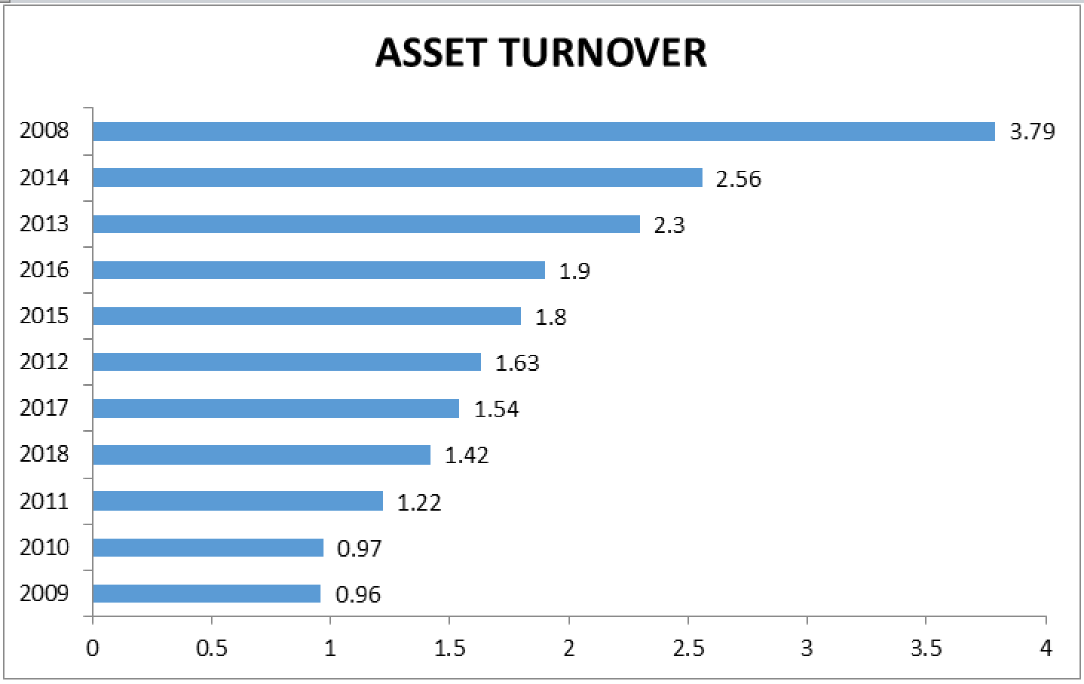

Chart-5:

In the year 2007-08, the asset turnover ratio is as high as 3.79 as depicted in the above chart which gradually falls down in the year 2008-09 showing the inefficiency of the firm to generate sales out of assets. Figures indicate that sales are very volatile as there has been significant variation in the turnover ratios over a period of time.

