

Ratio analysis and risk and return of fmcg industry essay sample

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Companies – ITC, HUL , Nestle India , Dabur , Godrej Consumer Products The Indian FMCG sector is the fourth largest sector in the economy with an estimated size of Rs. 1, 300 billion. The sector has shown an average annual growth of about 11% per annum over the last decade. Unlike the developed markets, which are prominently dominated by few large players, India's FMCG market is highly fragmented and a considerable part of the market comprises of unorganized players selling unbranded and unpackaged products. There are approximately 12-13 million retail stores in India, out of which 9 million are FMCG kirana stores.

Index concentration level:

The index is largely driven by ITC and HUL, as they contribute around 75% to the total index. Both companies have posted good results, thus helping the index to grow despite weak domestic market. If both these companies are excluded then the index comes out to be overvalued by only 7. 82%.

Therefore, the index has high dependency on these two companies. The Union Budget 2012-13 proved to a mixed bag for the FMCG industry. On one hand, minor increase in the tax exemption limits and some incentives on equity investments were positives as this would increase the disposable income levels. But on the other hand, the increase in excise duty more or less offset the above effect. We feel that smaller players would find it difficult to pass on the duty hikes to end consumers and will chose to take the brunt of this hike in a bid to maintain and grow market share. On the other hand, deep-pocket players like Nestle, ITC and HUL with their leadership position and strong brands will be able to pass on the hike to consumers. Going

forward, the easing of raw material prices and appreciation of rupee against <https://assignbuster.com/ratio-analysis-and-risk-and-return-of-fm-cg-industry-essay-sample/>

dollar would help the FMCG companies to maintain their margins in future. With increase in disposable income and favourable government policies, net sales growth is expected to remain robust in coming quarters.

Considering on-going economic uncertainty, we expect that FMCG industry will remain an attractive industry for investment, being a safe haven for investors. FMCG industry, as an investment: FMCG index has consistently given good return to investors over the years. Infact, FMCG index has given a return of 12% in 2011 despite negative returns from Sensex. Going forward, HUL and ITC are expected to record good performance, which could lead to positive impact on the valuation of the overall FMCG index. In FY-11, HUL has changed its business strategy and started focusing on rural market through increase in ad-spends, new launches and expanding distribution network. As a result, it posted good results so far and is expected to deliver good results in coming quarters as well.

ITC, market leader in cigarettes, has benefitted by favourable announcement in the Union Budget-13 wherein the Government increased the excise duty on bidi and other tobacco products which could lead to consumers shifting to cigarettes. With favourable government policies and its focus on growing food processing category, ITC is expected to post good results in coming years. Thus, FMCG index, being a defensive sector, will remain a safe bet for investors. But, as the figure indicates, most of the companies are trading at a premium to their MRPs. Despite this, there are a few fundamentally sound companies in FMCG industry, which are currently available at a good discount from their MRPs (intrinsic value). With the overall economic

situation not expected to change much in the coming quarters, investors would be well-advised to:

Current Ratio for all the firms is below the standard ratio 2: 1. All the firms are following the same trend as they have proportionately same difference between current ratio and quick ratio . Companies have a huge inventory base that holds a major part of current assets.

GCP performed better than all as there is a net increase in cash flow, increasing the company's liquidity to meet its short term liability.

ITC and Nestle India has a very low cash ratio. As Nestle has negative cash flow -44 Crores, although ITC performed well this year with a net cash flow of Rs 55 Crores but they invested in fixed assets and other investments resulted in very low cash.

HUL and Dabur also has a positive cash flow of Rs 694 Crores and Rs 98 Crores respectively, But HUL made investments and dabur has shown an increase over the previous years but not good as compared to its competitors.

Quick ratio of Dabur and GCP has increased over the previous year. GCP's cash ratio is increased from . 05 to . 4 also the current ratio is improved over previous year.

Turnover Ratios

2012-12 2010-11

Inventory Turnover Ratio

Fixed Asset Turnover Ratio

Total Assets Turnover Ratio

Debtor Turnover Ratio

Nestle has the highest inventory turnover ratio of 11.4 and inventory holding period of 31 days. A good inventory turnover ratio indicates that inventories are moving fast and that is required in FMCG industry. All the firms have an inventory ratio above 7 that is a good indication.

HUL has the highest total Assets turnover ratio and fixed assets turnover. GCP, ITC, Nestle made huge investment in 2011-12 that increased their total assets and fixed assets. The sales has also increased but due to investment and increase in fixed assets. Fixed assets and total assets turnover ratio are lower this year but we may see an improvement in the upcoming years where the investment made in fixed assets may help in increasing sales making the good utilization of assets.

Debtor Turnover ratio is high for Nestle 83 times making the average collection period close to 4 days which shows that companies credit policy are good and they are able to generate net capital in a very short time for day-to-day operating activities. The high value shows that management might be strict towards the debtors and playing safe by cash transactions.

Debtor turnover ratio for HUL is 28, Dabur is 17, ITC has 39 and GCP has 35 which shows they are able to collect the cash in maximum 21 days for

Dabur, which is a good indication for FMCG industry. As inventories moves fast they need cash for operating activities.

All the firms have asset management ratio's close to industry average. Nestle has outperformed both the years 2010-11 and 2011-12 as their Debtor turnover ratio is twice of the industry average.

