Project Dissertation

Financial Statement Analysis:

Hindustan Unilever Limited (HUL)

ITC Limited

Submitted by:

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2K17/MBA/013

Under the Guidance of:

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CERTIFICATE FROM INSTITUTE

This is to certify that the Project Report titled Financial Statement Analysis: Hindustan Unilever Limited (HUL) and ITC Limited**,** is an original and bonafide work carried out by **Ms. Anshu Jain** of MBA 2017-19 batch and was submitted to Delhi School of Management, Delhi Technological University, Bawana Road, Delhi-110042 in partial fulfilment of the requirement for the award of the degree of Masters of Business Administration.

_______________	_______________
Signature of Guide	Signature of Department Head
Dr. Archana Singh	Mr. Rajan Yadav

DECLARATION

I, **Anshu Jain**, student of MBA Batch 2017-19 of Delhi School of Management, Delhi Technological University, Bawana Road, Delhi-110042 declare that Project Report on **Financial Statement Analysis: Hindustan Unilever Limited (HUL) and ITC Limited** submitted in partial fulfilment of Degree of Masters of Business Administration is the original work conducted by me.

The information and data given in the report is authentic to the best of my knowledge.

This report has not been submitted to any other university for the award of any other degree, diploma and fellowship.

Anshu Jain

Place: New Delhi

Date of Submission:

ACKNOWLEDGEMENT

I gratefully acknowledge my profound gratefulness towards my esteemed guide, Dr. Archana Singh, Assistant Professor, Delhi School of Management, DTU, for her invaluable guidance, excellent supervision and constant encouragement during the entire duration of the project work. I am thankful to him to provide me with useful references and information, which were of significant importance for the completion of this study. Her valuable insights and attention to detail made this exercise a great learning experience. I perceive this achievement a milestone in my career development. I strive to use the skills and knowledge gained here in the best possible way and will continue to work on further improvement, in order to attain my desired career objectives. The project would never have been possible without his guidance and supervision.

I also express my sincere thanks to Dr. Rajan Yadav, Head of Department and all the faculty members of Delhi School of Management, DTU, Delhi. I extend my sincere gratitude and thanks to my friends and family for their help and assistance during my training, without whom it would not have been possible for the project to take its final shape. Apart from above, I would like to extend my sincere thanks to all those who filled my questionnaire and helped me in my research.

Sincerely,

Anshu Jain

EXECUTIVE SUMMARY

The report which is based on the Financial Statement Analysis of Hindustan Unilever Limited (HUL) and ITC Limited. By going through all the financial statements it is known that overall ITC Limited is working so well if compared to Hindustan Unilever Limited (HUL). But by going through the financial ratio analysis the facts were that Hindustan Unilever Limited (HUL) is much more competitive than ITC Limited.

HUL generates high sales for every unit of investment in operating assets whereas ITC has a better profit margin as compared to HUL. Low turnover for ITC may be due to the other businesses it is in which requires high investment in operating assets. HUL earns very high on its assets and has better usage of operating efficiency.

This is analyzed through financial analysis that ITC Limited is working so efficiently and effectively and is coming up with new features and advanced technology that others are not using.

In the report summery of both companies, financial statements, Du Point analysis, financial ratios, financial ratio analysis, cash flow are shown and finally the report is concluded and recommendations are given at the end.

TABLE OF CONTENTS

CHAPTER – 1: INTRODUCTION ABOUT THE COMPANY

1.1 Hindustan Unilever Limited

Hindustan Unilever Limited (HUL) is the Indian wing of the Multinational consumer goods company Lever International. It is based in Mumbai, Maharashtra and is owned by Anglo-Dutch Company. Unilever which owns a 67% controlling share in HUL as of March 2015 and is the holding company of HUL. HUL's products include foods, beverages, cleaning agents, personal care products and water purifiers. It is also among the biggest polluters in India.

HUL was established in 1933 as Lever Brothers and, in 1956, became known as Hindustan Lever Limited, as a result of a merger among Lever Brothers, Hindustan Vanaspati Mfg. Co. Ltd. and United Traders Ltd. It is headquartered in Mumbai, India and employs over 16,000 workers whilst also indirectly helping to facilitate the employment of over 65,000 people. The company was renamed in June 2007 as "Hindustan Unilever Limited"

HUL is the market leader in Indian consumer products with presence in over 20 consumer categories such as soaps, tea, detergents and shampoos amongst others with over 700 million Indian consumers using its products. Sixteen of HUL's brands featured in the ACNielsen Brand Equity list of 100 Most Trusted Brands Annual Survey (2014), carried out by Brand Equity, a supplement of The Economic Times.

