

SHARE ANALYSIS

-An easy introduction



NANA...



RAHUL! A NEW BICYCLE!

BOUGHT FROM MONEY I EARNED—DIVIDENDS I RECEIVED FROM HIND-MEDIA.



I'M GLAD HIND-MEDIA IS DOING WELL.

AND YOU'LL BE EVEN MORE HAPPY TO KNOW THAT PAPA IS THINKING OF BUYING SHARES.



TO BUY SHARES OR NOT TO BUY...



SACRED MONEY

YOU WOULD NEVER WANT TO RISK THIS PART OF YOUR SAVINGS. YOU MAY KEEP THIS AT HOME UNDER THE MATTRESS OR INVEST IN BANK ACCOUNTS AND IN GOVERNMENT GUARANTEED SCHEMES.

SERIOUS MONEY

THIS PART OF YOUR SAVINGS YOU ARE WILLING TO EXPOSE TO A LITTLE BIT OF RISK. YOU MAY BUY DEBENTURES ISSUED BY HIGH QUALITY COMPANIES, OR YOU COULD INVEST IN FDS OF GOOD CORPORATES.

AGGRESSIVE MONEY

THIS YOU MAY USE TO INVEST IN SHARES OR OTHER RELATIVELY RISKY INVESTMENTS WHICH HAVE A POTENTIAL OF GIVING EXCELLENT RETURNS.

REMEMBER, NO RISK, NO RETURNS. THE GREATER THE AMOUNT OR RISK YOU TAKE THE HIGHER IS THE RETURN YOU CAN HOPE TO GET.

SACRED MONEY AND AGGRESSIVE MONEY

SUPPOSE I AM PREPARED TO TAKE A RISK, A LITTLE RISK WITH A PART OF MY SAVINGS, HOW DO I GO ABOUT DECIDING WHAT TO INVEST IN?



YOU MUST GO FOR A MIXTURE OF BANK ACCOUNTS, UNITS OF MUTUAL FUNDS GOVERNMENT BONDS AND SHARES.



GOVERNMENT BONDS AND BANK ACCOUNTS ARE RELATIVELY RISK FREE. MUTUAL FUNDS ALSO CARRY LOWER RISK. WHAT ABOUT SHARES?



THE TOUGH PART IS SELECTING SHARES.



SOMETIMES, YOU MAY EVEN HAVE TO CONSULT AN INVESTMENT ADVISOR.



COULD YOU ARRANGE FOR ME TO MEET ONE?



NEED FOR EXPERT GUIDANCE

THE NEXT DAY—

VINOD, MEET MY SON, RAJESH AND MY GRANDSON, RAHUL.

SO YOU WANT TO INVEST IN SHARES.

WHILE DECIDING WHICH SHARES TO BUY YOU MUST EVALUATE THREE FACTORS.

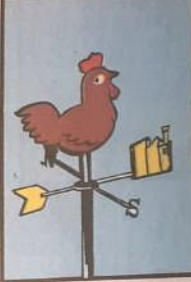


HELLO!

POLITICAL ENVIRONMENT AND MACRO ECONOMIC POLICIES.



INDUSTRY TRENDS.



CORPORATE PERFORMANCE AND MANAGEMENT CAPABILITIES.



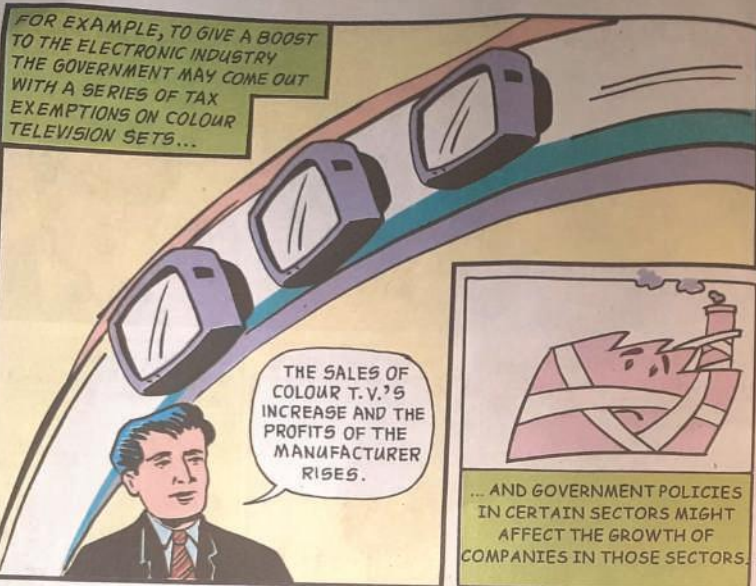
THE GOVERNMENT LAYS DOWN ECONOMIC POLICIES FROM TIME TO TIME. WE SHOULD ASSESS WHAT IMPACT THESE POLICIES WILL HAVE ON THE PRIVATE AND PUBLIC SECTOR AS A WHOLE.



WE MUST ALSO ASSESS HOW GOVERNMENT POLICIES CAN AFFECT A PARTICULAR COMPANY WHOSE SHARES WE ARE INTERESTED IN BUYING.

MAJOR FACTORS AFFECTING SHARES

FOR EXAMPLE, TO GIVE A BOOST TO THE ELECTRONIC INDUSTRY THE GOVERNMENT MAY COME OUT WITH A SERIES OF TAX EXEMPTIONS ON COLOUR TELEVISION SETS...



THE SALES OF COLOUR T.V.'S INCREASE AND THE PROFITS OF THE MANUFACTURER RISES.



... AND GOVERNMENT POLICIES IN CERTAIN SECTORS MIGHT AFFECT THE GROWTH OF COMPANIES IN THOSE SECTORS.



JUST THEN— NO, THANKS. I'LL HAVE MY PEPSI.

WHO HAD HEARD OF PEPSI A FEW YEARS AGO? OR OF AIRTEL AND SAMSUNG?



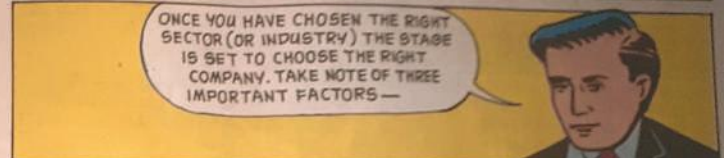
EVEN IN THE MID-1990'S, THERE WERE HARDLY ANY TELECOM COMPANIES FROM THE PRIVATE SECTOR, TODAY TELECOM SERVICES IS GROWING AT A RAPID PACE.

WE MUST THEN INVEST IN COMPANIES IN THE TELECOM INDUSTRY.

GOVERNMENT ECONOMIC POLICIES AND INDUSTRY TRENDS



BUT WHICH ONE OF THOSE COMPANIES? YOUR DECISION HAS TO BE RIGHT NOT ONLY AT THE MACRO LEVEL (TELECOM COMPANIES) BUT ALSO AT THE MICRO LEVEL—WHICH PARTICULAR COMPANY IS THE BEST BET?



