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ACC502 Financial Reporting and Analysis
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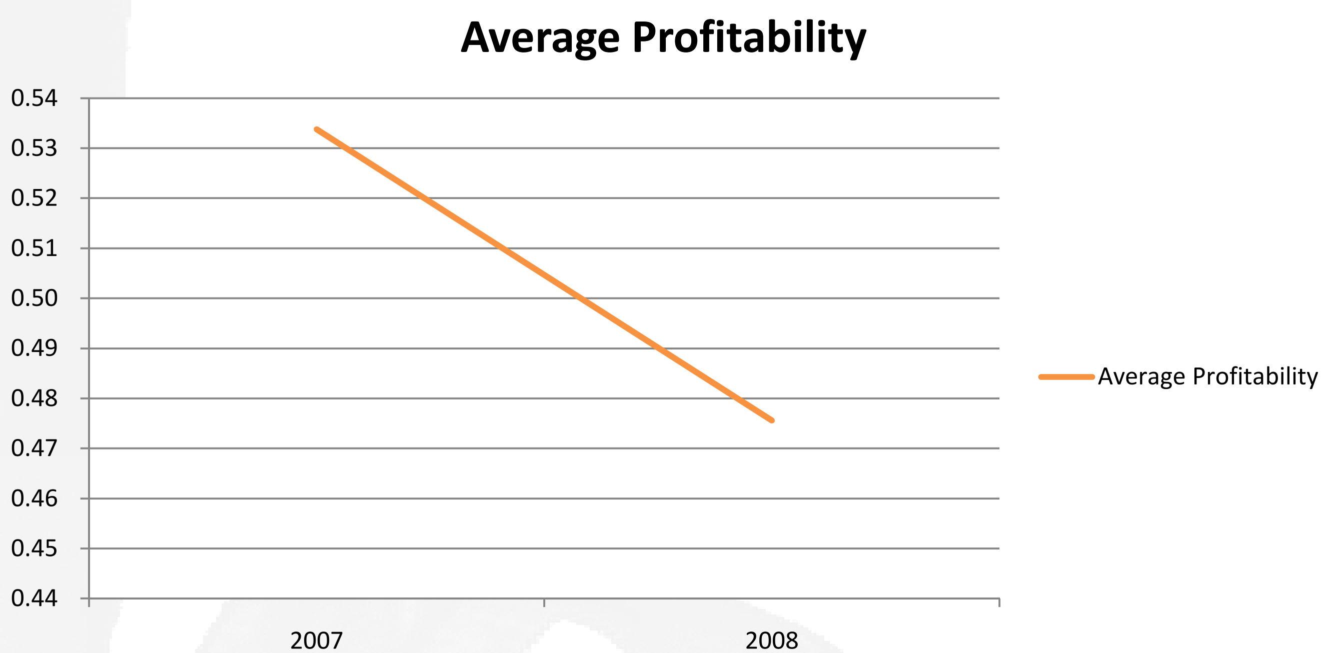
Case 1:

This document, as a proposed investor, using the financial statements of Hindustan Lever Limited (HLL), a fast moving consumer goods company, comment on the profitability, liquidity, activity and how efficient was the management in using the assets employed.

Analysis:



Profitability-wise, the return on equity was 77% in 2007 and decreased in 59% in 2008. Return on assets increased from 36% to 37% from 2007 to 2008. And the earnings per share were 36% in 2006, 47% in 2007 and 46% in 2008.

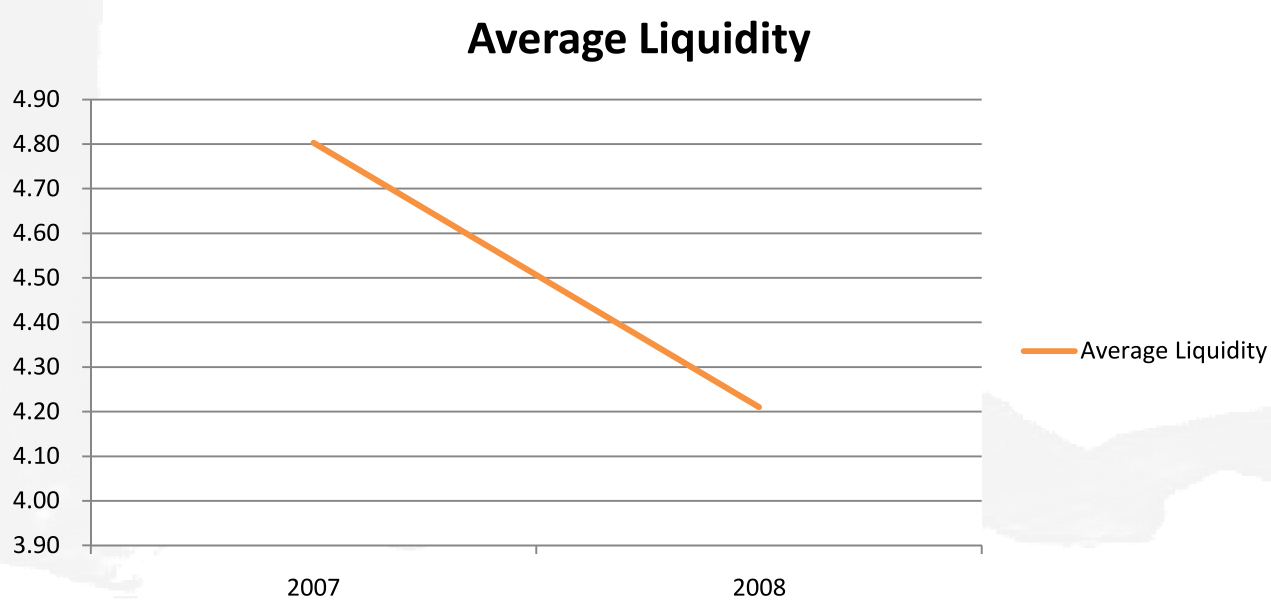
The average profitability in 2007 is 53% and 48% in 2008 were the average industry's average profitability is 34%.

