CHAPTER FIVE

ASSESSMENT OF THE FINANCIAL POSITION OF THE MYSORE PAPER MILLS LIMITED

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5.1 INTRODUCTION:

The financial statement is of immense use in judging the financial condition of a company. Financial analysis is the process of identifying the financial strengths and weaknesses, the most powerful tool in this behalf is the ratio analysis. Ratios are a useful way of presenting the financial information in an easily understandable form. Ratio analysis is used as a device to analyze and interprete the financial health of a firm.

5.2 RATIO ANALYSIS AND ITS INTERPRETATION:

Ratio is a commonly used statistical yardstick that provides a measure of the relationship between two figures. It is a simple arithmetic of the relationship of one number with another. It indicates the quotient of two mathematical things. This relationship can be expressed as percent, time or as a quotient.

The ratio analysis in itself does not convey much of the sense. It does not indicates good or bad condition, but it calls attention to an unusual situation, which must be interpreted in the light of the factual information.

Classification of Ratios:

For the purpose of examining the financial position, the following broadly classified ratios are usually used:

Financial ratios

Liquidity Ratios	Solvency Ratios	Profitability Ratios
(a) Current Ratio	(a) Debt Equity Ratio	(a) Gross Profit Ratio
(b) Quick Ratio	(b) Percentage of Net Worth to Total Assets	(b) Net Profit Ratio
	(c) Percentage of Net Block to Net Worth	

5.3 LIQUIDITY RATIOS:

Two important liquidity ratios are calculated to measure the short-term financial strengths, viz. (1) current ratio, and (2) quick ratio.

(a) Current Ratio:

The current ratio, also called the working capital ratio, is the most widely used ratio. It is the ratio of current assets to current liabilities and is expressed as:

$$\text{Current ratio} = \frac{\text{Total current assets}}{\text{Total current liabilities.}}$$

The generally accepted standard of this ratio is 2:1.

The current ratios of the Mysore Paper Mills Limited for the years 1989-90 to 1993-94 are shown in the following Table.

Table 5.1
Current Assets, Current Liabilities and Current Ratios of the Mysore Paper Mills Limited

(Rs.in lakhs)

Year	Current Assets	Current Liabilities	Current Ratio
1989-90	5678.42	1984.79	2.86:1
1990-91	6913.91	2324.63	2.97:1
1991-92	9341.30	3143.23	2.97:1
1992-93	12205.32	5399.18	2.26:1
1993-94	12716.01	5354.94	2.37:1

A relatively high current ratio is an indication that the firm is liquid and has the ability to pay its current obligations in time as and when they become due.

In the years 1989-90 and 1993-94, the current ratio is more than 2:1, i.e. at that time, the short-term solvency of the Company is considered to be good and the Company can meet its short term-term liabilities.

(b) Quick Ratio:

The quick ratio is another widely used device for judging the short-term debt repaying ability of the business in the near future. The ratio is designed to show the amount of cash available for meeting immediate payments. For calculating this ratio, the total of quick assets are divided by the total of current liabilities. Inventories and pre-paid expenses are not included in the quick assets.

The formula used for calculating the quick ratio cans be expressed as follows:

$$\text{Quick ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities.}}$$

The accepted standard for this ratio is 1:1.

Table 5.2
Quick Assets of the Mysore Paper Mills Limited

(Rs.in lakhs)

Year	Current Assets	Inventory less Prepaid Expen.	Quick Assets
1989-90	5678.42	3926.03	1752.39
1990-91	6913.91	4714.81	2199.10
1991-92	9341.30	6585.11	2756.19
1992-93	12205.32	8359.78	3845.54
1993-94	12716.01	5835.69	6880.32