1.2 ITC limited

Indian Tobacco Company Limited ("**ITC**" or the "**Company**") was incorporated on 24 August 1910 under the name of Imperial Tobacco Company of India Limited and its name was changed to ITC Limited in 1974. Today, the Company is rated among world's most reputable companies by Forbes magazine and among India's most valuable companies by Business Today. It ranks among India's '10 Most Valuable (Company) Brands', in a study conducted by Brand Finance and published by the Economic Times. The Company employs over 31,000 people at more than 60 locations across India and has a diversified presence in FMCG (Cigarettes, food, retail, personal care, education and stationary), Hotels, Paperboards & Specialty Papers, Packaging, Agri-Business, and Information Technology.

CHAPTER 2: SEGMENT REPORTING

Ind AS-108 mandates companies to provide some minimal segmental information. This includes information relating to segmental assets, liabilities, income, expenses, profits or losses and accounting policies. The quality of segment reporting is comparable across both companies. Both the companies report primary and secondary segments as required.Both the companies operate in the FMCG space.

2.1 Hindustan Unilever Limited: Segment Reporting

The Chief Operating Decision Maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the **Management Committee.**

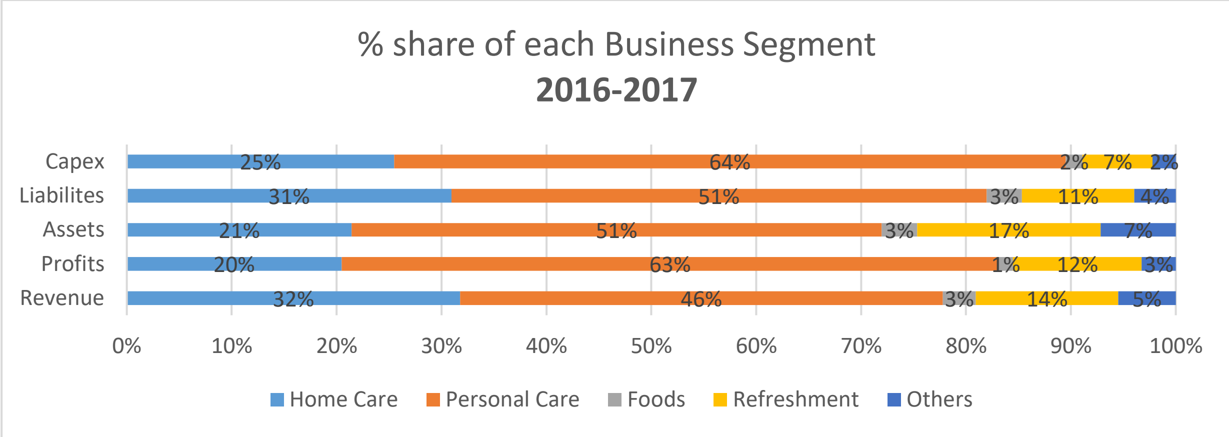
The Group **dominant risk, return and growth profile** is manifested through **business segmentation** (product area) as against geographical segmentation. Hence the primary segment is the business segment.

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risk and returns that are different from those of other business segments.

The CODM has determined the following reporting segments:

1. Home Care include detergent bars, detergent powders, detergent liquids, scourers, water business etc.
2. Personal Care include products in the categories of oral care, skin care (including soaps), hair care, deodorants, talcum powder, color cosmetics, salon services etc.
3. Foods include branded staples (atta, salt, bread, etc.) and culinary products (tomato based products, fruit based products, soups, etc.)
4. Refreshment include tea and coffee and frozen desserts.
5. Others include exports, infant care products etc.

The above business segments have been identified considering: a) the nature of products and services b) the differing risks and returns c) the internal organization and management structure, and d) the internal financial reporting systems.