ONCE YOU HAVE CHOSEN THE RIGHT SECTOR (OR INDUSTRY) THE STAGE IS SET TO CHOOSE THE RIGHT COMPANY. TAKE NOTE OF THREE IMPORTANT FACTORS —



THE PAST TRACK RECORD OF THE COMPANY, IF ANY.

THE MANAGEMENT AND EXISTING CULTURE OF THE COMPANY.

THE ABILITY OF THE MANAGEMENT TO LEAD THE COMPANY IN THE FUTURE GIVEN ITS TRACK RECORD.



IF THE COMPANY HAS BEEN CONSISTENTLY MAKING PROFITS FOR FIVE OR SIX CONSECUTIVE YEARS...

... IT IS QUITE LIKELY THAT IT WILL CONTINUE TO MAKE PROFITS IN THE FUTURE TOO.

CORPORATE PERFORMANCE

WHAT IF THE COMPANY HAS BEEN MAKING LOSSES FOR SEVEN CONSECUTIVE YEARS AND THE MANAGEMENT PROMISES A 'HUGE PROFIT' NEXT YEAR?



IN SUCH A SITUATION FIND ANSWERS TO THESE QUESTIONS.

DOES THE MANAGEMENT EXPECT A CHANGE IN GOVERNMENT POLICIES THAT WILL ALLOW IT TO RAISE PRICES AND MAINTAIN ITS COST LEVELS SO THAT PROFITABILITY JUMPS SHARPLY?



IS COMPANY X DEVELOPING A NEW PRODUCT THAT WILL FINALLY BE A SUCCESS IN THE MARKET?



HAVE CONSUMERS SWITCHED THEIR PREFERENCES FOR PRODUCTS MANUFACTURED BY RIVAL COMPANIES TO PRODUCTS MANUFACTURED BY COMPANY X? HAS THE MAIN SHAREHOLDER CHANGED ITS ATTITUDE TO COMPANY X OR ITS PHILOSOPHY OF MANAGEMENT AND CONTROL (AND HOW WOULD THIS AFFECT PROFITABILITY)?



BASIS FOR PROMISE

WHAT DO YOU MEAN BY MANAGEMENT STYLE AND CULTURE?

A COMPANY'S PRODUCT MAY BE OF A HIGH QUALITY BUT IF THE MANAGEMENT IS NOT ALIVE TO THE CHANGING TIME, DEMANDS AND COMPETITION, THE PRODUCT WILL FAIL IN THE MARKET.



IN THE 1970'S THE ONLY BATTLE MANAGERS HAD TO FIGHT WAS TO GET PERMIT AND LICENCES. NOBODY BOTHERED ABOUT THE CONSUMER WHO HAD TO BUY WHAT WAS AVAILABLE.



TODAY THERE IS COMPETITION. MANAGERS HAVE TO KNOW WHAT CONSUMERS WANT AND HOW MUCH THEY ARE WILLING TO PAY FOR IT. TODAY'S MANAGER NEEDS TO BE CONSTANTLY IN TOUCH WITH THE MARKET PLACE—CHECKING ON HIS COMPETITORS AND CAREFULLY ASSESSING THE ACCEPTANCE OF HIS PRODUCTS BY CONSUMERS.



WE ARE DOING A SURVEY ON WASHING SOAPS, MADAM. WOULD YOU PLEASE TELL US IF YOU ARE HAPPY WITH THE SOAPS AVAILABLE IN THE MARKET?

NO!

THE INVESTOR HAS TO WORRY ABOUT THE ABILITY OF THE MANAGEMENT TO LEAD THE COMPANY IN THE EVER UNCERTAIN FUTURE.



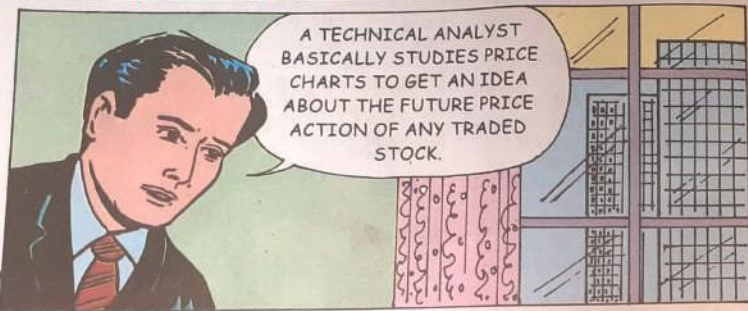
MANAGEMENT CAPABILITIES

Share Analysis

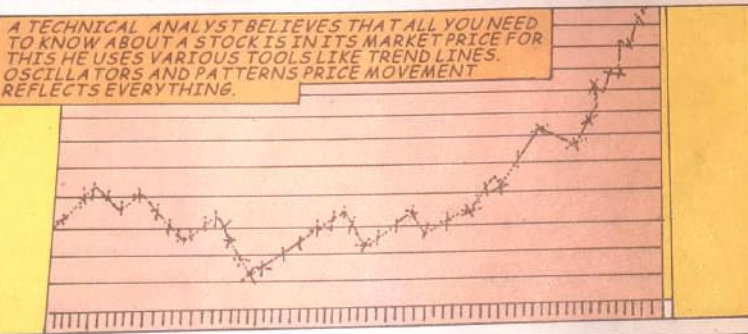


IT'S VERY EASY FOR YOU TO SAY THAT WE MUST ASSESS A COMPANY'S PERFORMANCE. BUT I AM A LAYMAN.

THERE ARE EXPERTS WHO HAVE SPECIALIZED IN THIS FIELD. FOR INSTANCE, TAKE THE HELP OF TECHNICAL ANALYSTS AND FUNDAMENTALISTS.



A TECHNICAL ANALYST BASICALLY STUDIES PRICE CHARTS TO GET AN IDEA ABOUT THE FUTURE PRICE ACTION OF ANY TRADED STOCK.



A TECHNICAL ANALYST BELIEVES THAT ALL YOU NEED TO KNOW ABOUT A STOCK IS IN ITS MARKET PRICE FOR THIS HE USES VARIOUS TOOLS LIKE TREND LINES, OSCILLATORS AND PATTERNS PRICE MOVEMENT REFLECTS EVERYTHING.

CHARTS AND GRAPHS



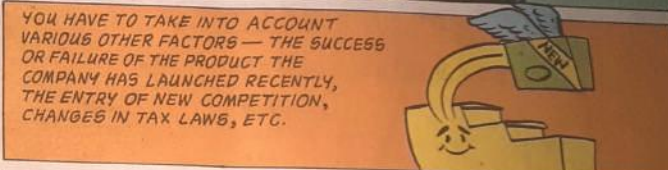
HE THEN ADVISES HIS CLIENTS TO BUY, SELL OR HOLD A SHARE OF A COMPANY.

IT APPEARS TO ME THAT YOUR TECHNICAL ANALYST IS CONCERNED WITH ONLY PAST EVENTS - HOW SHARES PERFORMED YESTERDAY!

