# Ratio Analysis: A Study on Financial Performance of Ashok Leyland

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**Abstract- Financial ratio analysis is the process of reviewing the financial position of the company. Ratio analysis is extensively used by firms as a technique to forecast the financial soundness of the company to build future growth. This study aims at analyzing the financial performance of Ashok Leyland by calculating financial ratios. The primary objective of this study is to evaluate the performance of Ashok Leyland during the last decade. The reference period taken for study is 10 years starting from 2009 to 2018. Eight Ratios were calculated to serve the purpose of assessing the financial performance of the companythat includes Return on Capital Employed, Return on Net Worth, Debt to Equity, Gross Profit Margin, Asset Turnover, Interest Coverage Ratio, Earnings per Share &Current Ratio. Secondary data was collected from Annual reports of Ashok Leyland to derive relevant information. CR, DR, QR and NPM have direct relation with the company's Performance. DTR and OPM have indirect relation with company's financials. The results reveal that the company has performed reasonably well during the reference period. The company has shown a good potential by earning returns for their shareholders. As a resultreturn on Capital Employed reached to a maximum of from 8.78 in 2009 to 30.91 in 2018.Increasing EPS reveals Company's ability to earn profits therefore maximized returns for the Investors.Declining Debt to Equity have a positive impact on the firm's performance as it depicts that the company used less debt to meet its financial obligations. It also shows, the company will be able to pay off their Loans and Advances in the future.**
**Keywords– Earnings per Share, Financial Ratios, Annual Report, Financial performance.**

## I. INTRODUCTION

Financial ratios are conventional yet powerful tool of analyzing the financial performance of the company. It facilitates the Investors, Creditors and Marketers to have insights on firm's performance. They are used to make predictions about the company's ongoing run and future growth. Primarily ratios are being used by the investors to make inter firm comparisons in order to maximize returns. The ratios are calculated by taking figures from the company's financials. Multiple ratios are calculated to ascertain the ability of an entity to pay debts, generate profits and maximize shareholders wealth.Ratios are broadly classified under five heads named as Profitability, Coverage, Turnover, Liquidity and stability ratios. Profitability ratios are used to estimate the overall profitability of the firm. Coverage ratios are used to ascertain the company's ability to meet their interest obligations. Turnover ratios indicates firm's capability to generate sales by utilizing their assets. Liquidity and stability ratios are calculated to judge the financial position of an entity from long-term and short-term solvency point of view.

## II. LITERATURE REVIEW

Altman (1968) stated the significance of financial ratios in forecasting the performance of the company. His research also claims that conventional financial ratios are no longer used for assessing the financial performance of the company. Hence, in order to enhance the ability of technique a set of financial ratios were combined with discriminant analysis approach and the results were very encouraging further edmister (1972) tests the usefulness of financial ratios in predicting the performance of small enterprises and also stated that not all ratios contributes in forecasting the firm's performance. The research also highlights the ratios that can be useful in forecasting the bankruptcy and financial performance of the organizations.Ohlson (1980) concluded that the predictive power of any model depends on the choice of variables chosen and financial report available and secondly ratios have become robust measure for forecasting financial performance of the firms. So, it becomes necessary to combine this technique with some other models in order to achieve more precise and reliable results further Chen &Shimerda (1981) examined each ratios contains some unique and common factors. Therefore, the study recommends selecting the ratios that capture the common and unique characteristic of an entity and also that provides useful insights on financial performance of an organization.Barnes (1987) stated that financial ratios are used for various purposes. It can be,to ascertain the financial performance of an organization, to check the cash inflows and outflows within the organization, to check firm's ability to make appropriate investments etc. They often compared with established standards to have better idea on financial soundness of the company. Pandya (2012) examined the financial performance of TSL using some financial ratios and stated that the company has done fairly well on some grounds but there are few areas that require sheer attention by the Promoters. Delen, Kuzey&Uyar (2013) analyzed the ratios that are important to check the financial viability of an entity. Ratios like Net Profit Margin, Debt Equity, Asset Turnover, and Leverage Ratios have significant impact on firm's financial performance and also stated that two profitability ratios Earnings before Tax to Equity Ratio and NPM impactscompany's performance the most.