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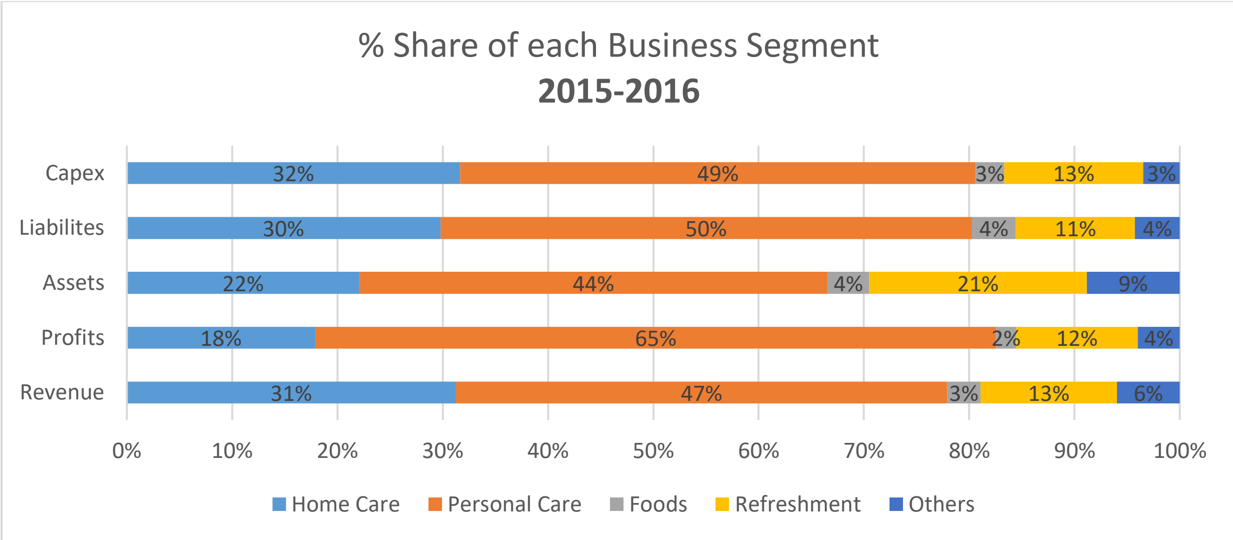

Table 2.2

Although the Group's operations are managed by product area, they have provided additional information based on geographies which has been classified as: India and Outside India.

The group is not reliant on revenues from transactions with any single external customer and does not receive 10% or more of its revenues from transactions with any single external customer.

The Y-o-Y Growth over the period 2016-17 is given in the below table

Y-o-Y Growth	Home Care	Personal Care	Foods	Refreshment	Others
Segment Revenue	*4.9%*	*1.9%*	*2.6%*	*8.3%*	*-5.1%*
Segment Assets	*6.2%*	*24.5%*	*-6.0%*	*-7.3%*	*-11.1%*

Segment Liabilities	*14.3%*	*11.1%*	*-10.8%*	*3.9%*	*2.7%*
Segment Profit	*19.7%*	*1.3%*	*-23.4%*	*11.2%*	*-14.9%*
Segment Capex	*48.6%*	*141.4%*	*9.5%*	*-6.8%*	*18.5%*

Table 2.3

Analysis

- The segment reporting is oriented towards product approach (line of business approach).
- The dominant segment is Personal Care as it contributes approximately 50 percent share of revenue and profits. It is followed by Home Care, Refreshment and Foods.
- There has been a significant increase in investment in Personal Care portfolio (Y-o-Y growth in total assets north of 20 percent) as can be seen by the 141.4 percent increase in capital expenditure over the last year.
- Investment in Refreshment division has reduced as can be seen by declining capex and asset share.
- Revenue from the personal care division has seen a muted 1.9 percent growth in revenue. It can be inferred that the benefits of the increased investment is yet to accrue to the company is the form of increased sales.
- Asset turnover ratio in refreshment segment has improved as seen by increasing revenue and declining asset share. This prima facie indicates increase in operating efficiency.

2.2 ITC Limited: Segment Reporting

The Company's corporate strategy aims at creating multiple drivers of growth anchored on its core competencies. The Company is currently focused on four business groups: FMCG, Hotels, Paperboards, Paper and Packaging and Agri-Business.

The Company's organizational structure and governance processes are designed to support effective management of multiple businesses while retaining focus on each one of them. The Operating Segments have been reported in a manner consistent with the internal reporting provided to the Corporate Management Committee, which is the Chief Operating Decision Maker.

