Indian oil and gas sector- financial ratios essay

Business, Industries

INTRODUCTIONThe Oil & Gas industry is the totality of all of the industries involved in the production and sale of fuel, including fuel extraction, manufacturing, refining and distribution. Modern society consumes large amounts of fuel, and the energy industry is a crucial part of the infrastructure and maintenance of society in almost all countries. Oil and gas exploration and production (E&P) companies are unique from a valuation standpoint. Because of this, investors need to focus on a different subset of ratios to analyze the growth and profitability of these companies.

Company revenues are important, but focus should be on netback. The netback is calculated by taking all of the revenues from the oil, less all costs associated with getting the oil to a market. These costs can include, but are not limited to, importing, transportation, production and refining costs, and royalty fees. Oil and gas stocks are broken down into three parts: UpstreamMidstreamDownstreamAn oil and gas company can contain anywhere from one to all three parts. Upstream refers to E&P. The second is midstream. It includes storing, transporting and marketing of oil, natural gas liquids and natural gas. The last is downstream, which is the refining of crude and the distribution of its byproducts.

There are more than 20 companies operating in this sector but in this phase of the report we have taken simple average of ratios of 6 different Oil & Gas companies in India to analyze the overall condition ofthis industry. These 6 companies are Essar India, Cairn India, Bharat Petroleum, ONGC, HPCL and GAIL. CategoryRatioYear IIYear ILiquidity RatiosCurrent Ratio1. 581. 12Quick Ratio1. 340. 84Absolute quick ratio0.

230. 30Activity RatiosDebtors Turnover Ratio15. 4718. 38Inventory Turnover Ratio10.

8510. 92Creditors turnover ratio13. 1711. 61Working capital turnover ratio-15.

21-1. 86Solvency RatiosDebt -equity Ratio0. 940. 83Equity ratio0.

460. 48Interest coverage ratio185. 58584. 44Debt to total capital ratio0. 390. 38Solvency ratio0.

1480. 098Profitability RatiosGross profit ratio0. 320. 14Operating profit ratio0.

220. 13Net profit ratio0. 180. 09Return on equity1. 511.

18ROCE0. 130. 09ROI0. 130. 06PE Ratio-61. 99249.

49EPS28. 6017. 20[APPENDIX]OBJECTIVEOverall objective of this report is to calculate the financial ratios of the Oil & Gas sector as a whole using these 6 companies and analyze the performance of the industry thereof. RATIO ANALYSISLIQUIDITY RATIOLiquidity scenario in the Oil & Gas sector, comprising these 6 companies, has improved from last year. The liquidity position of the industry has moved closer to an ideal current ratio of 2: 1 mainly because of high liquidity position of Cairn India whose current ratio has radically improved to 4. 85 from 1. 74.

While all other companies’ liquidity ratios are lower than the industry average, Cairn India’s liquidity is way above the average. Also it is important to notice that Essar India and GAIL's liquidity position has declined during this period while the industry's average position has improved even in this volatile economic scenario. While Cairn India is the biggest contributor to Industry's improved liquidity position, Cairn India is also the major contributor to the decline in absolute liquidity of the industry which has declined to 0. 23 from 0. 3. This means that Cairn's liquidity has improved mainly in terms of increased trade receivables. While Cairn's current ratio has increased three times, its absolute liquid ratio has declined from 0.

34 to 0. 05 which means that the company is operating through a lot of credit sales. ACTIVITY RATIOOverall operating efficiency of the Oil & Gas Industry has declined drastically in two years. There has been a negative growth in terms of inventory, debtors and credit turnover.

The most concerned fact to notice here is that the industry is facing a situation of working capital deficit which has become worst in the current year. We noticed that Cairn India is operating through a lot of credit sales which is a worrying fact, adding to this problem Cairn India's debtor turnover has drastically declined to 7. 86 from 18. 62. This means that the company's efficiency to turn their debtors into cash has declined when the company is mostly dealing in credit sales. Few companies have shown glimmer hope of improvement in their efficiency like Essar whose overall efficiency has improved this year, but the company is still facing the problem of working capital deficit.

SOLVENCY RATIOBecause of a huge working capital deficit, many companies in the industry were forced to take debt which has increased the debt equity ratio of the industry. While some companies like ONGC, Bharat Petroleum and Essar were paying off their debt, other companies like Cairn, GAIL and HPCL were taking more debt to finance their working capital deficit. This has led to slight increase in debt to total capital ratio and a negligible decline I the equity ratio of the industry.

Since the profitability growth of the industry is limited because of volatile markets and increase of debt in total capital of the companies, the interest coverage capability of the industry has drastically declined from 584. 44 to 185. 58. This is mainly because of Cairn India whose interest coverage ratio fell from 2339. 36 to 101.

56. Earlier Cairn India wasn’t using much debt but later was forced to take more debt and hence cover the interest payments with its limited profits. PROFITABILITY RATIOThe overall profitability of the industry has improved slightly from previous year except the Price Earning ratio which has declined drastically. Except for Essar India, all the companies are earning net profit in the current year.

Cairn India and Essar, both have earned gross profits this year after getting losses last year. Despite of improved profitability, the price earning ratio for the industry has declined from 249. 49 to (61. 99). This is mainly because of Cairn India whose P/E ratio fell straight from 1450. 22 to 3. 54.

This means that the market price of Cairn and other Oil & Gas companies isn’t backed by enough earnings. APPENDIX