## III. RESEARCH METHODOLOGY

The study is descriptive in nature. Different ratios were calculated to ascertain the financial performance of the company. Data was collected from the secondary sources such as journals and annual report of Ashok Leyland of past 10 years. Bar charts were drawn on Excel to have a better understanding of company's financials over a period of ten years.

## IV. RESEARCH OBJECTIVE

To ascertain the financial performance of the company.
To compare the ratios with the established standards.

## V. ANALYSIS

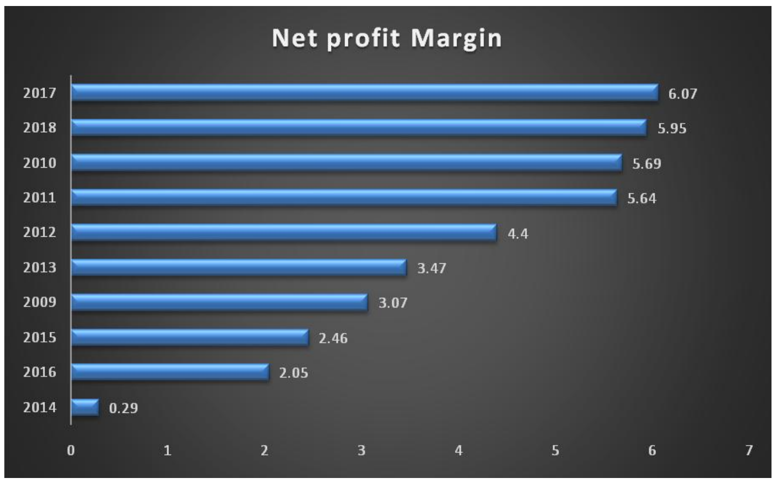


Chart 1
The above chart depicts the firm managed to earn some profits out of sales with a maximum of 6.07 in 2017 and minimum of 0.29 in 2014. The average Net profit margin comes out to be 3.91 with a standard deviation of 1.87. The figures of 2014 raise a serious concern for the investors as company failed to ascertain profits due to decreasing demand. However, company managed to earn profits again as they managed to rise their net profit margin to 2.46 in 2015 from lowest in 2014.

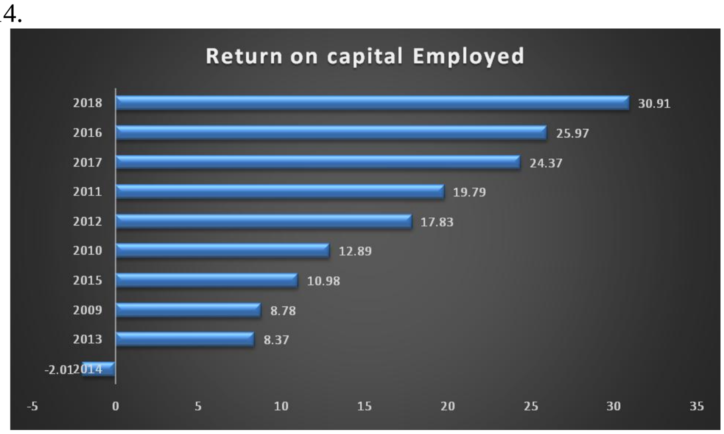


Chart 2
The above chart depicts the firm's ability to generate returns by utilizing their capital. The company managed to earn fair returns by efficiently deploying their resources against investments. However, in 2014 they failed miserably in deploying their assets as the ROACE came out to be -2.01 which is matter of question on the firm's

ability to choose effective investment policies. The average of return on capital employed worked out to be 15.79 with a standard deviation of 9.37.