The cost of goods sold decreased 1.6% in 2007. However, it increased 13.8% in 2008. In 2006, it was 63.7%, in 2007 59.5% and 64.1% in 2008 of the net sales. Revenues increased 4.4% in 2007 and 14.4% in 2008. To net sales, revenues were 96% in 2006, 94% in 2007 and 100.7% in 2008.

As the number of shares increased in 2007, calculating the earnings per share, to be conservative, required us to use the new number of shares in all years, including the ones had fewer shares.

When it comes to the price-earnings ratio, we see that it is decreasing as 8.43 times in 2006, 7.96 times in 2007 and 4.55 times in 2008. Comparing it to the average industry, it is much less than 20 times.

Using the Operation index, operation cash flow ratio, and cash flow return on assets to see how the quality of earnings goes, we see that OI is increasing 13% in 2008. Operation CF ratio increases 16% in 2008. And CF return on assets is decreasing 11% in 2008. On average, the quality of earnings increases from 60% to 66%.



Liquidity-wise, it appears that the current and quick ratios are increasing from 2006 to 2008. However, the receivables turnover is decreasing. By taking the average of the three to visualize how they affect the overall liquidity, it appears that this average becomes 480% and 421% in 2007 and 2008 respectively. The average liquidity of the average industry in 2008 is 490%. Using the average method, it appears that Hindustan Lever Limited isn't liquid as much as the average industry is.

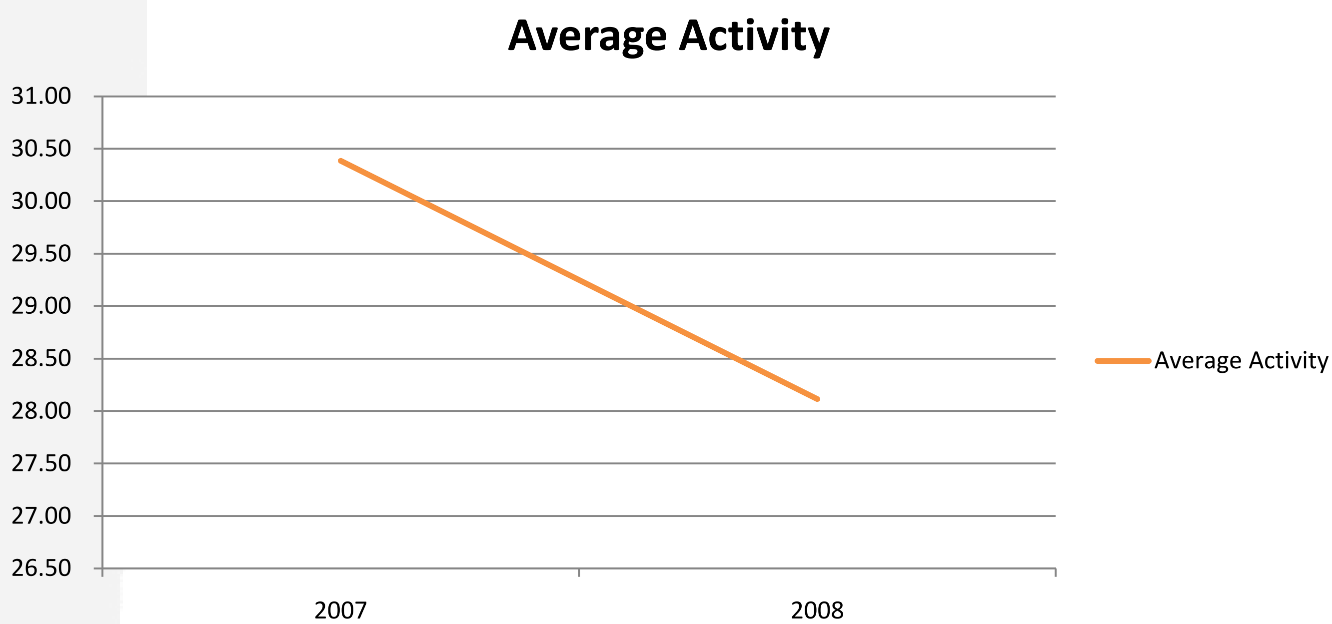
The company's current ratio increased from 1.59, 1.70 to 1.76 in 2006, 2007 to 2008 respectively. The average industry current ratio in 2008 is 1.60. The company's quick ratio increased from 0.60, 0.75 to 0.76 in 2006, 2007 to 2008 respectively. The average industry quick ratio in 2008 is 1.25. The receivables turnover decreased in 2008 from 2007 as from 11.97 to 10.11 where the average industry receivables turnover is 12.