The business groups comprise the following:

FMCG: Cigarettes – Cigarettes, Cigars etc. Others – Branded Packaged Foods Businesses (Staples; Snacks and Meals; Dairy and Beverages; Confections); Apparel; Education and Stationery Products; Personal Care Products; Safety Matches and Agarbattis.

Hotels – Hoteliering.

Paperboards, Paper and Packaging – Paperboards, Paper including Specialty Paper and Packaging including Flexibles.

Agri Business – Agri commodities such as soya, spices, coffee and leaf tobacco.

The geographical information considered for disclosure are **– Sales within India, Sales outside India**.

Segment results of 'FMCG : Others' are after considering significant business development, brand building and gestation costs of the Branded Packaged Foods businesses and Personal Care Products business.

As stock options are granted under ITC ESOS to align the interests of employees with those of shareholders and also to attract and retain talent for the enterprise as a whole, the option value of ITC ESOS do not form part of the segment performance reviewed by the Corporate Management Committee.

The Company is not reliant on revenues from transactions with any single external customer and does not receive 10% or more of its revenues from transactions with any single external customer.

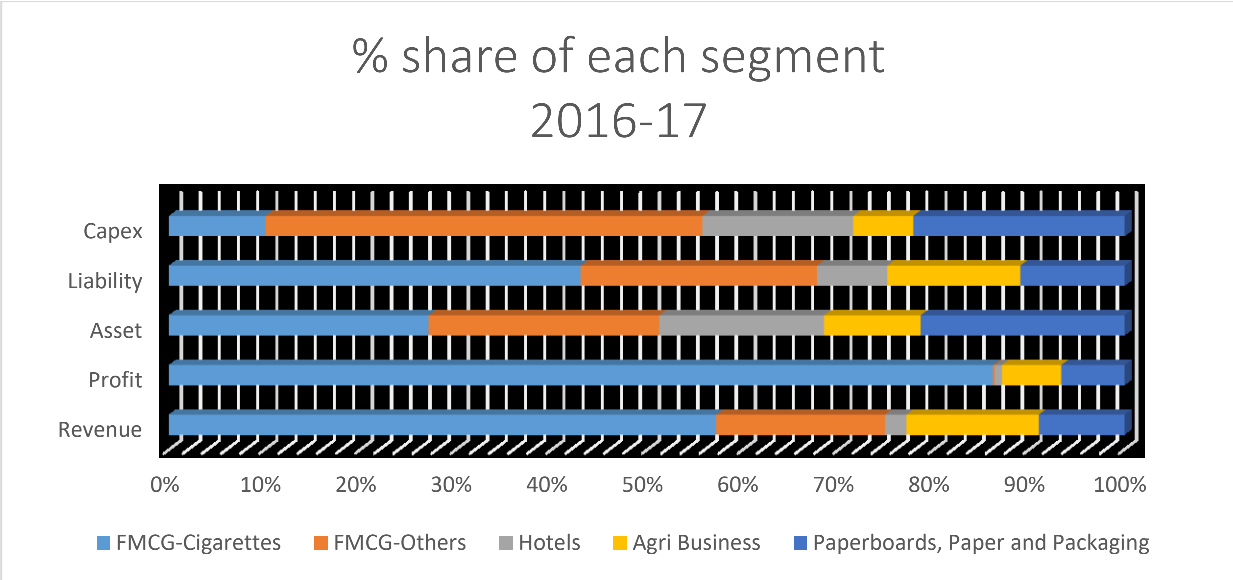

Table 2.4

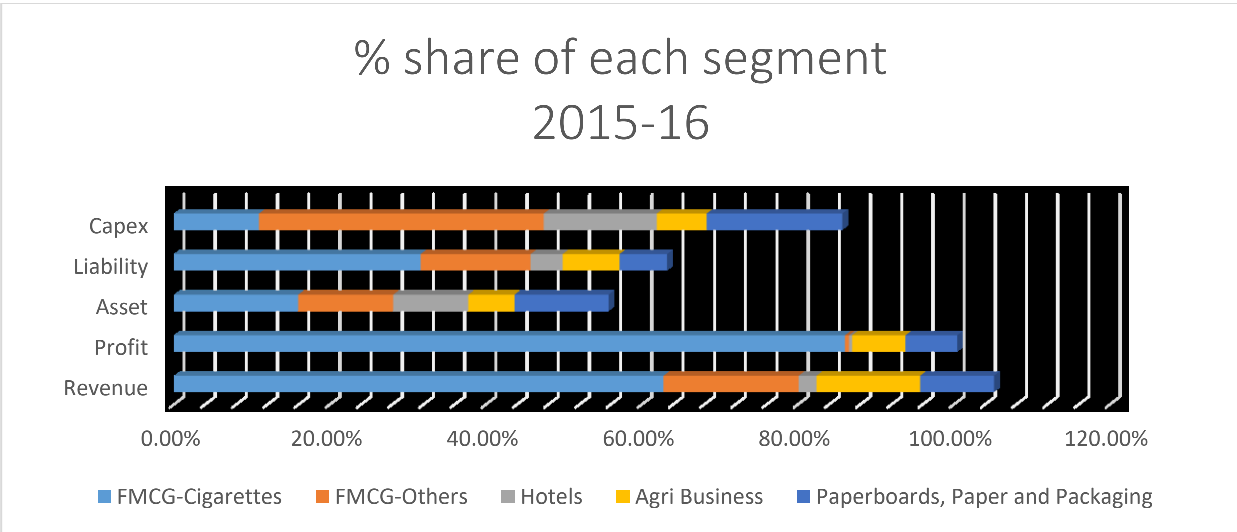

Table 2.5

The **Y-o-Y Growth** over the period 2016-17 is given in the below table

YoY	Revenue	Profit	Asset	Liability	Capex
FMCG-Cigarettes	-8.85%	-0.08%	-7.16%	-12.65%	-24.11%
FMCG-Others	1.97%	-62.58%	7.78%	12.56%	2.65%
Hotels	-1.53%	86.96%	-2.69%	14.92%	-10.62%
Agri Business	4.62%	-8.97%	-7.00%	23.05%	-18.90%
Paperboards, Paper and Packaging	-4.98%	-0.14%	-3.25%	15.28%	4.73%

Table 2.6

Analysis

- The segment reporting is oriented towards product approach (line of business approach).
