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Financial performance analysis of selected steel companies

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Abstract
Financial performance analysis is very useful to provide information about the financial position and performance of an enterprise which is helpful for various users in making economic decisions. Financial statements should be understandable, relevant, reliable and comparable. Many techniques are used for financial performance analysis. Some of these techniques are working capital management, capital structure analysis, cash flow analysis and dividend policy analysis. Capital Structure, cash flow statements and dividend policy of selected steel companies have been analysed. These techniques serve as different components and indicators of financial performance analysis. Working capital is a financial metric which represents operating liquidity available to a business, organisation or other entity, including governmental entity. Along with fixed assets such as plant and equipment, working capital is considered a part of operating capital. Decisions relating to working capital and short-term financing are referred to as working capital management. These involve managing the relationship between a firm's short-term assets and its short-term liabilities.

Keywords: working capital, dividend policy, cash flow, capital structure, working capital management

Introduction

Working Capital

Gross working capital is total of current assets and net working capital is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity has a working capital deficiency, also called a working capital deficit and face problems to perform day to day operations. Working capital can be measured by using different methods.

Net Working Capital = Current Assets − Current Liabilities.

Net Operating Working Capital = Current Assets − Non Interest-bearing Current Liabilities.

Equity Working Capital = Current Assets − Current Liabilities − Long-term Debt.

A company can be endowed with assets and profitability but short of liquidity if its assets cannot readily be converted into cash. Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable and cash.

Management will use a combination of policies and techniques for the management of working capital. These policies aim at managing the current assets (generally cash and cash equivalents, inventories and debtors) and the short-term financing, such that cash flows and returns are acceptable.

Capital Structure- An Introduction

The term ‘capital structure’ is constituted with two words i.e. ‘capital’ and ‘structure’. In accounting, capital refers to the investment in business required for its running while structure is the manner in which anything is constructed. Basically structure is an engineering term, which refers to the arrangement of various components in some standard proportion of a building structure. As such, capital structure is mix-up of various sources of capital. Capital structure is the mixture of sources of funds utilised by a firm (debentures, preference shares and equity shares), i.e. a mix of a company’s long-term debt, specific short-term debt, equity shares and preference shares. The capital structure shows how a firm finances its overall operations and growth by using different sources of funds. Capital structure is a business finance term that describes the proportion of a company’s capital, or operating money, that is obtained through debt and equity.

Debt includes loans and other types of credit that must be repaid in the future, usually with interest. Equity involves selling a partial interest in the company to investors, usually in the form of stock. In contrast to debt financing, equity financing does not involve a direct obligation to pay dividend and repay the funds. Equity shareholders are the real owner of the business, and are able to exercise some degree of control over the firm/organisation.

Financial experts have different opinion regarding composition of funds in capital structure. Some experts are of the opinion that both long-term as well as short-term funds should be included in capital structure. Shall and Halery states: “The capital structure refers to the proportion of different type of financing used by the firm [1].”

In the words of Moyer, McGuigan and Kretlow, “The amount of permanent short-term, long-term, preferred stock and common stock used to finance a firm constitute the capital structure” [2] Hampton rightly said that, “A firms’ capital structure is the relation between the debt and equity that make up the firm's financing of its assets [3]."

Glautier and Underdown reveals that, "The capital structure may consist of both share capital and loan capital, and represents the long-term capital available to the company, as distinct from short-term capital represented by the credit facilities offered by trade creditors and bank overdrafts [4]."

Weston and Brigham states: "The permanent financing of the firm represented by long-term debt, preferred stock net worth but excluding all short-term credit [5]." In the shape of formula capital structure may be expressed as follows:

Capital Structure = Long-term debt + Net worth.
Or
Capital Structure = Total Assets - Current Liabilities.

Capital Structure Analysis of Steel Industries in India

Capital structure can be analysed with the help of leverage ratios. The leverage or solvency ratios refer to the ability of a concern to meet its long term obligations. Long-term solvency ratios also indicate firm's ability to meet the fixed interest costs and repayment schedules associated with its long-term borrowings. These ratios indicate the degree to which the activities of a firm are supported by creditors' funds as opposed to owners. The relationship of owner's equity to borrowed funds is an important indicator of financial strength.