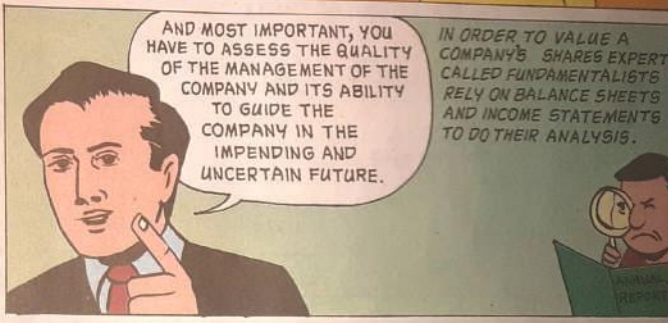


CAN YOU PREDICT HOW THE COMPANY IS GOING TO PERFORM ON THE BASIS OF THESE BEAUTIFUL GRAPHS AND CHARTS?

NO. MERE CHARTS AND GRAPHS ARE NOT ADEQUATE ENOUGH TO PREDICT THE FUTURE PERFORMANCE OF A COMPANY.



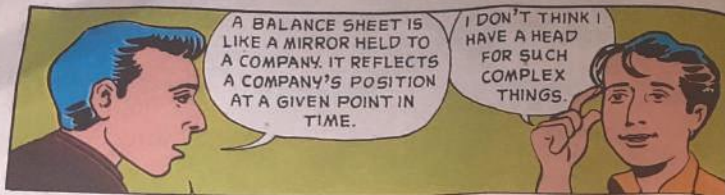
YOU HAVE TO TAKE INTO ACCOUNT VARIOUS OTHER FACTORS - THE SUCCESS OR FAILURE OF THE PRODUCT THE COMPANY HAS LAUNCHED RECENTLY, THE ENTRY OF NEW COMPETITION, CHANGES IN TAX LAWS, ETC.



AND MOST IMPORTANT, YOU HAVE TO ASSESS THE QUALITY OF THE MANAGEMENT OF THE COMPANY AND ITS ABILITY TO GUIDE THE COMPANY IN THE IMPENDING AND UNCERTAIN FUTURE.

IN ORDER TO VALUE A COMPANY'S SHARES EXPERTS CALLED FUNDAMENTALISTS RELY ON BALANCE SHEETS AND INCOME STATEMENTS TO DO THEIR ANALYSIS.

FUNDAMENTAL ANALYSIS



COTTON INDIA LTD.

BALANCE SHEET AS ON DECEMBER 31, 2004

(in Rs Lakhs)

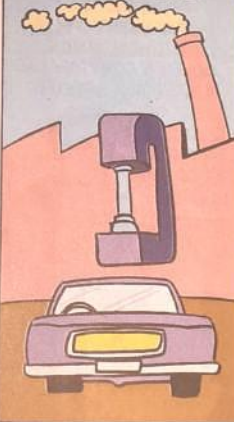


ASSETS	2002	2003
Fixed assets	976.1	971.3
Investments	1.6	0.3
Current assets, Loans and Advances	4223.6	3455.7
Miscellaneous Expenditure	0.5	0.2
Total Assets	5201.8	4427.5
LIABILITIES		
Current Liabilities and Provisions	2440.3	1986.1
Long-term Liabilities	242.5	263.4
Share Capital	1291.1	1291.1
Reserves and Surplus	1227.9	886.9
	5201.8	4427.5

ASSETS AND LIABILITIES

Share Analysis



KINDS OF ASSETS

FIXED ASSETS	INVESTMENTS	CURRENT ASSETS
<p>THE COMPANY MAY OWN PLANTS AND MACHINERY, LAND, AUTOMOBILES, HOUSES, ETC. WHICH ARE COLLECTIVELY KNOWN AS FIXED ASSETS.</p> 	<p>OVER THE YEARS THE COMPANY MAY HAVE BOUGHT SHARES IN OTHER COMPANIES, BONDS ISSUED BY THE GOVERNMENT OF INDIA, OR UNITS ISSUED BY MUTUAL FUNDS. THESE ARE THE "INVESTMENTS" OF THE COMPANY.</p> 	<p>MONEY THAT IS LYING IN BANK ACCOUNTS IN CASH IN THE OFFICES, GOODS THAT ARE LYING AS INVENTORY IN THE WAREHOUSES OR FACTORIES, ETC. ARE KNOWN AS CURRENT ASSETS.</p> 

KINDS OF ASSETS

TYPES OF LIABILITIES

SHORT-TERM LIABILITIES

SHORT-TERM LIABILITIES (OR "CURRENT LIABILITIES") IS WHAT THE COMPANY HAS TO PAY TO CREDITORS WITHIN TWELVE MONTHS;



LONG-TERM LIABILITIES

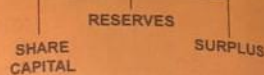
LONG-TERM LIABILITIES IS WHAT THE COMPANY HAS TO PAY TO CREDITORS ONLY AFTER A PERIOD OF TWELVE MONTHS, AND



SHAREHOLDERS EQUITY

SHAREHOLDERS EQUITY (OR NET WORTH) BELONGS TO THE COMPANY'S SHAREHOLDERS. THIS IS EQUIVALENT TO THE SHARE CAPITAL OF THE COMPANY PLUS THE RESERVES AND SURPLUS.

SHAREHOLDERS EQUITY



THE BALANCE SHEET IS A PICTURE OF A COMPANY AT A SPECIFIC POINT IN TIME—USUALLY THE YEAR-ENDING OF THE COMPANY. A COMPARISON OF BALANCE SHEETS OVER A PERIOD OF TIME GIVES YOU A SOURCES AND USES STATEMENT, WHICH DEPICTS CHANGES IN WHAT THE COMPANY OWNS (ITS ASSETS) AND WHAT THE COMPANY OWES (ITS LIABILITIES).



AND WHAT IS AN INCOME STATEMENT?

THE INCOME STATEMENT TELLS YOU HOW MUCH MONEY A COMPANY HAS MADE FOR A SPECIFIC PERIOD OF TIME USUALLY THE FINANCIAL YEAR OF THE COMPANY.



AN EVALUATION OF MANY INCOME STATEMENTS OVER MANY YEARS WILL GIVE A TREND OF THE COMPANY'S SALES, COST OF PRODUCTION, INTEREST CHARGES, NET PROFIT AFTER TAX, ETC.



KINDS OF LIABILITIES

Share Analysis

COTTON INDIA LIMITED

Profit and Loss Account for the period ended December 31, 2003

INCOME

	(In Rs Lakhs)
Net Sales	7918.6
Other Income	0.8
Increase in stock of finished goods and semi-finished goods	0.3
	<u>7919.7</u>

EXPENDITURE

Raw materials and components consumed	3755.8
Purchase of components for sale	280.3
Manufacturing expenses	698.4
Excise duties	342.6
Employees remuneration and benefits	579.3
Administrative, selling and other expenses	504.1
Interest and finance charges	100
	<u>6328.5</u>
Profit before depreciation	1590.1
Depreciation	135.8
Profit before taxation	1454.3
Provision for taxation	790
Net profit after tax	664.3
Provision for dividends	322.7
Net profit carried to balance sheet	341.6

INCOME STATEMENTS

Share Analysis



SINCE MANY COMPANIES HAVE DIFFERENT WAYS OF PRESENTING THEIR BALANCE SHEETS AND INCOME STATEMENTS, THE ANALYST REWRITES THE DATA PRESENTED BY THE COMPANIES IN THEIR OWN WAY. THEY USE ANALYSIS SHEETS SIMILAR TO THE ONE SHOWN HERE TO SUMMARISE THE KEY DATA THAT ENABLES THEM TO VALUE COMPANIES. LET US EXAMINE THESE IN DETAIL.