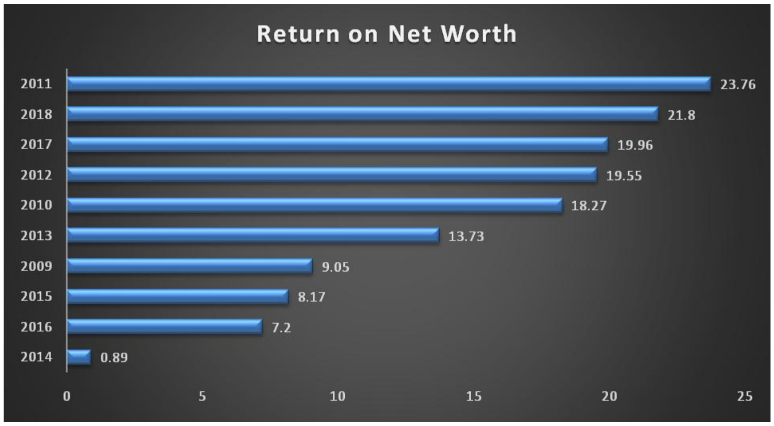


Chart 3

The above chart shows the return investors earned through their investments. The average return on net worth came out to be 14.24 with a standard deviation of 7.19. 2014 can be regarded as the worst year for the shareholders as return on net worth declined to lowest 0.89 in 2014 from 13.73 in the preceding year. However, since then the company managed to maintain a healthy percentage in terms of returns as the ratio jumped significantly from 0.89 to 8.17 in 2015.

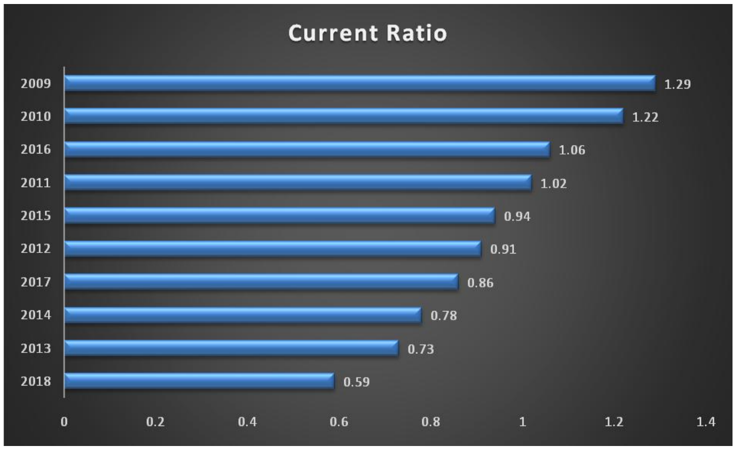


Chart 4

The above chart depicts the company's ability to manage working capital to meet its short term obligations. The average of current ratio came out to be 0.94 with a standard deviation of 0.21. Company has managed to keep its ratio from 0.9 to 1.5 which indicates the firm's ability to meet their short term loans efficiently. However, during 2018 the current ratio fell to 0.59 which indicates a shortage of cash to meet working capital requirements.

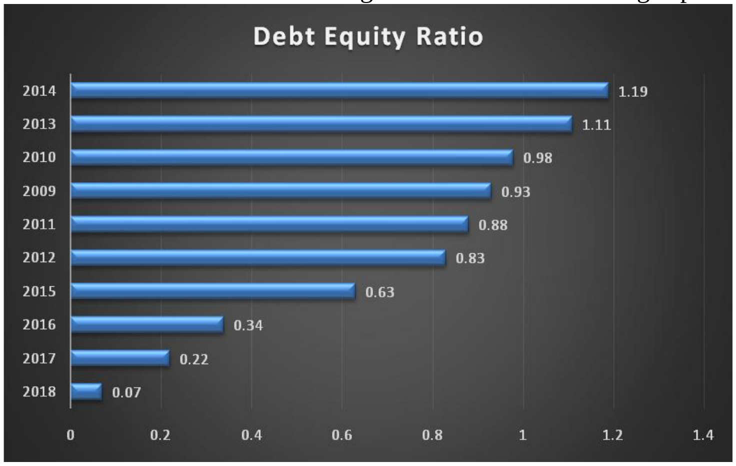

Chart 5

The above chart shows the proportion of the company's assets that are being financed through debt. The average debt-equity ratio worked out to be 0.72 with a standard deviation of 0.37. The decreasing debt-equity ratio indicates the company has been passive in financing its assets using debt. However, 2014 is marked as the highest debt year in which company made maximum use of debt to finance their assets.