The greater the proportion of equity funds, the greater the degree of financial strength. Financial leverage will be to the advantage of the ordinary shareholders as long as the rate of earnings on capital employed is greater than the rate payable on borrowed funds. The following ratios serve the purpose of analysing capital structure and to identify the financial strength and risk of steel companies:

- Debt to equity ratio
- Proprietary ratio

Debt to Equity Ratio

This ratio indicates the extent to which debt is covered by shareholders' funds. It reflects the relative position of the equity holders and the lenders and indicates the company's policy on the mix of capital funds.

$$\text{Debt to Equity Ratio} = \frac{\text{Debt}}{\text{Equity}}$$

Debt includes debentures, long term loans and equity includes equity share capital, preference share capital and reserve and surplus.

This ratio shows that for every 1 rupee of shareholders how many rupees of debt are there. In the interest of lenders this should be less but from shareholder point of view this ratio should be more than one. The standard ratio is 2:1. It is clear from the table 1 that no company was able to maintain at the desired level. The position of Essar Steel Limited is poor in comparison with other companies. Its debt equity Ratio was 1.53 in the year 2008-09. Other companies are having very low ratio. SAIL has ratio of 0.54 and JSW Steel Ltd. has ratio of 0.69 in the year 2010-11.

High ratio is also a negative indicator. SAIL is maintaining lowest debt equity ratio which is good but sometimes it is not treated beneficial from shareholders point of view. Concept of trading on equity is very important in this respect. Accordingly optimum utilisation of debt should be made. In view of this ratio of SAIL can also not be said satisfactory.

Table 1: Debt to Equity Ratio of Selected Steel Companies

Name of Companies	Particulars	Mar' 11	Mar' 10	Mar' 09	Mar' 08	Mar' 07
JSW Steel Limited	Debt	11951.34	11585.10	11272.63	7546.53	4173.03
	Equity	17225.27	9706.34	7959.25	7677.25	5399.18
	Ratio	0.69	1.19	1.42	0.98	0.77
Tata Steel Limited	Debt	28301.14	25239.20	26946.18	18021.69	9645.33
	Equity	48444.63	37168.75	29599.53	27145.62	13893.62
	Ratio	0.58	0.68	0.91	0.66	0.69
SAIL	Debt	20165.49	16511.25	7562.83	3045.24	4180.52
	Equity	37069.47	33316.70	27984.10	23004.09	17184.00
	Ratio	0.54	0.50	0.27	0.13	0.24
Essar Steel Limited	Debt	22383.40	18187.24	7311.39	6113.50	6943.24
	Equity	10021.02	9125.36	4775.66	4631.33	4467.95
	Ratio	2.23	1.99	1.53	1.32	1.55

***Source*:** Annual Reports and Accounts of JSW Steel Limited, Tata Steel Ltd., SAIL and Essar Steel Ltd., 2006-07 to 2010-11.

Proprietary Ratio

A variant to the debt to equity ratio is the proprietary ratio which is also known as equity ratio. This ratio establishes relationship between shareholders' funds to total assets of the firm.

$$\text{Proprietary Ratio} = \frac{\text{Shareholders funds}}{\text{Total assets}} \times 100$$

Shareholders fund include share capital and reserves and surplus. Total assets include fixed assets and current assets excluding fictitious assets.

This ratio shows the shareholders fund in relation to total assets. Therefore higher the ratio better the position of the company will be. In view of this Tata Steel Limited has highest proprietary ratio of 54.10 per cent in the year 2010-11, whereas during the year 2006-07 this was 45.04 per cent. This ratio was showing increasing trend which was good indicator. In the year 2007-08 SAIL has highest ratio of 56.36 per cent. Other companies were maintaining good ratio but looking at overall position it was clear that there was fluctuating trend in proprietary ratio.