ANALYSIS SHEET

PAGE ONE

Company's Name: COTTON INDIA LTD.
Year Ending: December 31

	EQUITY	PREFERENCE
Paid-up Capital:	Rs. 12,90,92,000	nil
Number of shareholders	8,340	
Percentage holding of Indian promoters	26%	
Percentage holding foreign collaborators	26%	
Percentage holding of NRIs	5%	
Percentage holding of government institutions	11%	
Percentage holding of general public	32%	
No. of shares with public (floating stock)	41,30,940	
Approximate daily traded volume	70,000 shares	
Daily trading volume as % of floating stock	1.70%	
Listed at	Mumbai	
Objects and activities: Manufacturers textiles, chemicals and foodstuffs		

ANALYSIS SHEET

Share Analysis

GENERALLY, 3 TO 5 YEARS OF PAST DATA IS COLLECTED AND ANALYSED ON THE FOLLOWING LINES.



The first page of the analyst's sheet gives the general data on the company

- (i) the name,
- (ii) year ending,
- (iii) the current paid-up equity share capital of the company and the current paid-up preference share capital of the company,
- (iv) the number of shareholders who hold equity shares and preference shares,
- (v) the shareholding is also broken up to determine how to determine how many shares are held by NRIs, the government etc. - changes in these holdings give the analyst an idea of whether the promoters are buying or selling shares of the company and can be an indication of the faith the promoters and management have in their own company
- (vi) The daily trading volume figures give the analyst an idea of how easy it may be to purchase shares of the company in the stock market.
- (vii) the stock exchange where the company is listed is also noted and, finally,
- (viii) the activities of the company are summarized.

ANALYSIS SHEET I DOES NOT STATE WHAT IS MY EARNING ON THE SHARES I OWN.

YOU WILL FIND THIS INFORMATION IN ANALYSIS SHEET II - EQUITY SHARE DATA.

BY PRESENTING ALL INFORMATION ON A PER SHARE BASIS YOU CAN COMPARE THE PROFITABILITY OF VARIOUS COMPANIES IN THE SAME INDUSTRY AND ALSO IN DIFFERENT INDUSTRIES.



EQUITY SHARE DATA TELLS YOU HOW WELL THE COMPANY IS DOING PER SHARE YOU OWN WHAT PROFITS THE COMPANY IS MAKING PER SHARE YOU OWN AND HOW MUCH OF IT IS BEING PAID TO YOU IN THE FORM OF DIVIDENDS PER SHARE YOU OWN.

THE ANALYSIS SHEET

Share Analysis

EQUITY SHARE DATA

PAGE TWO

Company's Name : COTTON INDIA LIMITED

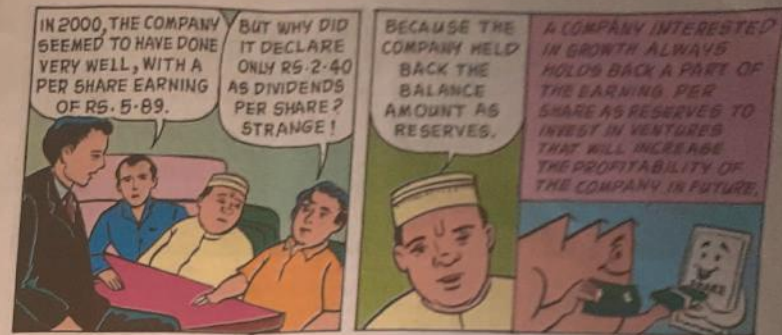
Year ending: December 31

Year ended	1999	2000	2001	2002	2003
Number of shares outstanding (in lakhs)	80.7	80.7	80.7	129.1	129.1
Paid-up value per share	10	10	10	10	10
Not adjusted for bonus/rights					
Number of shares(in lakhs) outstanding constant at	80.7	80.7	80.7	80.7	80.7
Net Sales Per Share	74	82.6	86.05	91.5	98.1
Earnings Per Share	4.31	5.89	6.13	6.64	8.24
Cash Flow Per Share	5.14	6.76	7.54	8.14	9.92
Dividends Per Share	2.4	2.4	2.2	3.52	4
After adjusting for bonus/rights					
Net Sales Per share	74	82.6	86.05	57.2	61.35
Earnings Per Share	4.31	5.89	6.13	4.15	5.15
Cash Flow Per Share	5.14	6.76	7.54	5.09	6.2
Dividends Per Share	2.4	2.4	2.2	2.2	2.5
Market Price (i) High	45	50	67.5	54	95
(ii) Low	35.5	40.3	48.5	45	67.5
Book Value	17.25	20.75	23.85	16.9	19.5
P/E ratio	9.5	8.1	10.8	11.3	16.5
P/Cash Flow Ratio	7.9	7.1	8.6	9.2	13.7
Yield	5.9	5	3.4	4.7	2.9
Market Price to Book Value	2.3	2.3	2.8	2.8	4.4

KEY: ■ Rupees ■ Percentage ■ Ratio

EQUITY SHARE DATA

Share Analysis



WE MUST JUDGE A COMPANY ON THE BASIS OF ITS EARNINGS PER SHARE AND NOT ON THE DIVIDENDS PER SHARE WHICH COULD BE FAR LESS. WHAT A COMPANY RETAINS AS RESERVES, ALSO BELONG TO THE SHAREHOLDERS.

BUT IN 2002 THE EARNING PER SHARE HAS COME DOWN TO RS. 4-15. BAD SIGN, EH?

AND WHEN A COMPANY HAS NO FURTHER USE OF RESERVES IT WILL RETURN IT TO THE SHAREHOLDERS IN THE FUTURE AS BONUS SHARES OR AS DIVIDENDS.

THIS INCREASE IN SHARES IS DUE TO THE ISSUE OF BONUS SHARES IN THE RATIO OF 1:2 I.E., ONE FREE BONUS SHARE FOR EVERY TWO SHARES.

IF WE WERE TO READ JUST THE DATA ON THE ASSUMPTION THAT THE NUMBER OF SHARES OUTSTANDING HAD NOT CHANGED AT ALL BETWEEN 1999 AND 2003 WE SEE A CONTINUOUS UPWARD TREND. A VERY GOOD SIGN.



EARNINGS PER SHARE AND DIVIDENDS PER SHARE

WHAT IS CASH FLOW?

CASH FLOW IS A RELATIVELY LESS USED BUT IMPORTANT RATIO.