The decrease in the average liquidity was mainly caused by the decrease receivables turnover ratio. However, compared to the average industry, our average liquidity in 2008 was less due to the quick ratio and receivables turnover being both less than the average industry.

As it related to our company's liquidity, we need to take a look at the company's expansion. When taking a look at the Land and Building and Plant and Machinery, we see that they both get increased. PM, in 2007 from 2006, increases 38% and, in 2008 from 2007, increases 31%. LB is also increasing 10% in 2007 from 2006, and 65% from 2008 from 2007. PM, increasingly, became 16% of the total assets where LB, increasingly too, became 8.1% of the total assets. This makes us have "expanding" into consideration.

The company is saving cash as it increased 1% in 2007 and 87% in 2008. Compared to revenues' increase 4% in 2007 and 10% in 2008, it appears that assets some assets' elements were built using liabilities as we see accounts payable and long-term bank borrowings are increasing in 2007 and 2008. However, the accounts payable to total assets was decreasing. Accordingly, the total liability was increasing due to the increase in long-term bank borrowings as its percentage to total assets increased to 16.5% in 2007 and 18.7 in 2008.

The quality of earnings seems to be decreasing as the interest paid ratio was 5% in 2007 and 8% in 2008. The debit interests increased 20% in 2007 and 75.5% in 2008. It is 0.7% in 2006, 0.9% in 2007, and 1.4% in 2008 of the net sales.



Activity-wise, the receivables turnover, as we mentioned, decreased in 2008 from 2007 as from 11.97 to 10.11 where the average industry receivables turnover is 12.

The days to sell inventory decreased from 48.8 to 46.1. This means the company is doing quite effort in selling inventory. However, compared to the average industry, it is still higher than 30 days.

Conclusion

Since the company is expanding, cash savings will result. We noticed that the average liquidity is decreasing in 2007 and 2008. The main cause of this decrease was the receivables turnover. The company needs to perform better on collecting receivables to have better results of liquidity. However, the company's liquidity in 2007 was closer to the average industry's liquidity than 2008 where 2008's liquidity isn't that much far from the average industry's one. This still tells us that our company's liquidity is in the acceptable range.

The company, according to the current ratio, compared to the average industry ratios, able enough to pay its short-term debts.

For the company to save cash, liabilities increases and the shareholders' equity decreases. This, quantitatively, will have a negative impact on the return on shareholders' equity. This will have another negative impact on the interest paid ratio. As the company is borrowing, the interest paid increases.

The cost of goods sold increased in 2008 and the company did not adjust its selling price. This indicates that the company is holding competition, or some elastic products. This, indeed, will have a negative impact on the return on assets. The return on assets, taking advantage of the reduction of other expenses, is increasing and still higher than the average industry ratios, which is even better.

The price-earnings ratio is much higher than the average industry. Based on this, the stock price of underestimated by the market. The cause of this might be one of the following:

- Market gets less attracted to this company because the liabilities are increasing, disregarding the company's expanding.
- The company's non-financial profile is inefficient. I.e. "Al-Bahar companies are, financially, perfect. However, their stock price is low due to Al-Bahar investing history in not supporting his company's during crisis" – By Dr. Osama Al-Hares.

And that is actually negative enough compared to the industry's average which is 20. However, having such liquidity and profitability at this stock price would be considered as a good performance of the company. This means the management is good enough in maintaining their assets, especially while expanding.

Based on the analysis, I suggest:

- Maintain the receivables to get better results. Focusing on receivables to the acceptable range of industry and better will have a better impact on the company's liquidity.

- The liability to assets should not get to a point that moves investors away. Although the company is expanding, liabilities should be maintained better by maintaining alternatives. For example, expenses alternatives increase cash where liabilities can be decreased without affecting the desired cash amount.

- The market value, compared to the industry average, is quite low. The management must consider the reason, either the increase in liabilities or the non-financially reputation or profile reason, and work on eliminating it.