Table 2: Proprietary Ratio of Selected Steel Companies

Name of Companies	Particulars	Mar' 11	Mar' 10	Mar' 09	Mar' 08	Mar' 07
JSW Steel Limited	Shareholders' funds	17225.27	9706.34	7959.25	7677.25	5399.18
	Total Assets	41558.38	30878.28	28210.25	20577.45	12870.60
	Ratio (%)	41.45	31.43	28.21	37.31	41.95
Tata Steel Limited	Shareholders' funds	48444.63	37168.75	29599.53	27145.62	13893.62
	Total Assets	89551.72	72236.31	67139.09	53689.19	30848.63
	Ratio (%)	54.10	51.45	44.09	50.56	45.04
SAIL	Shareholders' funds	37069.47	33316.70	27984.10	23004.09	17184.00
	Total Assets	76082.99	68391.40	53976.64	40816.68	33726.16
	Ratio (%)	48.72	48.71	51.84	56.36	50.95
Essar Steel Limited	Shareholders' funds	10021.02	9125.36	4775.66	4631.33	4467.95
	Total Assets	36737.04	32239.19	15087.16	14306.45	14828.21
	Ratio (%)	27.28	28.31	31.48	32.37	30.13

***Source*:** Annual Reports and Accounts of JSW Steel Limited, Tata Steel Ltd., SAIL and Essar Steel Ltd., 2006-07 to 2010-11.

Cash flow Analysis of Selected Steel Companies

Cash flow statement may provide considerable information about what is really happening in a business beyond that contained in either the income statement or the balance sheet. Three major financial statements are ordinarily required for external reports an income statement, a balance sheet and a statement of cash flows. The purpose of the statement of cash flow is to highlight the major activities that directly and indirectly impact cash flows and hence affect the overall cash balance. Managers focus on cash for a very good reason without sufficient cash balance at the right time, a company may miss golden opportunities or may even fall into bankruptcy. The cash flow statement answers questions that cannot be answered by the income statement and a balance sheet.

Table 3: Cash Flow Statement of JSW Steel Limited (₹ in Crore)

Particulars	Mar' 11	Mar' 10	Mar' 09	Mar' 08	Mar' 07
Profit Before Taxation	2782.28	2819.65	677.63	2484.12	1915.18
Net Cash Flow from Operating Activity	2042.98	3282.60	4056.12	3551.87	2822.26
Net Cash Used in Investing Activity	-7160.31	-3147.78	-5834.86	-5636.37	-2244.55
Net Cash Used in Financing Activity	5279.39	-246.62	1848.53	2125.77	-384.39
Net Increase/Decrease in Cash and Cash Equivalent	162.06	-111.80	69.79	41.27	193.32
Cash and Cash Equivalent Begin of Year	264.81	376.61	306.82	265.55	49.08
Cash and Cash Equivalent End of Year	426.87	264.81	376.61	306.82	242.40

***Source*:** Annual Reports and Accounts of JSW Steel Limited, 2006-07 to 2010-11.

Table 3 reveals that overall position of the company is good. Profit before tax has increased from ₹1915.18 crore in the year 2006-07 to ₹2782.28 crore in the year 2010-11. The growth rate remained 1.45 times during the period of study. The year 2008-09 witnessed a decline of PBT to ₹677.63. This was a period of recession in world economy. In this period business operating activities were not declined but profits were squished. This is proved that net cash flow-operating activity remained positive during all the five years.

Net cash used in investing activities remained negative during all the five years. It was negative ₹2244.55 crore in the year 2006-07, then increased to negative ₹5636.37 crore in the year 2007-08, it became more negative ₹5834.86 crore in the year 2008-09 and negative ₹3147.78 crore in the year 2009-10. It became negative ₹7160.31 crore in the year 2010-11. Main reason of becoming negative was that JSW Steel Limited was continuously investing huge amount in its new projects, expansion of projects and purchases of fixed assets.

Net cash used in financing activity was fluctuating. It was highest in the year 2010-11 at ₹5279.39 crore before this it was negative ₹246.62 crore in the year 2009-10. Closing balance of cash and equivalent was increasing except in the year 2009-10. JSW Steel Limited should keep close watch on its cash position.