- The dominant segment is FMCG (cigarettes plus others) as it contributes approximately 80 percent share of revenue and profits. It is followed by Hotels and Paper products.
- There has been a significant increase in growth in profit of Hotel segment and a significant decrease in FMCG-other products.
- Capital expenditure has increased for other FMCG and Paper while Assets have increased only for FMCG-other segment
- Revenue has seen muted downward effect from all segments other than FMCG-other and Agri business

CHAPTER 3: FINANCIAL ANAYSIS

3.1 Hindustan Unilever Limited

3.1.1 Reformulated Financial Statements

Hindustan Unilever Limited			(crores)
As on 31st March	2017	2016	2015
Operating assets			
Property, Plant & Equipment	3968	3165	2676
Capital work in progress	229	408	511
Other Intangible assets	370	12	22
Goodwill on Consolidation	81	81	81
Investment in subsidiaries		26	20
Non Current tax assets(net)	461	381	363
Deferred Tax assets net	170	168	157
Other Non current assets	75	55	50
Inventories	2541	2726	2816
Trade Receivables	1085	1264	1007
Other Current Assets	598	525	439
Assets Held for Sale	47	22	9
	9625	**8833**	**8151**
Operating Liabilites			
Provisions	514	623	518
Non Current tax liabilities	432	306	230
Deferred Tax liabilities		1	
Other Non current liabilities	207	184	134
Dues to others	6186	5685	5441
Other Current liab	664	654	762
Provisions	392	293	230
	8395	7746	7315
Net Operating Assets	1230	1087	836
Financial Assets			
Investments	6	6	6
Other financial Assets	128	147	120
Investments	3788	2560	2773
Cash and Cash equivalents	628	830	805
Bank Balance other than C&C	1200	2179	1881
Other Financial Assets	331	239	295
Total	6081	5961	5880
Financial Obligation			
Other Financial liabilities	73	20	20
Borrowings	277	177	
Other Financial llab	195	258	223
	545	455	243
Net Financial Assets	5536	5506	5637
Equity			
Equity Share Capital	216	216	216
Other Equity	6528	6357	6238
Common Shareholders Equity	6744	6573	6454
Non- Controlling Interest	22	20	19