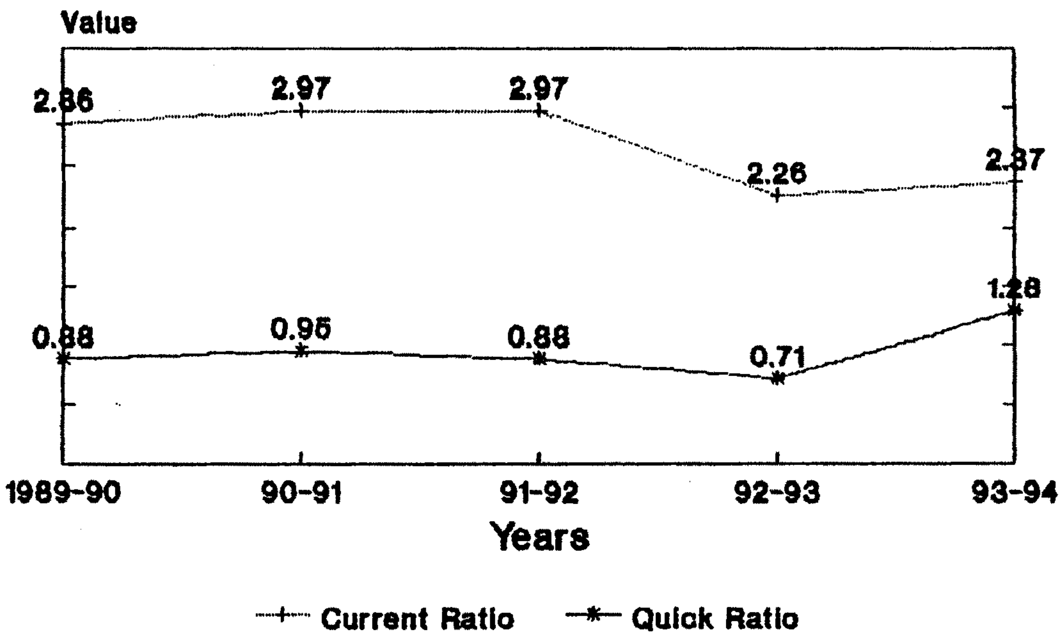
Table 5.3
Quick Ratio of the Mysore Paper Mills Limited

(Rs.in lakhs)

Year	Quick Assets	Current Liabilities	Quick Ratio
1989-90	1752.39	1984.79	0.88:1
1990-91	2199.10	2324.63	0.95:1
1991-92	2756.19	3143.23	0.88:1
1992-93	3845.54	5399.18	0.71:1
1993-94	6880.32	5354.94	1.28:1

Tables 5.2 and 5.3 together indicate the total quick assets and the total current liabilities as well as the quick ratio of the Mysore Paper Mills Limited. During the study period with reference to the standard value of 1:1. The quick

Graph 5.1 (Tables 5.1&5.3) Liquid Ratios



ratio was not satisfactory for four years, namely, 1989-90 to 1992-93, but it became satisfactory in the year 1994.

It is also observed through the comparison between the current ratio and the quick ratio that the inventory has played a significant role in the current assets of the Company.

5.4 SOLVENCY RATIOS:

The term 'solvency ratio' refers to the ability of the firm to meet its long term obligations. It is also called 'capital structure ratio'. These ratios indicate the funds provided by the owners and the creditors. The solvency is judged by calculating the following ratios:

(a) Debt to Equity Ratio:

This ratio is calculated to measure the relative claims of outsiders against the firm's assets. The ratio indicates the relationship between the outside funds and internal funds. The higher debt to equity ratio indicates higher borrowing and lower ratio shows less borrowing by the firm. This ratio indicates the financial stability of the firm. It is calculated as:

$$\text{Debt to Equity Ratio} = \frac{\text{Long-term debt}}{\text{Shareholders' Equity.}}$$

Table 5.4 shows the Mysore Paper Mills Limited's Debt, Equity and Debt-Equity ratio for the study period.