Table 4: Cash Flow Statement of Tata Steel Limited (₹ in Crore)

Particulars	Mar' 11	Mar' 10	Mar' 09	Mar' 08	Mar' 07
Profit Before Taxation	9776.85	7214.30	7315.61	7066.36	6261.65
Net Cash Flow from Operating Activity	8542.72	8369.22	7397.22	6254.20	4896.00
Net Cash Used in Investing Activity	-13288.13	-5254.84	-9428.08	-29318.58	-5429.50
Net Cash Used in Financing Activity	5652.81	-1473.13	3156.42	15848.07	7926.46
Net Increase/Decrease in Cash and Cash Equivalent	907.40	1641.25	1125.56	-7216.31	7392.96
Cash and Cash Equivalent Begin of Year	3234.14	1592.89	465.04	7681.35	288.39
Cash and Cash Equivalent End of Year	4141.54	3234.14	1590.60	465.04	7681.35

***Source*:** Annual Reports and Accounts of Tata Steel Limited, 2006-07 to 2010-11.

Net cash used in investing activities remained negative during all the five years, it was negative ₹5429.50 crore in the year

2006-07, then increased to negative ₹29318.58 crore in the year 2007-08 it decreased to negative ₹9428.08 crore in the year 2008-09, negative ₹5254.84 crore in the year 2009-10. It increased to negative ₹13288.13 crore in the year 2010-11. This amount was negative because Tata Steel Limited was investing amount in fixed assets, projects and investments.

Net cash used in financing activity remained negative during 2009-10. It was highest ₹15848.07 crore in the year 2007-08. Closing balance of cash and equivalent was also at satisfactory level it was lowest ₹465.04 crore in the year 2007-08.

Table 5: Cash Flow Statement of Steel Authority of India Limited (₹ in Crore)

Particulars	Mar' 11	Mar' 10	Mar' 09	Mar' 08	Mar' 07
Profit Before Taxation	7194.31	10132.03	9403.45	11468.73	9423.05
Net Cash Flow from Operating Activity	2156.02	4800.48	6124.26	8378.18	5632.91
Net Cash Used in Investing Activity	-8933.28	-8021.15	-4406.47	-1139.89	-587.53
Net Cash Used in Financing Activity	1817.52	7395.00	2751.30	-3088.68	-1608.19
Net Increase/Decrease in Cash and Cash Equivalent	-4959.74	4174.33	4469.09	4149.61	3437.19
Cash and Cash Equivalent Begin of Year	22439.00	18264.67	13759.44	9609.83	6172.64
Cash and Cash Equivalent End of Year	17479.26	22439.00	18228.53	13759.44	9609.83

Source: Annual Reports and Accounts of SAIL 2006-07 to 2010-11.

On analysing the cash flow statement of Steel Authority of India Limited it is apparent that overall position of the company was good. The profit before tax has increased from ₹9423.05 crore in the year 2006-07 to ₹11468.76 crore in the year 2007-08, then became ₹9403.45 crore in the year 2008-09, ₹10132.03 crore in the year 2009-10 and ₹7194.31 crore in the year 2010-11. Net cash flow-operating activity was also changing in line with profit before tax. It was ₹5632.91 crore in the year 2006-07 and it became ₹8378.18 crore in the year 2007-08, but decreased to ₹6124.26 crore in the year 2008-09, ₹4800.48 crore in the year 2009-10 and ₹2156.02 crore in the year 2010-11.

Net cash used in investing activities remained negative during all the five years, it was negative ₹587.53 crore in the year 2006-07, then increased to negative ₹1139.89 crore in the year 2007-08 and further increased to negative ₹8933.28 crore in the year 2010-11. This amount was negative because Steel Authority of India Limited was investing huge amount in fixed assets and investment.

Net cash used in financing activity remained negative during 2006-07 and 2007-08 at ₹1608.19 crore and ₹3088.68 crore r.espectively.