Debt – Management Ratio

2011-12 2010-11

Debt-Equity Ratio

Debt Ratio

Debt- Equity ratio is 0 for HUL and ITC and GCP has 7 times and Nestle has 10 times. As all these firms has very low debt and equity, but higher reserves.

Nestle financed its activities through loan this year and took Rs. 976 Crores as loan and low equity of Rs. 96 Crores made the debt-equity ratio very high. Similarly GCP also took debt in 2011-12 of Rs. 237 Crores but the low equity of Rs. 34 Crores made the debt-equity ratio higher.

So higher value of debt-equity ratio does not mean that the companies are relying mainly on debt.

Debt-Assets ratio / Gearing ratio is below 0. 5 for all the firms indicates that companies are less risky. As they have more assets than debts. In future they can meet their long term liabilities with the value of assets they have.

ITC and HUL has 0 debt-assets ratio, which indicates their strong position in industry. As they are the major players in FMCG industry and are capable enough to meet their assets with reserves and surplus, not relying on debts/equity.

Nestle had 0 debt in 2010-11 and in 2011-12 they financed through loan, which increased debt-equity ratio from 0 to 10. GCP had a higher debt-equity ratio in 2010-11 but it is reduced to 7 in 2011-12. All the other firms maintained low debt ratio and debt-equity ratio in both years.

Profit Margin Ratio

2011-12 2010-11

Gross Profit Margin

Operating Profit Margin

Net Profit Margin

All the firms has Gross profit margin above 45%, but ITC has the highest gross profit margin of 59% which indicates good control of cost-of-goods sold and operating profit margin 35%. But GCP has the highest net profit margin of 20%. For both years 2010-11 and 2011-12 ITC has highest gross profit margin and operating profit margin ratio which indicates their efficient production process. The gross profit margin indicates the efficiency of production and pricing, a higher gross profit margin indicates the firms production process are well working. All the firms have a net profit margin over 10% which shows that industry is performing well.

Profitability Ratios

2011-12 2010-11

Return on Equity

Return on Assets

ROE and ROA is higher for all the firms. GCP leads with 1800% returns, HUL has 1200% , Dabur 200% , ITC 700% , Nestle 1000% return, which is a good sign for investment. As Rs. 1 investment would give a Rs. 18 return. But the companies are not relying much on equity.

ROA is highest for HUL , as the firm is utilizing its assets and has an ROA of 1700%. Other firms also have ROA above 500% , which indicates that they are utilizing the assets very well. As a result the firms are intensively investing in fixed assets as to generate more volumes.

GCP has highest ROE for both years and much above industry average. Risk and Return

NIFTY:

Average daily Market Return| 9. 0381E-05|

Average Annual Return| 2. 28%|

Geometric Mean Return| 1. 000017478|

Variance of Index| | 0. 0001462|

| | | |

Risk Free Return, Rf| | 8. 09%|

HUL:

Average Daily Return of Stock| 0. 001163679|

Average Annual Return| 29. 32%|

Standard Deviation of Daily Stock Return| 0. 014864983|

Variance of Daily Stock Return| 0. 000220968|

Covariance of Stock and NIFTY| 3. 3892E-05|

Geometric Mean Return| 1. 001053876|

BETA (using slope fn)| 0. 232281744|

Required Rate of Return| 6. 74%|

Systematic Risk of Stock| 0. 001987823|

Unsystematic Risk| 0. 053696042|

ITC:

Average Daily Return of Stock| 0. 00017751|

Average Annual Return| 4. 47%|

Standard Deviation of Daily Stock Return| 0. 026776465|

Variance of Daily Stock Return| 0. 000716979|

Covariance of Stock and NIFTY| 6. 83846E-05|

Geometric Mean Return| 0. 999678281|

BETA (using slope fn)| 0. 468678957|

Required Rate of Return| 5. 37%|

Systematic Risk of Stock| 0. 008092792|

Unsystematic Risk| 0. 172585932|

Dabur:

Average Daily Return of Stock| -0. 000291509|

Average Annual Return| -7. 35%|

Standard Deviation of Daily Stock Return| 0. 027196376|

Variance of Daily Stock Return| 0. 000739643|

Covariance of Stock and NIFTY| 4. 95522E-05|

Geometric Mean Return| 0. 999201699|

BETA (using slope fn)| 0. 339609723|

Required Rate of Return| 6. 12%|

Systematic Risk of Stock| 0. 004249205|

Unsystematic Risk| 0. 182140793|

Nestle India:

Average Daily Return of Stock| 0. 001214306|

Average Annual Return| 30. 60%|

Standard Deviation of Daily Stock Return| 0. 015235535|

Variance of Daily Stock Return| 0. 000232122|

Covariance of Stock and NIFTY| 4. 02109E-05|

Geometric Mean Return| 1. 001098493|

BETA (using slope fn)| 0. 275588703|

Required Rate of Return| 6. 49%|

Systematic Risk of Stock| 0. 002798145|

Unsystematic Risk| 0. 055696483|

Godrej Consumer Products:

Average Daily Return of Stock| 0. 001382|

Average Annual Return| 34. 83%|

Standard Deviation of Daily Stock Return| 0. 020148|

Variance of Daily Stock Return| 0. 000406|

Covariance of Stock and NIFTY| 2. 7E-05|

Geometric Mean Return| 1. 001183|

BETA| 0. 185288|

Required Rate of Return| 7. 01%|

Systematic Risk of Stock| 0. 001265|

Unsystematic Risk| 0. 101034|