Table 5.4
Debt, Equity and Debt:Equity Ratios of
the Mysore Paper Mills Limited

(Rs. in lakhs)

Year	Debt	Equity	Debt to Equity Ratio
1989-90	17413.75	15610.36	1.16:1
1990-91	15178.37	14190.86	1.06:1
1991-92	14788.99	12735.20	1.16:1
1992-93	15733.33	10986.98	1.43:1
1993-94	10920.48	11835.02	0.92:1

Table 5.4 above records the average debt equity ratio of the Mysore Paper Mills Limited for the five years of study period with reference to the standard value of 1:1. It indicates that the external borrowing was more than the internal sources of finances for the first four years. In the year 1993-94, the ratio has gone below the standard, which indicates that the Company has tapped internal sources of finance. Overall, during the years 1989-90 to 1992-93, the external borrowings of the Company exceeded the shareholders' equity.

(b) Percentage of Net Worth to Total Assets:

This ratio brings out the self-contribution made towards acquiring total assets, i.e. whether it has borrowed much or vice-versa. The ratio is calculated using the formula:

$$\text{Percentage of Net Worth to Total Assets} = \frac{\text{Net Worth*}}{\text{Total Assets}} \times 100$$

*Net Worth = (Share capital + Reserves) less Intangible assets

Graph 5.2 (Tables 5.4) Solvency Ratios

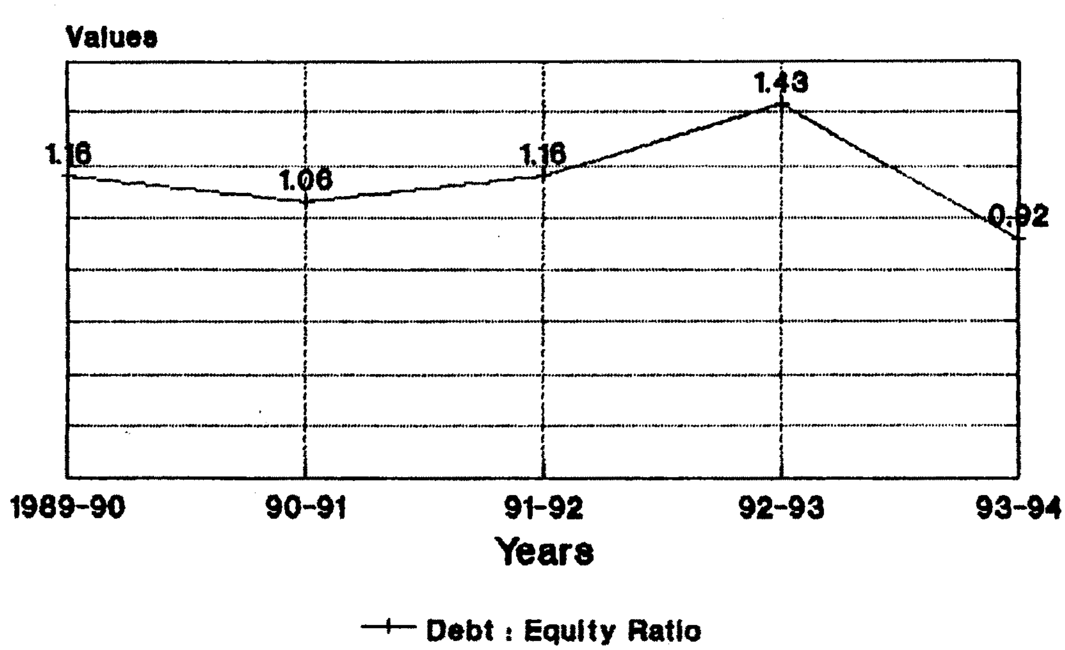


Table 5.5
Percentage of Net Worth to Total Assets Ratio of the Mysore Paper Mills Limited

(Rs.in lakhs)

Year	Net Worth	Total Assets	Ratio (%)
1989-90	15684.10	35227.93	44.52
1990-91	14264.60	31912.89	44.69
1991-92	12808.94	30886.45	41.47
1992-93	11060.72	32338.52	34.20
1993-94	11840.07	28175.56	42.02

Table 5.5 above shows that the Mysore Paper Mills Limited's average percentage of net worth to total assets was 41.38 during the five years 1989-90 to 1993-94. In other words, the Company had raised 58.62% of the finance for acquiring its assets from outside sources.