CASH FLOW IS A MEASURE OF THE AMOUNT OF CASH AVAILABLE TO THE COMPANY. TO ARRIVE AT THIS YOU HAVE TO ADD BACK ALL THE NON-CASH CHARGES SUCH AS DEPRECIATION TO THE NET PROFIT AFTER TAX. IF THIS FIGURE IS DIVIDED BY THE NUMBER OF SHARES OUTSTANDING, WE GET THE CASH FLOW PER SHARE.

AND WHAT IS DEPRECIATION?

THE COMPANY IS AWARE THAT THE MACHINES IT HAS BOUGHT CANNOT LAST FOR EVER. IT CALCULATES HOW LONG A MACHINE IS LIKELY TO LAST AND EVERY YEAR IT PUTS AWAY A CERTAIN AMOUNT OF MONEY AS DEPRECIATION, THUS MAKING PROVISION FOR PURCHASE OF NEW MACHINES IN THE FUTURE, AS REPLACEMENTS FOR THE OLD. HENCE DEPRECIATION IS A "NON-CASH CHARGE" SINCE THE MONEY IS NOT ACTUALLY GIVEN TO SOMEBODY BUT IS MERELY KEPT ASIDE BY THE COMPANY.

THE DEPRECIATION AMOUNT IS DEDUCTED FROM THE PROFIT BEFORE TAXATION. SOME COMPANIES MAY SHOW VERY LITTLE DEPRECIATION SO THAT THEIR PROFIT COULD LOOK LARGER. WHEREAS, IF OTHER COMPANIES SHOW ACTUAL DEPRECIATION THEIR PROFITS LOOK SMALLER IN COMPARISON.

	Company A	Company B
	Rs.	Rs.
Profit before depreciation	40,000	40,000
Depreciation	-10,000	-2,000
Profit after depreciation	30,000	38,000
Provision For		
Taxation		
Net Profit after tax	30,000	38,000
Depreciation added back	10,000	2,000
Cash flow	40,000	40,000

$$\text{Cash flow per share} = \frac{\text{Cash Flow}}{\text{No. of outstanding shares}}$$

CASH FLOW

THE MARKET PRICE GIVES THE HIGH AND LOW FOR THAT COMPANY'S SHARE IN A PARTICULAR YEAR.

IN 2002 THE COMPANY'S PRICE REACHED A HIGH OF RS. 54 ONLY, WHEREAS IN PREVIOUS YEAR IT WAS RS. 67.50! WHY THE DECLINE?

IN VIEW OF THE BONUS SHARES ISSUED IN THAT YEAR, I THINK THERE IS NO NEED FOR ALARM!

Year	High	Low	Total shares	Total value
2001	67.50	50	100	Rs. 6750
2002	54	35	150	Rs. 4500

WHEN COMPARING THE HIGH AND LOW PRICES OF A COMPANY'S SHARE PRICE OVER A PERIOD OF TIME, IT IS IMPORTANT TO TAKE INTO ACCOUNT ANY RIGHTS OR BONUS ISSUES THAT MAY HAVE OCCURRED DURING THE PERIOD.

IS THERE ANY RELATIONSHIP BETWEEN THE MARKET PRICE OF A SHARE AND THE EARNING PER SHARE?

YES, YES WHEN THE EARNING PER SHARE IS 5.15 AND YOU BUY A SHARE IN THAT COMPANY FOR RS. 86. HOW MUCH ARE YOU PAYING FOR EVERY RUPEE EARNED PER SHARE?

$$\frac{86.00}{5.15} = 16$$

16 TIMES!

THIS RELATIONSHIP IS EXPRESSED BY THE P/E OR PRICE TO EARNING RATIO.

$$\text{P/E ratio} = \frac{\text{Market Price per share}}{\text{earnings per share}} = \frac{86.00}{5.15} = 16$$

THE 'P/E RATIO IS THE MARKET PRICE OF THE COMPANY'S SHARE DIVIDED BY ITS EARNING PER SHARE.

SIMILARLY THE PRICE TO CASH FLOW RATIO MEASURES THE MARKET PRICE OF THE COMPANY'S SHARE DIVIDED BY ITS CASH FLOW.

$$\text{The price to cash flow ratio} = \frac{\text{Market price of the company's share}}{\text{its cash flow}}$$

THE MARKET PRICE, P/E RATIO AND CASH FLOW RATIO

YOU HAVE BEEN SILENT, RAJESH. WHAT IS WORRYING YOU?

SUPPOSE... SUPPOSE A COMPANY WITH HUGE LIABILITIES GOES INTO LIQUIDATION?

O PAPA, YOU ARE SO PESSIMISTIC!

NO, RAHUL. YOUR FATHER IS ONLY CAUTIOUS.

YOUR WORRY IS TAKEN CARE OF BY THE BOOK VALUE.

THE BOOK VALUE IS THE NET WORTH OF THE COMPANY (EQUITY SHARE CAPITAL PLUS RESERVES) DIVIDED BY THE NUMBER OF SHARES OUTSTANDING.

ASSUMING THAT THE COMPANY SUFFERS HEAVY LOSSES AND GOES INTO LIQUIDATION, IT MAY HAVE PROPERTY SUCH AS LAND AND BUILDINGS INCLUDED IN THE BOOK VALUE. THE COMPANY COULD SELL ITS PROPERTY AND PAY OFF DEBTORS.

IF THE MARKET PRICE TO BOOK VALUE IS MORE THAN 1.00, IT MEANS THAT THE MARKET IS VALUING THE COMPANY AT A PRICE HIGHER THAN WHAT THE COMPANY FEELS IT WOULD GET IF IT WERE TO SELL ALL THE ASSETS OF THE COMPANY AND PAY OFF ITS LENDERS.

IF, ON THE OTHER HAND, THE RATIO IS LESS THAN 1.00, IT MEANS THAT THE BREAK-UP VALUE AS CALCULATED BY THE COMPANY EXCEEDS THE VALUE OF THE COMPANY AS DETERMINED BY THE MARKET.

THE ACTUAL VALUE OF ASSETS OWNED BY ANY COMPANY MAY BE DIFFERENT FROM THE BOOK VALUE. FOR EXAMPLE, IF THE COMPANY HAD PURCHASED LAND MANY YEARS AGO, THEN THE CURRENT VALUE OF THE LAND IS PROBABLY MUCH MORE THAN WHAT IS SHOWN IN THE BALANCE SHEET. ON THE OTHER HAND, BECAUSE TECHNOLOGY CHANGES QUITE QUICKLY, ASSETS SUCH AS MACHINES, (WHICH MAY HAVE BEEN BOUGHT MANY YEARS AGO BUT WHICH ARE NOW OBSOLETE) MAY BE WORTH LESS THAN THE VALUE SHOWN IN THE BALANCE SHEET.

BOOK VALUE AND MARKET PRICE TO BOOK VALUE

THE YIELD OF A SHARE INVESTMENT REFERS TO THE AMOUNT OF DIVIDEND INCOME ONE HAS RECEIVED FROM THE COMPANY IN RELATION TO ITS SHARE PRICE.

YIELD = DIVIDENDS RECEIVED PER SHARE / MARKET PRICE PER SHARE = 2.59 / 95.00 = 2.9%

THE YIELD, ACCORDING TO THIS TABLE, IS 2.9% ON A SHARE PRICE OF RS. 86. WHY, EVEN BANK DEPOSITS FETCH US BETTER RETURNS!