Table 3.1 Reformulated Balance Sheet

Reformulated Income Statement						
(in INR crores)						
		2015		**2016**		**2017**
Operating Revenues		30,805.62		31,987.17		31,890.00
Cost of Sales		15,910.24		15,633.74		16,081.00
Gross Margin		14,895.38		16,353.43		15,809.00
Operating Expenses						
Adminstrative expenses		1,578.89		1,592.02		1,620.00
Advertising		3,872.40		4,526.17		3,470.00
Operating income from sales (before tax)		9,444.09		10,235.24		10,719.00
Taxes						
Taxes as reported	1,872.16		1,788.22		1,906.00	
Tax on financial items and other						
operating income (-1179.34+72.40 in 2015)	1,106.94	2,979.10	1,483.54	3,271.76	1,496.19	3,402.19
Operating income from sales (after tax)		6,464.99		6,963.48		7,316.81
Other operating income (before tax items)						
Interest on income tax refund	7.79		7.28		0.00	
Other expenses	-4,141.76		-4,493.87		-4,778.00	
Exceptional items	664.30		-39.03		241.00	
Tax on other income/expenses	-1,179.34	-2,290.33	-1,538.26	-2,987.36	-1,570.26	-2,966.74
Other operating income (after tax items)						
Currency translation gains (losses)						
Hedging gains(losses)						
Effect of accounting changes (15.6+10.1)						
Operating income (after tax)		4,174.66		3,976.11		4,350.07
Financing income (expense)						
Interest income		197.99		226.78		262.00
Dividend income		118.23		165.72		178.00
Gain on investments valued at fair value		0.00		0.00		86.00
Gain on sale of financial investments		294.38		100.85		0.00
Interest expense		16.82		0.18		22.00
Loan Processing charges		380.78		332.20		290.00
Net interest income		213.00		160.97		214.00
Tax effect (at 33.99 & 34.61%)		72.40		54.71		74.07
Net interest income after tax		140.60		106.26		139.93
Remeasurements of the net defined benefit plans		0.00		0.00		-21.00
Debt instruments marked to fair value		0.00		0.00		1.00
Comprehensive income		4,315.26		4,082.37		4,470.00

Table 3.2

3.1.2 Profitability Analysis Using Modified DuPont Analysis

HINDUSTAN UNILEVER LIMITED			
	2015	2016	2017
Revenue	30,805.62	31,987.17	31,890.00
NOA	1230	1087	836
NFA	5536	5506	5637
CSE	6766	6593	6473
OI	4,174.66	3,976.11	4,350.07
CI	4315.26	4082.37	4470
NFI	140.60	106.26	139.93
ATO	25.04521951	29.42701932	38.14593301
PM	13.55%	12.43%	13.64%
RNOA	339.40%	365.79%	520.34%
FLLEV	-0.818208691	-0.835128166	-0.870848138
OLLEV	6.825203252	7.126034959	8.75
RNFA	2.54%	1.93%	2.48%
ROCE	63.78%	61.92%	69.37%

Table 3.3

ROCE=RNOA-NFA/CSE*(RNOA-RNFA)

3.2 ITC limited

3.2.1 Reformulated Financial Statements

		2017		2016
Operating Revenues		42,803.61		39,192.10
Cost of Sales	17,201.95		14,645.90	
Gross Margin				
Operating Expenses				
Adminstrative expenses	3,631.73		3,440.97	
Operating income from sales (before tax)		21,969.93		21,105.23
Taxes				
Taxes as reported	5,566.69		5,375.95	
Tax on financial items and other	-2,046.07	7,612.76	-2,199.19	7,575.14
Operating income from sales (after tax)		14,357.17		13,530.09
Other operating income (before tax items)				
Interest on income tax refund				
Foreign exchange gain arising out of operations		8.39		-5.50
Other expenses		-7,686.81		-7,731.78
Gain on disposal of subsidiary		144.95		
Remeasurements of the defined benefit plans		-27.19		-49.09
Effective portion of losses on designated portion of hedging instruments in a cash flow hedge		-61.19		0.00
Share of operating profit of associates and joint ventures		5.97		8.42
Share of OCI in Associates and Joint Ventures		10.71		-9.69
Exchange differences in translating the financial statements of foreign operations		-55.55		-4.34
Effective portion of gains / (losses) on designated portion of hedging instruments in a cash flow hedge		18.29		-2.32
Exceptional items				
Other operating income before tax		-7,607.23		-7,758.82
Tax on other income/expenses		-2,648.11		-2,699.93
Other operating income after tax		-4,959.12		-5,058.89
Operating income (after tax)				
Financing income (expense)				
Interest income		903.16		881.02
Dividend income		0.14		59.87
Gain on investments valued at fair value		663.62		552.73
Other financial income		41.27		42.68
Interest expense		-24.30		-53.60
Tradable Equity instruments marked at fair value through other comprehensive income		139.68		-32.21
Current investments marked to fair value				
Loan Processing charges				
Net interest income		1,723.57		1,450.49
Tax effect (at 33.99 & 34.61%)		602.04		500.74
Net interest income after tax		1,121.53		949.75
Comprehensive income		**10,519.58**		**9,420.95**