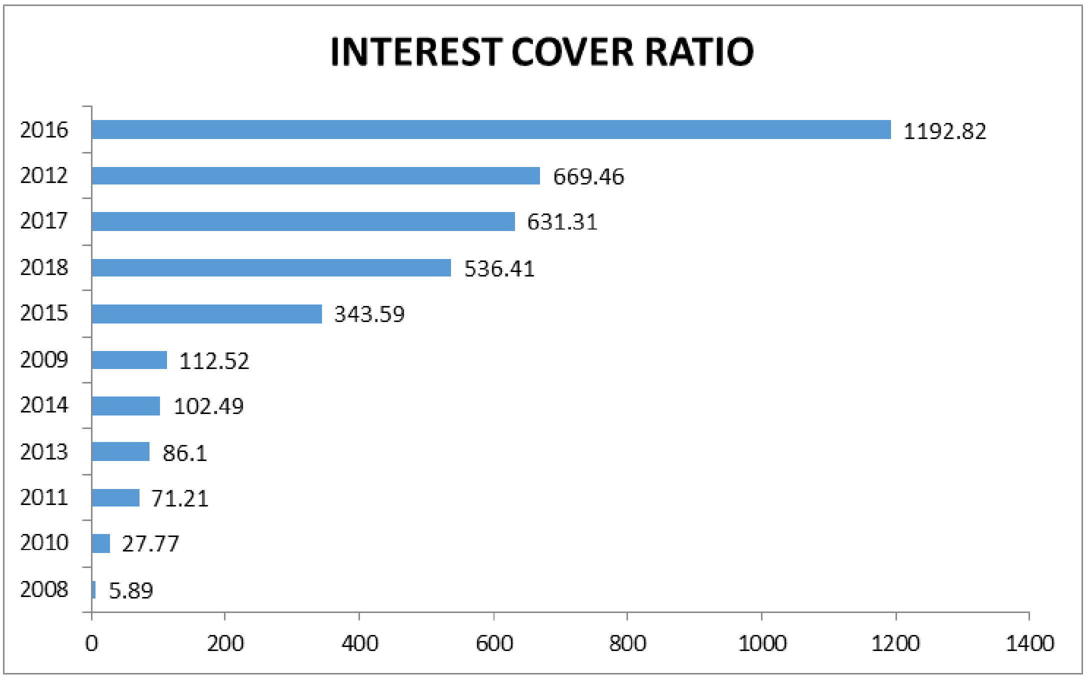

Chart-6:

Interest coverage ratio has increased significantly from 5.89 to 536.41 witnessing the quantum jump of almost 90 times indicating robust earnings to cover the fixed interest obligations. Average interest cover ratio worked out to be 343.59. This ratio indicates that Eicher Motors is in the position to meeting their debt obligations and may not face any insolvency as it has favourable ICR.

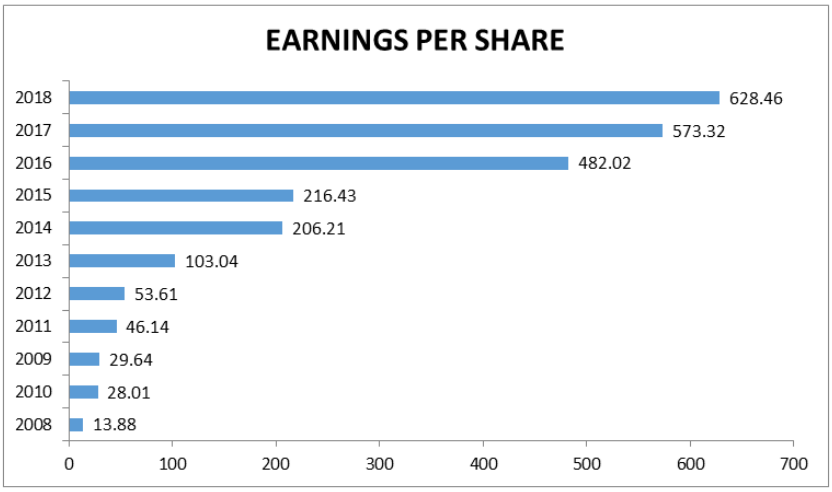

Chart 7:

Chart-7 depicts the higher EPS figure in year 2018 i.e. 628.46. A higher EPS shows the higher earnings, strong financial position and therefore Eicher Motors is a reliable company to invest money. A consistent improvement in the Earning per share year after year is the indication of continuous improvement in the earning potential of the company.

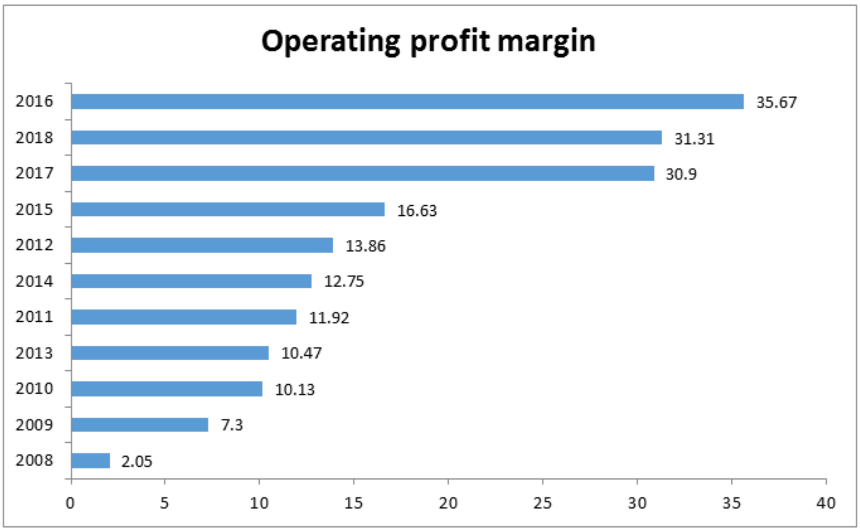

Chart-8:

A higher operating margin of 31.31 in year 2017-18 compared with a lower ratio of 2.05 in 2007-08 shows that the company is earning from its on-going operations to pay for its total costs. It shows that business operating activities are sustainable.