BUT RAJESH, THE SHARE WHICH REACHED A HIGH OF RS. 95 IN 2003 WAS AVAILABLE FOR RS. 54 IN 2002 IN ONE YEAR THE SHARE PRICE HAS NEARLY DOUBLED.

WHILE INVESTING IN SHARES ONE IS REALLY LOOKING FOR AN APPRECIATION IN THE SHARE PRICE, NOT ONLY FOR A RETURN FROM DIVIDENDS.

THE YIELD IS REALLY THE "LITTLE EXTRA" THAT ONE GETS FOR INVESTING IN SHARES AND A SORT OF INSURANCE IN CASE THE PRICE OF THIS SHARE DECLINES.

RETURNS FROM SHARE = DIVIDENDS RECEIVED + INCREASE/DECREASE IN PRICE OF SHARES INVESTMENT

YIELD AND RETURNS

INCOME DATA

PAGE THREE

Company's Name: COTTON INDIA LIMITED

Year Ending: December

Year ended	1999	2000	2001	2002	2003
Net sales	5968.7	6657.3	6943.9	7385	7918.6
Operating Profit	830.6	1041.6	1199	1320.3	1446.2
Operating Profit to Sales	13.9	15.6	17.3	17.9	18.3
Capital Expenditure	289.8	280.4	198.7	121.4	138.3
Depreciation	66.5	40.6	114	120.5	135.8
Interest Expenses	74.7	68.6	82.3	89.7	100
Pre-tax Profit	848.1	1060.2	1209.6	1330.9	1454.3
Interest Coverage Ratio	12.4	16.4	15.7	15.8	15.5
Pre-tax Profit to Sales	14.2	15.9	17.4	18	18.4
Effective Tax Rate	58.9	55.2	59.1	59.7	54.3
Net Profit	348.1	475.1	494.6	535.9	664.3
Net Profit to Sales	5.8	7.1	7.1	7.3	8.4

KEY: ■ Rs. In Lakhs ■ Percentage ■ Ratio

INCOME DATA

HAVE A LOOK AT THE INCOME DATA, RAHUL. ARE YOU SATISFIED WITH SALES AND PROFITS?

THE SALES AND OPERATING PROFIT TO SALES HAVE SHOWN A STEADY INCREASE.

ANY DROP IN THE OPERATING PROFIT TO SALES IS A SOURCE OF WORRY TO A FINANCIAL ANALYST SINCE IT MAY INDICATE THAT THE COMPANY'S PRODUCTS ARE NO LONGER PROFITABLE.

BETWEEN 1999 AND 2001 THE CAPITAL EXPENDITURE IN NEW MACHINERY EXCEEDED THE COST OF WEAR AND TEAR OF EXISTING MACHINERY (DEPRECIATION), BUT, SINCE 2002 IT ONLY MATCHES THE DEPRECIATION EXPENSES.

WHEN THE CAPITAL EXPENDITURE MATCHES DEPRECIATION IT MEANS THE COMPANY HAS NO EXPANSION PLANS.

WHEN IT APPEARS THAT THE COMPANY HAS NO PLANS OF EXPANSION ASK THESE QUESTIONS -

HAS THE COMPANY STOPPED EXPANDING BECAUSE IT HAS LOST FAITH IN THE FUTURE OF ITS OWN BUSINESS AND DOES NOT WANT TO INVEST ANY MORE MONEY IN PLANT AND EQUIPMENT? OR, IS THE MARKET FOR ITS PRODUCTS FULLY SATURATED AND, HENCE, THE MANAGEMENT FEELS THAT IT IS POINTLESS INVESTING IN EXTRA MACHINES FOR FUTURE GROWTH?

THE PRE-TAX PROFIT TO SALES FIGURE HAS BEEN INCREASING STEADILY OVER THE YEARS.

SINCE TAX RATES IN INDIA ARE QUITE HIGH, GOOD TAX PLANNING IS IMPORTANT. THE EFFECTIVE TAX RATE MEASURES THE TAX PAID BY THE COMPANY IN RELATION TO ITS PRE-TAX PROFIT.

THERE HAS BEEN A SLIGHT DECLINE IN THE PERCENTAGE OF TAXES PAID TO THE GOVERNMENT. THIS IS GOOD FOR THE SHARE HOLDERS

THE NET PROFIT TO SALES MEASURES THE PROFITABILITY OF THE COMPANY IN RELATION TO ITS SALES OR REVENUES. IN THE CASE OF COTTON INDIA, THIS PERCENTAGE HAS CONSTANTLY BEEN RISING - A GOOD SIGN FOR SHARE HOLDERS.

INCOME DATA

Share Analysis

BALANCE SHEET DATA

PAGE FOUR

Company's Name: COTTON INDIA LIMITED

As on December 31	1999	2000	2001	2002	2003
Cash	264.7	146.5	244.7	432.1	175.5
Current Assets	2724.9	2837.2	2997.7	3455.7	4223.6
Current Liabilities	1859.1	1830.8	1801.7	1986.1	2440.3
Current Ratio	1.5	1.5	1.7	1.7	1.7
Total Assets	3393.7	3722.6	3967.9	4427.5	5201.8
Sales to Assets	1.8	1.8	1.7	1.6	1.5
Return on Assets	12	14	13.3	13.5	15
Deferred Liabilities (LTD)	140	215.7	240.8	263.4	242.5
Net Worth (Shareholders Equity)	1394.6	1676.1	1925.4	2177.4	2518.9
Total Capitalisation	1534.6	1891.8	2166.2	2440.7	2761.5
Debt to Equity Ratio	0.1	0.1	0.1	0.1	0.1
Return on Shareholders Equity	28.1	34.1	29.5	27.8	30.5

KEY: ■ Rs in lakhs ■ Percentage ■ Ratio

BALANCE SHEET DATA

CURRENT RATIO

Share Analysis

WHAT IS THE SALES TO ASSETS RATIO?

THE SALES TO ASSETS RATIO TELLS YOU HOW WELL A COMPANY IS UTILISING ITS ASSETS.

THE SALES TO ASSETS RATIO OF THIS COMPANY SEEMS TO BE RATHER LOW.

BECAUSE THIS IS A MANUFACTURING COMPANY.

COMPANIES ENGAGED IN THE MANUFACTURE OF FERTILISERS, STEEL AND CEMENT HAVE SMALLER SALES-TO-ASSET RATIOS BECAUSE THEY ARE MORE CAPITAL-INTENSIVE, i.e. THEY NEED TO INVEST IN FACTORIES AND MACHINERY UNLIKE THE TRADING COMPANIES. GENERALLY TRADING COMPANIES HAVE HIGH SALES-TO-ASSETS RATIOS BECAUSE THEY HAVE VERY HIGH SALES ON A SMALL ASSET BASE.

AND WHAT IS 'RETURN-ON-ASSETS'?

THE RETURN-ON-ASSETS FIGURES TELLS YOU HOW MUCH MONEY THE COMPANY IS MAKING RELATIVE TO THE TOTAL ASSETS THAT IT OWNS.