(c) Percentage of Net Block to Net Worth:

This ratio shows the relationship between fixed assets and own funds. A higher ratio of fixed assets to net worth indicates that the mill is mainly dependent on the outside finance. Excessive dependence on the outside finance results in low working capital. The ratio is calculated as:

$$\text{Percentage of Net Block to Net Worth} = \frac{\text{Fixed Assets}}{\text{Net Worth}} \times 100.$$

Graph 5.3 (Tables 5.5-6) Solvency Ratios

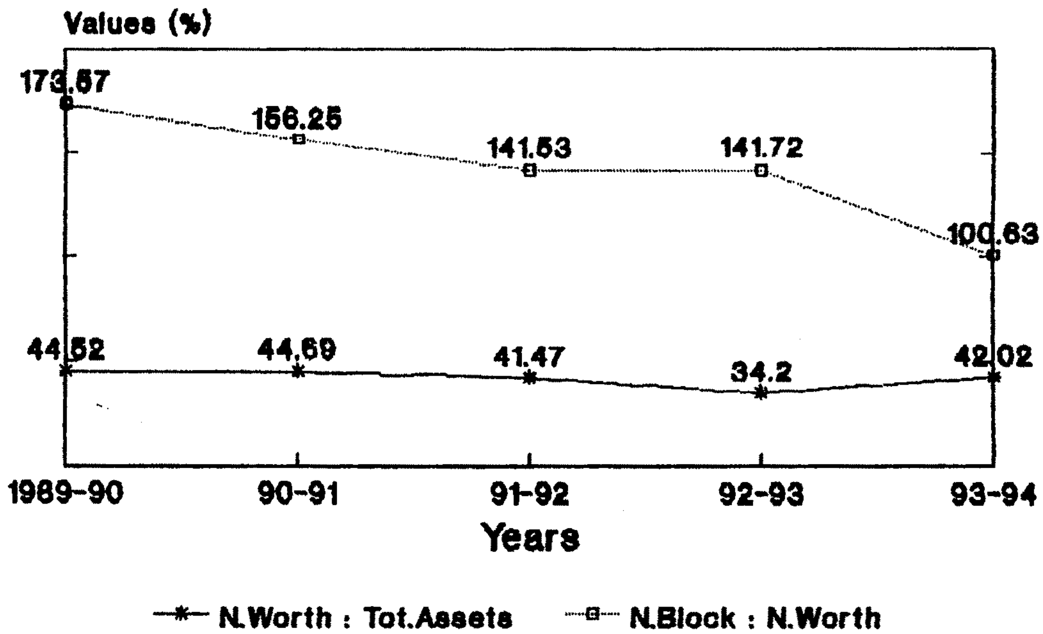


Table 5.6
Net Block, Net Worth and Ratio (%)

(Rs.in lakhs)

Year	Net Block or Fixed Assets	Net Worth	Ratio (%)
1989-90	27223.70	15684.10	173.57
1990-91	22288.68	14264.60	156.25
1991-92	18129.11	12808.94	141.53
1992-93	15676.16	11060.72	141.72
1993-94	11914.35	11840.07	100.63

Table 5.6 above shows that the average percentage of net block to net worth was more, because net block or fixed assets indicate that the Company was mainly dependent on the outside finance during the study period.

5.5 PROFITABILITY RATIOS:

Profitability is an indication of the efficiency of a business enterprises, measured int erms of profit or surplus. Profitability ratio is considered to be the key ratio to measure the overall performance and efficiency. The financial position of an enterprise can be judged by studying the following profitability ratios:

(a) Gross Profit Ratio,

(b) Net Profit Ratio,

(a) <u>Gross Profit Ratio</u>:

The Gross profit ratio measures the relationship of gross profit to sales. It is calculated as:

Gross Profit Ratio = Gross Profit/Sales X 100.