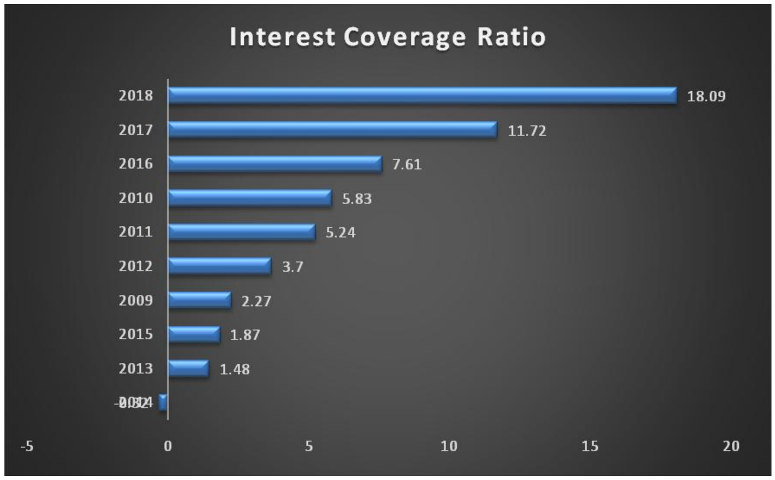


Chart 6

The above chart shows the company's capability to pay their interest obligations. Increasing Interest Coverage Ratio encourages the investors to invest in this company but at the same the figures of 2014 raises concern for the shareholders. Thought the firm has performed well in the past 3 years but the negative results of 2014 raises question on the company's capability to meet their financial obligations. The average of Interest Coverage Ratio was worked out to be 5.75 with a standard deviation of 5.27.

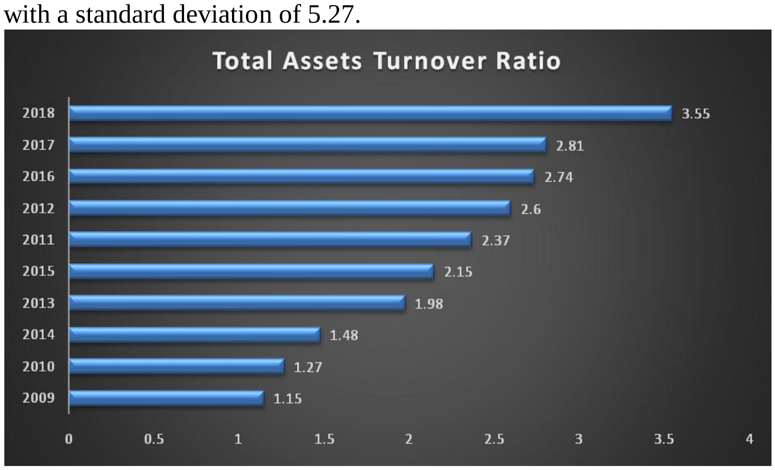


Chart 7

The above chart depicts the company's ability to generate sales by utilizing their assets. Increasing TATR indicates the firm's ability to realize profits using their assets. It also indicates that the firm has efficiently utilized their assets to generate sales. However, there have been instances where the company failed miserably to generate sales out of their assets. The average of Total Assets Turnover Ratio came 2.21 with a standard deviation of 0.72.