THE RATIO TELLS YOU HOW WELL THE COMPANY IS UTILISING ITS ASSETS TO GENERATE PROFITS.

YOU MUST ALSO KNOW THE LIABILITIES OF THE COMPANY YOU ARE INVESTING IN.

DEFERRED LIABILITIES IS NOTHING BUT THE LONG-TERM DEBT (PAYABLE AFTER MORE THAN ONE YEAR) THAT THE COMPANY OWES ITS CREDITORS SUCH AS BANKS (WHO MAY HAVE GIVEN IT LOANS) OR TO INVESTORS (WHO MAY HAVE INVESTED IN FIXED-DEPOSITS OR DEBENTURES ISSUED BY THE COMPANY).

SALES- TO-ASSETS RATIO AND DEFERRED LIABILITIES

AND HOW CAN WE JUDGE WHETHER A COMPANY HAS THE CAPACITY TO EXPAND?

WELL, BY LOOKING AT ITS CAPITAL STRUCTURE.

THE TOTAL CAPITALISATION IS A MEASURE OF ALL THE CAPITAL AVAILABLE TO A COMPANY WHETHER THEY ARE:

1. BORROWED FUNDS PROVIDED BY BANKS AND DEBENTURE-HOLDERS (DEFERRED LIABILITIES), OR
2. FUNDS BELONGING TO ITS SHARE-HOLDERS—THE NET WORTH.

THE LONG-TERM DEBT TO CAPITALISATION RATIO MEASURES THAT PART OF THE COMPANY'S TOTAL CAPITAL WHICH IS BORROWED FUNDS AND HAS TO BE REPAYED.

A LOWER RATIO MEANS THAT THE COMPANY HAS THE CAPACITY TO BORROW MORE. A HIGH RATIO MEANS THAT THE COMPANY HAS A LARGER AMOUNT OF BORROWED FUNDS AND, HENCE, MORE INTEREST TO PAY. MOST COMPANIES IN INDIA HAVE A DEBT-TO-EQUITY RATIO OF 2:1. COMPANIES INVESTING IN HUGE CAPITAL-INTENSIVE PROJECTS SUCH AS STEEL, CEMENT, OR FERTILISER PLANTS HAVE HIGHER DEBT-TO-EQUITY RATIOS.

THE INTEREST COVERAGE RATIO IS A MEASURE OF A COMPANY'S ABILITY TO PAY ITS INTEREST CHARGES.

$$\text{INTEREST COVERAGE} = \frac{\text{PROFIT BEFORE INTEREST AND TAXES}}{\text{INTEREST EXPENSE}}$$

A HIGH RATIO INDICATES A GOOD ABILITY TO PAY INTEREST, HENCE, LESS RISK INVOLVED IN LENDING TO THE COMPANY. A LOW RATIO INDICATES A LOWER ABILITY TO PAY INTEREST, HENCE, MORE RISK INVOLVED IN LENDING TO THE COMPANY.

DEBT RATIOS

THE RETURN ON SHAREHOLDERS EQUITY RATIO TELLS YOU HOW MUCH MONEY THE COMPANY IS EARNING FOR ITS SHAREHOLDERS.

IF, ON THE OTHER HAND, THE EQUITY BASE IS HIGH THEN, FOR THE SAME PROFIT, THE RETURN ON SHAREHOLDERS EQUITY WOULD BE LOW - A DISAPPOINTMENT FOR SHAREHOLDERS.

IF THE EQUITY BASE IS SMALL AND THE COMPANY EARNS A LOT OF MONEY THEN THE RETURN ON NET WORTH FIGURE WOULD BE HIGH.



FOR A SHAREHOLDER, THE RETURN ON EQUITY FIGURES ARE THE MOST IMPORTANT AND HE MUST CAREFULLY ANALYSE FACTORS THAT MAY AFFECT THIS RATIO.



THE RETURN TO A SHAREHOLDER IS A FUNCTION OF THE PROFITABILITY OF THE COMPANY WITH REFERENCE TO ITS SALES - THE HIGHER THE PROFIT, THE HIGHER THE RETURN TO A SHAREHOLDER...



$$\text{RETURN ON EQUITY} = \frac{\text{NET INCOME}}{\text{EQUITY}} = \frac{\text{NET INCOME}}{\text{SALES}} \times \frac{\text{SALES}}{\text{ASSETS}} \times \frac{\text{ASSETS}}{\text{EQUITY}}$$

... A FUNCTION OF HOW WELL THE COMPANY UTILISES ITS ASSETS - THE MORE SALES THE COMPANY CAN GENERATE PER UNIT OF ASSETS, THE HIGHER IS THE RETURN FOR THE SHAREHOLDER...



... A FUNCTION OF HOW MUCH OF THE ASSETS THAT THE COMPANY OWNS IS FINANCED OUT OF BORROWED MONEY RATHER THAN SHAREHOLDER'S MONEY - HIGHER THE LEVERAGE, GREATER THE RETURN FOR THE SHAREHOLDERS.



RETURN ON EQUITY

Share Analysis

BUT WHAT DO ALL THESE NUMBERS MEAN?

A THOROUGH ANALYSIS OF THESE NUMBERS AND RATIOS TELLS HOW WELL A COMPANY HAS DONE IN THE PAST AND, THEREBY HELPS TO MAKE AN ASSESSMENT OF HOW WELL IT COULD DO IN THE FUTURE. REMEMBER, PAST PERFORMANCE MAY NOT CORRECTLY PREDICT THE FUTURE, BUT IT DOES SERVE AS A GUIDE.

WELL, RAHUL, LET'S GET BACK TO WHAT I SAID AT THE BEGINNING. WHEN DECIDING WHICH SHARES TO BUY LOOK AT THREE FACTORS:

1. THE POLITICAL ENVIRONMENT AND ECONOMIC POLICES AT THE NATIONAL LEVEL.
2. THE TRENDS IN A PARTICULAR INDUSTRY.
3. CORPORATE PERFORMANCE AND MANAGEMENT CAPABILITIES.

BUT HOW IMPORTANT ARE THESE NUMBERS? IN WHAT WAY DO THEY INFLUENCE YOUR DECISION ON A COMPANY'S SHARE?



GOOD QUESTION. DIFFERENT ANALYSTS GIVE DIFFERENT WEIGHTAGE TO THE THREE FACTORS. PERSONALLY, I GIVE 25% WEIGHTAGE TO POLITICAL ENVIRONMENT AND INDUSTRY TRENDS, ANOTHER 25% WEIGHTAGE TO MANAGEMENT CAPABILITIES AND THE BALANCE 50% TO THE COMPANY'S PAST PERFORMANCE.

ARE THESE WEIGHTS FIXED FOR ALL COMPANIES.