Table 5.7
Gross Profit, Sales and Gross Profit Ratio (%) of the Mysore Paper Mills Limited

(Rs.in lakhs)

Year	Gross Profit	Sales	Gross Profit Ratio (%)
1989-90	-	16277	-
1990-91	4530	16278	27.83
1991-92	3714	19206	19.34
1992-93	2878	19554	14.71
1993-94	3119	25579	12.19

It is seen from the above Table that the gross profitability of the Mysore Paper Mills Limited is decreasing persistently over the study period.

(b) Net Profit Ratio:

The Net profit ratio shows the relationship between the net profit and sales. It indicates the efficiency of the management. The ratio can be calculated as follows:

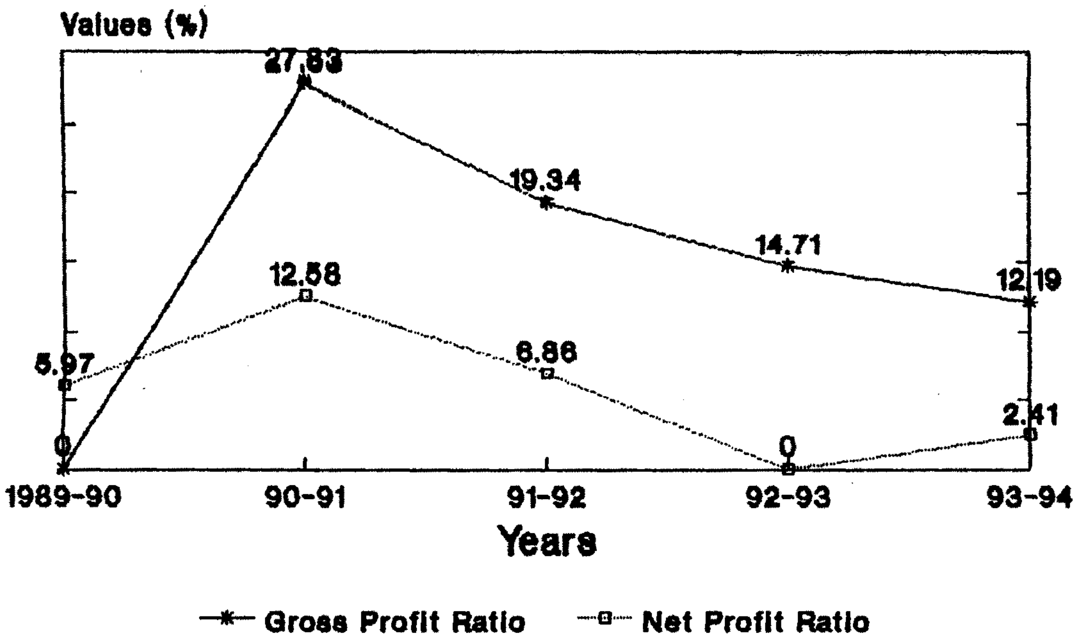
Net Profit Ratio = Net Profit/Sales X 100.

Table 5.8
Net Profit, Sales and Net Profit Ratio of the Mysore Paper Mills Limited

(Rs.in lakhs)

Year	Net Profit	Sales	Net Profit Ratio (%)
1989-90	972.00	16277	5.97
1990-91	2048.00	16278	12.58
1991-92	1318.00	19206	6.86
1992-93	-	19554	-
1993-94	617.00	25579	2.41

Graph 5.4 (Tables 5.7-8) Profit.Ratios



The net profit ratio of the Company for the last five years shows a substantial fluctuation. The Company earned a net profit of 5.97% in the year 1989-90, which increased to 12.58% in 1990-91 but declined to 6.86% the next year and vanished altogether in the year 1992-93. The Company could make only a slight recovery in the year 1993-94 earning a net profit of 2.41%.

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