Table 6: Cash Flow Statement of Essar Steel Limited (₹ in Crore)

Particulars	Mar' 11	Mar' 10	Mar' 09	Mar' 08	Mar' 07
Profit Before Tax	-377.50	72.03	300.81	831.38	683.46
Net Cash Flow from Operating Activity	29.71	92.07	1775.10	2365.24	2010.09
Net Cash Used in Investing Activity	-4585.35	-6221.15	-1286.26	-640.70	-1423.02
Net Cash Used in Financing Activity	4363.33	5961.06	-380.17	-1757.91	-880.00
Net Increase/Decrease In Cash and Cash Equivalent	-192.31	-192.31	108.67	-33.37	-292.93
Cash and Cash Equivalent Begin of Year	340.14	508.16	399.49	432.86	725.79
Cash and Cash Equivalent End of Year	147.83	340.14	508.16	399.49	432.86

Source: Annual Reports and Accounts of Essar Steel Limited, 2006-07 to 2010-11.

Net cash used in investing activities remained negative during all years, it was negative ₹1423.02 crore in the year 2006-07, then became negative ₹640.70 crore in the year 2007-08, it decreased to negative ₹1286.26 crore in the year 2008-09 and further decreased to negative ₹4585.35 crore in the year 2010-11.

Net cash used in financing activity remained negative upto 2008-09 then it became positive after this. Closing balance of cash and cash equivalent also remained at satisfactory level.

Dividend Policy

In the literature of financial management, dividend policy is one of the important decision areas, where a firm has to make a choice between distribution of profit to the shareholders and retaining them back into business for growth and development. The ultimate objective of a firm is the maximisation of its value or that of its shares.

One school consists of people like James E. Walter and Myron J. Gordon, who believe that current cash dividends are less risky than future capital gains. Thus, they say that investors prefer those firms which pay regular dividends and such dividends affect the market price of the share. Another school linked to Modigliani and Miller holds that investors don't really choose between future gains and cash dividends [6].

Dividend payout trends in Selected Steel Companies

Dividend decisions are important for every company, steel companies are not an exception. To analyse the dividend payout trends of steel companies can be analysed with the help of statistical tools. Arithmetic mean, standard deviation, coefficient of variation, correlation coefficient and t-test can be used for such analysis.

The Table 7 analyse the liquidity position and dividend payment practices of Tata Steel Ltd. average capital employed was ₹52881.14 crore. Average current ratio of company was 0.93 which was below the standard ratio of 2, however in the year 2006-07 its current ratio was 1.95 which is very near to standard ratio of 2. In spite of such low average current ratio company has average dividend payout ratio of 20.29 per cent.

Table 7: Dividend Policy Analysis of Tata Steel Ltd.

Years	Current Ratio	Earnings Per Share	Capital Employed	Dividend Per Share	Dividend Payout Ratio
2006-07	1.95	65.28	23538.95	14.59	22.35
2007-08	0.53	66.81	45167.31	16.75	25.07
2008-09	0.64	69.45	56545.71	16.00	23.04
2009-10	0.75	60.26	62407.95	8.57	14.22
2010-11	0.76	75.62	76745.77	12.69	16.78
Mean	0.93	67.48	52881.14	13.72	20.29
Standard deviation	0.52	5.05	18187.15	2.92	4.09
Coefficient of variation	48.36%	7.48%	34.39%	22.28%	20.16%

***Source*:** Annual Reports and Accounts of Tata Steel Industries Limited, 2006-07 to 2010-11.

Variation in dividend per share was very much which is evident by standard deviation of 2.92 and coefficient of variation of 22.28 per cent. Dividend per share of 2009-10 was ₹8.57 only whereas average dividend per share is ₹13.72. Variations in dividend payout ratio were also significant. The standard deviation of dividend payout ratio was 4.09 and coefficient of variation was 20.16 per cent.

The Table 8 depicts the short-term solvency position and dividend payment policies of JSW Steel Ltd. average capital employed was ₹18899.18 crore. Average current ratio of company was 0.58 which was very much low than the standard current ratio of 2. Variation in current ratio was 29.31 per cent, in spite of such low current ratio company has average dividend payout ratio of 11.57 per cent.

Table 8: Dividend Policy Analysis of JSW Steel Ltd.