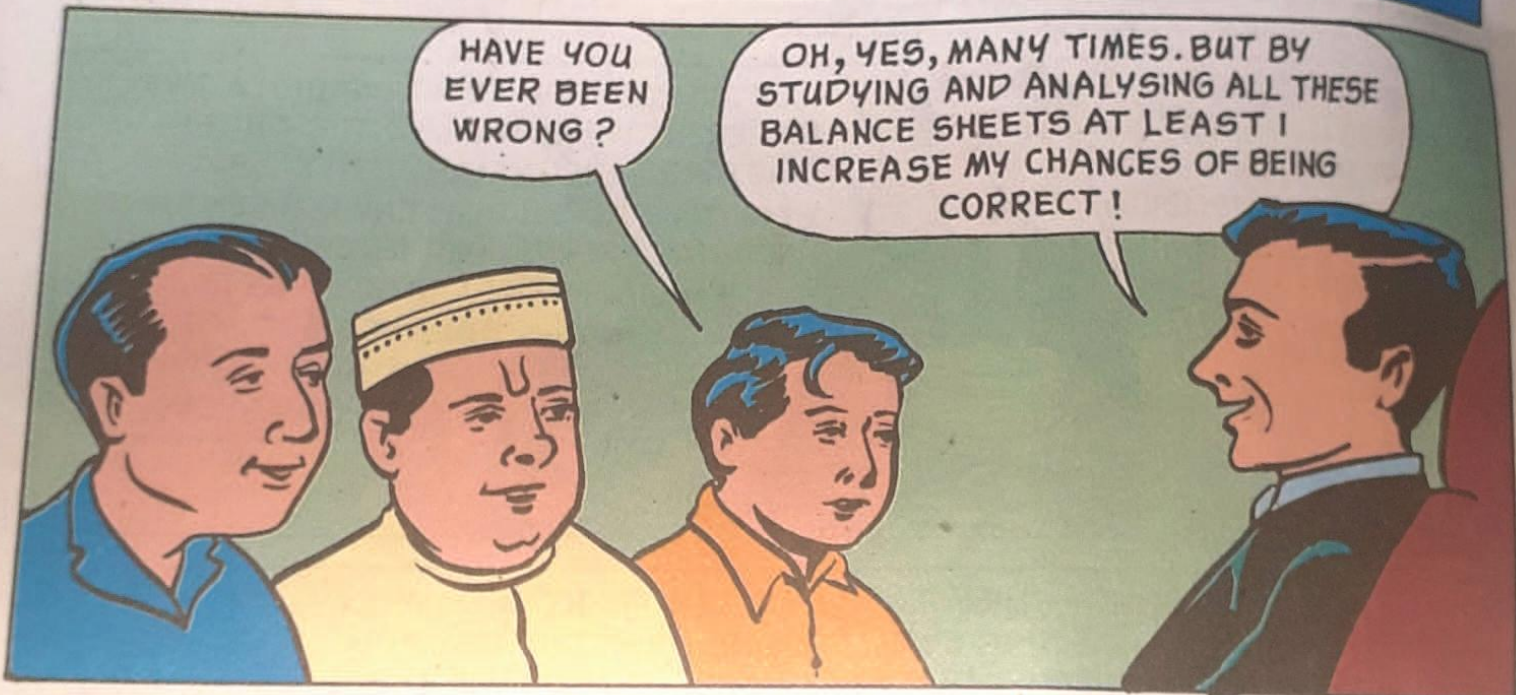
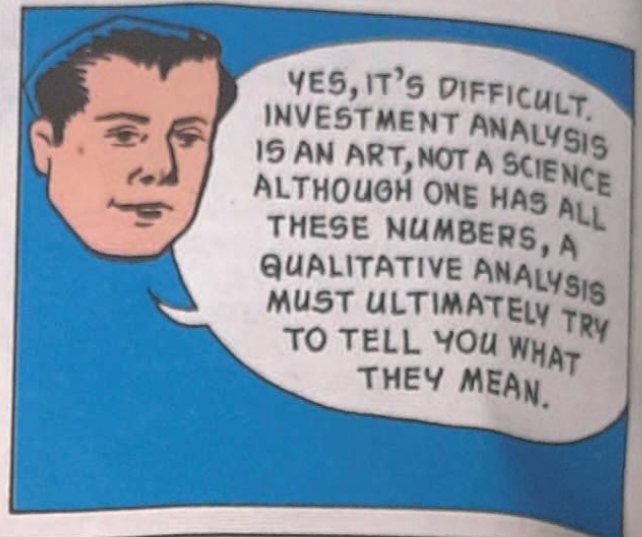
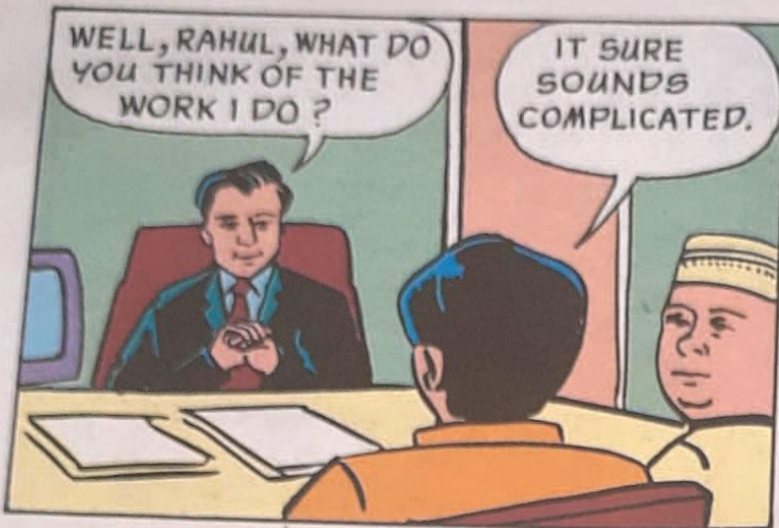


OH, NO - THEY ARE QUITE ARBITRARY. BUT MY LOGIC IS THAT EVEN IF GOVERNMENT POLICIES ARE NOT POSITIVE (BUT NEITHER NEGATIVE) AND IF THE MANAGEMENT IS AVERAGE THEN, AS LONG AS THE COMPANY HAS A DECENT PRODUCT, IT WILL CONTINUE TO BENEFIT AND SHOW GOOD PROFITS (OR LOSE MONEY IF THE PRODUCT IS BAD) - BASED ON THE MOMENTUM OF ITS PAST PERFORMANCE. OTHER ANALYSTS MAY FEEL THAT THE PAST DOES NOT MATTER, BUT THE MANAGEMENT OR GOVERNMENT INCENTIVES CAN WORK MIRACLES WITH A COMPANY'S PERFORMANCE. EVERY ANALYST HAS HIS OWN VIEW.



INTERPRETING NUMBERS

Share Analysis



INVESTMENT, RAHUL, IS RISKY BUSINESS. YOU CAN NEVER BE 100% SURE OF ANYTHING BUT, BY COLLECTING AND ANALYSING ALL SORTS OF DATA, ONE CAN TRY TO MAKE A MORE EDUCATED GUESS ON WHICH SHARES ONE SHOULD BUY OR SELL. YOU MAY NOT BE RIGHT ALL THE TIME, BUT AT LEAST THERE IS A SMALLER CHANCE OF BEING WRONG!



INVESTMENT ANALYSIS - AN ART