Table 3.4 Reformulated Balance Sheet

ITC limited				(crores)
As on 31st March	2017	2016	2015	
Operating assets				
Property, Plant & Equipment	15262.27	14459.36	14370.09	
Capital work in progress	3684.20	2528.97	2104.83	
Goodwill	202.53	202.53	207.99	
Other Intangible assets	428.68	444.74	423.93	
Intangible Assets under dev.	45.69	30.75	28.65	
Less provision for lease			-1.05	
Deferred tax assets (net)	44.95	40.54	36.91	
Other non current assets	3202.61	2954.71	2200.15	
Inventories	8671.10	9062.10	8506.70	
Biological assets	70.05	67.25	51.18	
Trade Receivables	2474.29	1917.18	1978.32	
Other Current Assets	657.07	553.39	599.01	
Total	34743.44	32261.52	30506.71	
Operating Liabilites				
Non-current Provisions	158.42	135.42	123.67	
Deferred Tax liabilities	1878.77	1880.00	1688.47	
Other Non current liabilities	17.79	4.15	3.36	
Trades payable	2659.33	2339.29	1976.94	
Other Current liab	3327.46	3396.52	3014.80	
Current Provisions	61.16	71.40	89.73	
Current tax liabilities	150.70	84.80	42.68	
Total	8253.63	7911.58	6939.65	
Net Operating Assets	26489.81	24349.94	23567.06	
Financial Assets				
Non-current Investments	6693.99	5125.81	1412.72	
loans	8.54	12.96	16.47	
Other non-current financial Assets	100.71	1038.01	1384.01	
Current Investments	10332.39	6621.78	6266.30	
Cash and Cash equivalents	333.07	283.59	155.69	
Bank Balance other than C&C	2634.33	5779.71	6415.55	
current loans	6.78	8.07	8.66	
Other current assets	1090.02	560.43	380.86	
Total	21199.83	19430.36	16040.26	
Financial Obligation				
Other non-current Financial liabilities	41.21	46.77	39.31	
Borrowings	18.40	26.66	39.77	
current borrowings	19.11	43.95	184.95	
Other current Financial llab	903.25	722.50	783.43	
Total	981.97	839.88	1047.46	
Net Financial Assets	20217.86	18590.48	14992.80	
Net Financial Obligations	-20217.86	-18590.48	-14992.80	
Equity				
Equity Share Capital	1214.74	804.72	801.55	
Other Equity	45198.19	41874.80	37533.19	
Common Shareholders Equity	46412.93	42679.52	38334.74	
Non-controlling interests	294.74	260.9	225.12	

Table 3.5

3.1.2 Profitability Analysis Using Modified DuPont Analysis

ITC LIMITED		
	2016	2017
Revenue	39,192.10	42,803.61
NOA	24349.94	26489.81
NFA	18590.48	20217.86
CSE	42940.42	46707.67
OI	8,471.20	9,398.05
CI	9420.95	10519.58
NFI	949.75	1,121.53
ATO	1.609535794	1.615851907
PM	21.61%	21.96%
RNOA	34.79%	35.48%
FLLEV	-0.432936613	-0.432859528
OLLEV	0.324911684	0.311577546
RNFA	5.11%	5.55%
ROCE	21.94%	22.52%

Table 3.6

a) Like HUL, ITC Limited also has net financial assets, instead of net financial obligations. Its ROE is reduced by the presence of NFA. Its return on NFA is low (5%) as compared to return on assets (35%).

b) FLLEV of the company is negative as the company's investment in financial assets exceeds its financial obligations. Absolute value of FLLEV has remained unchanged from 2016 to 2017. It shows company's strategy to maintain a fixed percentage (of CSE) of financial assets.

c) Asset Turnover for the company has improved slightly from 2016 a slight or no change in operating efficiency of the company. It may be due to the reason that the company s already operating at higher levels of efficiency.

d) Operating Leverage of the company has decreased from last year which in turn affects company's RNOA. Increase in RNOA can be attributed to increase in ROOA.