Years	Current Ratio	Earnings Per share	Capital Employed	Dividend Per share	Dividend Payout Ratio
2006-07	0.85	78.78	9572.21	12.50	15.87
2007-08	0.55	92.42	15223.78	14.00	15.15
2008-09	0.38	24.52	19231.88	1.00	4.08
2009-10	0.45	106.36	21291.44	9.50	8.93
2010-11	0.68	97.16	29176.61	13.42	13.81
Mean	0.58	79.85	18899.18	10.08	11.57
Standard deviation	0.17	29.06	6510.92	4.80	4.46
Coefficient of variation	29.31%	79.85%	34.45%	47.62%	38.55%

***Source*:** Annual Reports and Accounts of JSW Steel Limited, 2006-07 to 2010-11.

Variation in dividend per share was very much which is clear from the fact that dividend per share of 2008-09 was only ₹1 whereas average dividend per share is ₹10.08. The reduction in DPS was due to world economy recession. This fact was also confirmed by standard deviation of 4.80 and coefficient of variation of 47.62 per cent. Similarly, variations in dividend payout ratio were also significant. Dividend payout ratio of 2008-09 was only 4.08 per cent whereas average dividend payout ratio was 11.57 per cent. The standard deviation of dividend payout ratio was 4.46 and coefficient of variation was 38.55 per cent.

Table 9: Dividend Policy Analysis of SAIL

Years	Current Ratio	Earnings Per Share	Capital Employed	Dividend Per Share	Dividend Payout Ratio
2006-07	1.78	15.02	21364.52	3.10	20.64
2007-08	1.81	18.25	26049.33	3.70	20.27
2008-09	1.89	15.28	35546.93	2.60	17.02
2009-10	2.08	16.35	49827.95	3.30	20.18
2010-11	1.93	11.87	57234.96	2.40	20.22
Mean	1.90	15.35	38004.74	3.02	19.67
Standard deviation	0.1	2.08	13678.15	0.47	1.33
Coefficient of variation	5.26%	13.55%	36.00%	15.56%	6.76%

***Source*:** Annual Reports and Accounts of SAIL 2006-07 to 2010-11.

The Table 9 shows the current ratio to describe short term solvency position and dividend payout ratio to describe dividend payment policies of SAIL. Capital employed of 2010-11 was ₹57234.96 crore which was very different from average capital employed of ₹38004.74 crore. Average current ratio of company was 1.90 which was very close to the standard current ratio of 2. Variation in current ratio was very low i.e. 5.26 per cent. In spite of such a good current ratio, company has average dividend payout ratio of only 19.67 per cent. Variation in dividend per share was very low which was evident by a low standard deviation of 1.33 and coefficient of variation of 6.76 per cent. Similarly, variations in dividend per share were also not so significant. The standard deviation of dividend per share was very low 0.47 and coefficient of variation was 15.56 per cent.

Table 10: Dividend Policy Analysis of Essar Steel Ltd.

Years	Current Ratio	Earning Per Share	Capital Employed	Dividend Per Share	Dividend Payout Ratio
2006-07	0.95	3.83	11411.19	Nil	Nil
2007-08	0.88	3.66	10744.83	Nil	Nil
2008-09	1.18	1.62	12087.05	Nil	Nil
2009-10	1.02	0.10	27312.60	Nil	Nil
2010-11	1.51	(0.75)	32404.42	Nil	Nil
Mean	1.11	1.69	18792.02	Nil	Nil
Standard deviation	0.22	1.84	9187.91	Nil	Nil
Coefficient of variation	19.82%	108.88%	48.89%	Nil	Nil

***Source*:** Annual Reports and Accounts of Essar Steel Ltd., 2006-07 to 2010-11.

The Table 10 shows the current ratio to describe short-term solvency position and dividend payout ratio to describe dividend payment policies of Essar Steel Limited. Capital employed of 2010-11 was ₹32404.42 crore which was very high from average capital employed of ₹18792.02 crore. Average current ratio of company was 1.11 which was not so close to the standard current ratio of 2. Variation in current ratio was moderate i.e. 19.82 per cent. In spite of average current ratio, company has nil dividend per share and dividend payout ratio.

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