DISCUSSION

HIGHER EBIDTA/TURNOVER

Higher EBIDTA implies the operational efficiency of the company which gives positive signals to the investors that the company is efficient in generating profits. This ratio also indicates that the company is able to meet their financial obligations before interest, tax, dividend and amortization. However, there is no significant improvement from the preceding years.

INCREASING RETURN ON CAPITAL EMPLOYED

Increasing return on capital employed shows the ability of the firm to deploy resources and utilize maximum out of it thus benefit for shareholders. There was significant decline in the year 2018 from the all-time high in the year to 78.64. Company fails to maintain consistency in terms of ROCE that is a matter of concern as it forms a bad image in the minds of the investors.

DECLINING RETURN ON AVERAGE CAPITAL EMPLOYED

This ratio implies company has failed to convert their profits into capital that gives negative impact of the company. Company failed to make profitable investments thereby decreasing ROACE. However, there is a significant increase in the percentage during the year 2008-2018. This also implies company failed to grab the investment opportunities and utilize their resources in the best possible way.

DECREASING ASSET TURNOVER

This ratio gives insight on company's ability in utilizing their assets to generate sales. Decreasing asset turnover is a matter of concern for Eicher Motors as they failed miserably in utilizing their assets. This put-up a big question mark on the firm's ability. It creates a negative impression on the minds of the stakeholders which might lead to re-think of investment.

FINANCIAL LEVERAGE

This ratio indicates firm's capital structure. There is not much change in firm's capital structure as debt equity ratio remains unchanged in the year 2018. This ratio measures the company's ability to pay its long term debts. However, it can be interpreted from the company's financial reports that the company has reduced its debt to magnify the returns for their shareholders in the future.

INCREASING INTEREST COVERAGE RATIO

There was a significant jump in the interest coverage ratio over the last decade which implies that company reduced their dependency on debt. This is good sign for the company as lower the interest coverage, less the burden to pay its long term liabilities especially loans. However it declined in the year 2018 which can create an alarming situation for the promoters of the company.

INCREASING EARNINGS PER SHARE

This ratio measures the profitability of the company. Eicher Motors showed consistency in terms of profits. This creates a virtuous image in the minds of the investors. By Looking at the figures it can be said that company has performed well.

INCREASING OPERATING PROFIT RATIO

The operating profit has increased from the year 2008 to 2018 implies that company has efficiently managed their costs and expenses associated with their business activities. It also indicates company's ability to make profits after paying variable cost such as wages, purchase of raw material etc. Surprisingly, it has increased from 2.05% to 31.31% in the year 2018.

KEY FINDINGS

Return on capital employed of Eicher Motors has increased significantly for all kinds of stakeholders. It implies that they have done a great job in deployment of resources that generated high returns for their shareholders during the reference period. They also did extremely well in maximizing return for their equity shareholders as average on net worth increased from 8.1% in 2008 to 31.88 % in 2018. However chart shows a decline in returns in the past 5 years which can be a matter of concern in future. In terms of leverage ratios Eicher Motors have done well as they managed to maintain a low debt-equity ratio and high Interest on coverage ratio that indicates less financial risk. This also implies that they have retained their capacity to borrow money and may en-cash benefits from trading on equity. They have reduced their dependence on debt by decreasing their debt equity ratio to 0.01 in 2018 from 0.04 in 2008. There is a significant and consistent increase in earnings per share of Eicher motors which indicates that the company has managed to make profits during the last decade that gives a positive indication to the investors in terms of capacity and efficiency. However decreasing asset turnover ratio is a major concern for the company as they failed miserably to generate sales by using their assets. Management needs to solve this problem to ascertain high sales that in turn will maximize the wealth of shareholders. Operating profit margin measures the operational efficiency of the company and decreasing margin implies that the company has failed to produce according to their efficiency. They witnessed a quantum jump in operating profit from 2.05% in 2008 to 31.31% in 2018.

CONCLUSION

This study reveals that Eicher motors has performed well almost on all parameters explicitly in higher returns on net worth and capital employed. Low debt to equity also gives signal of low risk and less chances of insolvency. The company has managed to earn higher returns for its shareholders and market seems to be favouring the stock of Eicher motors.

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