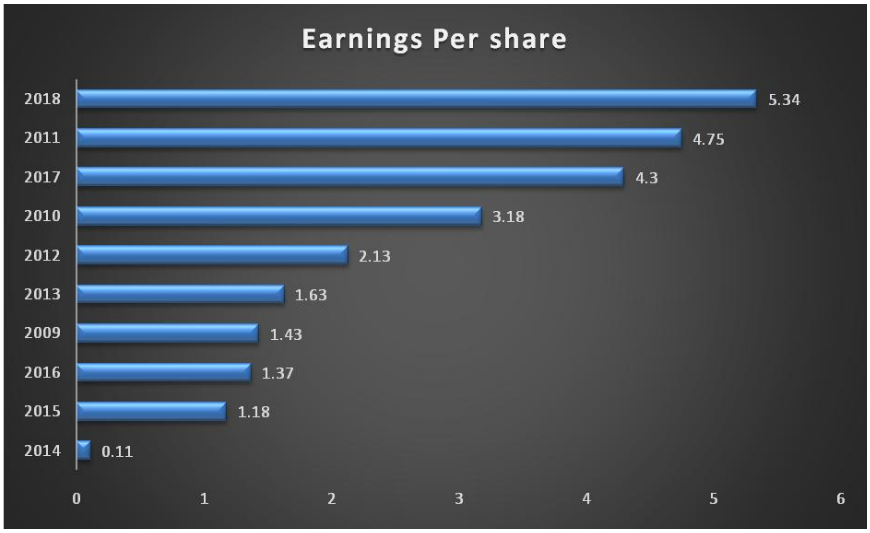


Chart 8

The above chart shows the profitability of the firm. Earnings per Share is used to measure the overall profitability of an organization. However, the above results are not very encouraging from the investor's point of view. The average of EPS turned out to be 2.54 with a standard deviation of 1.66.

## VI. DISCUSSIONS

### *6.1 high net profit margin*

The company showed some consistency in earning profits over a period of 10 years. However, there were few instances where the company failed to make profits. One year that can be pointed out majorly was 2014 where the company saw a collapse in terms of profits due to decreasing demand of trucks which was caused due to a slowdown in the infrastructure industry. Due to this company started giving discounts on heavy motor vehicles thereby affecting the profitability.

### *6.2 increasing return on capital employed*

The company showed good potential by earning returns on their capital as they managed to reach an all-time high of 30.91% in 2018 from negative figures of 2.01% in 2014. The crisis in the infrastructure industry led to a significant contraction in returns as they failed to make good investment opportunities.

### *6.3 increasing return on net worth*

Return on net worth also get affected because recession in infrastructure industry as a result the investors started to pull back their money from the company. Another reason that had a significant impact on company's earnings was entrance of a new company named Bharat Benz. They started to feed the market with made-in-India trucks challenging the 65 year old giant company Ashok Leyland. However, since then the company has recovered as well as they reached to 21.8% in 2018.

### *6.4 decreasing current ratio*

The current ratio helps the investors in identifying the company's ability to manage working capital requirements. During the last 10 years they have shown consistency in maintaining their cash. This indicates the company's decision making ability to meet day to day expenses. However, in 2018, there was a surprise decline in the current ratio as it went on to 0.58 indicating the company may soon require Debt to finance their working capital.

### *6.5 decreasing debt equity ratio*

This ratio is used to evaluate a company's financial leverage. At the time of crisis in 2014, the company used more debt to meet their financial obligations. Since then it has been reduced significantly as it came down to 0.07 in 2018. This indicates that the company is now using their own money to finance their activities and therefore less risk. This is a good sign for the existing stakeholders as well as for the future investors.

*6.6 increasing interest coverage ratio*

There was a significant increase in Interest coverage ratio over a period of ten years. The company has shown some promising results in the past few years as they reached to a new high of 18.09 in 2018. This indicates that the company has something left in it after the crisis of 2014 which had a significant impact on company's financials. The figures also encourages the investors to invest in this company as it promises to earn higher returns for their shareholders.

*6.7 increasing assets turnover ratio*

This ratio implies how efficiently company is able to generate sales by utilizing their assets. The figures have increased three times over a period of ten years from 1.15 in 2009 to 3.55 in 2018 indicating company's potential to generate sales. This also indicates that the company has effectively managed the consumers trust by providing high quality products despite the recession of 2014.

*6.8 increasing earnings per share*

This ratio evaluates the overall profitability of the firm and the results of past 10 years show that the company have done fair job. However, the results are not very encouraging when compared with other company in the same industry. The crisis of 2014 in the infrastructure industry like mine etc. impacted the company's financial as EPS came down to 0.11 in 2014. However, since then the company recovered as they reach to 5.34 in 2018.

## VI. CONCLUSION

The results reveal that the company has performed very well almost on all parameters as the Return on Capital Employed and Net worth went to an all-time high. Decreasing debt- equity ratio indicates low risk and less chances of insolvency in the long run. However, the results also highlights few areas that needs to be considered like current ratio can be a matter of concern for the investors as it directly impacts the company's financial performance. Also, the company has recovered well from the recession of 2014 and the possible reasons could be the policies adopted by the company such as voluntary retirement scheme and sell-off non-core assets has worked well in favor of the company.

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