ROCE of ITC has increased from 2016 to 2017 due increase in ATO and RNOA, whereas increase in RNFA and decrease in OLLEV has a negative effect on ROCE.

CHAPTER 4: COMPARATIVE ANALYSIS

4.1 HUL vs ITC

a) HUL shows better operational efficiency as its ATO is higher than that of the ITC. HUL generates high sales for every unit of investment in operating assets. Whereas ITC has a better profit margin as compared to HUL. Low turnover for ITC may be due to the other businesses it is in which requires high investment in operating assets.
b) HUL earns very high on its assets as its RNOA is very high when compared to ITC. It can be due to better usage of operating efficiency.
c) Financial Leverage of ITC is low when compared to HUL in absolute terms which indicates that it invests less in financial assets as compared to HUL. Also, ITC generates better returns on its financial investments.
d) Overall ROCE for HUL is high than ITC's ROCE which shows that HUL is able to produce better results for the equity shareholders.

CHAPTER 5: CASH FLOW ANALYSIS

5.1 HINDUSTAN UNILEVER CASH FLOW ANALYSIS

1. **Cash Flow Yield Ratio**

The cash flow yield ratio of the company has been improving implying the fact that the company's quality of earnings is improving. The cash flow yield ratio has increased from 0.89 in 2015 to 1.20 in 2017 signifying an improvement in quality of earnings.

2. **Dividend policy**

We can notice that there has not been much issue of stock. However the dividend payout has increased. In 2016, the dividend payout increased by around 15.20% in comparison to 2015. In 2017 also the dividend payout increased by 6.50% We also notice that the overall cash balance has reduced in 2017 from 2016 i.e. from INR 830 crores to 630 crores This implies that the company is ready to pay dividend in spite of reducing cash balance and the management is confident of the company's potential to generate cash flows in future. Moreover this has been the way of rewarding the shareholders. The company has declared dividends at INR 15-16 per share over the last years while the face value of one share is INR 1.

3. **Working Capital**

The company has reduced its non-cash working capital hugely to generate operating cash flows in 2017 of an amount of INR 715 crores. The company has increased its creditors to a huge extent and also reduced its trade receivables & inventory. This may imply that the credit policy of the company has improved. The company has also done well to reduce its inventory over the years as we could see that the inventory has reduced over all the 3 years.

4. **Capital expenditure – internal growth policy**

The company has greatly increased its capital expenditure over the last two years. There was a 33.73% increase in 2016 in comparison to 2015 and an increase of 37.41% in 2017 in comparison to 2016. The company has also reduced its sale of fixed assets in 2016 by a 82% in comparison to 2015. All these are indicative of the fact that the company aims for internal growth by increasing its investment in operating assets. As a result, the depreciation has also increased over the past two years.

5. **Depreciation as a percentage of net income**

The net income has grown over the past two years. Depreciation as a percentage of net income has also increased in 2017. This is because of the increase in capex.

6. **Net capex/depreciation**

Net capex/depreciation has also become more than 1 which is vital to keep the company whole. Not only keeping the company whole, it is a good sign that the company wants to grow by investing more in the existing business. The ratio has become more than 2 in 2016 & continued the trend in 2017.

7. **Cash flow adequacy ratio**

Cash flow adequacy ratio of the company is approximately 1.13 which is more than 1. Thus it is at a sufficient level if we consider the need to spend on fixed asset purchases,inventory additions and cash dividends.

8. **Investment in financial assets**

The company had cash inflows from net investment activities in 2015 and 2016. However in 2017, the company has had a cash outflow for net investment activities to a tune of INR 1,131 crores approx. This along with increasing capex, dividend payment implies that the company is becoming cash rich year by year.

9. **Cash Reinvestment ratio**

Cash Reinvestment ratio is much more than the satisfactory levels of 7 to 11 percent in all the three years. This implies that the company is reinvesting back into the business a significant amount of its cash flow from operations after meeting its commitment of dividend payment.

10. **Financing needs**

The company has met its financing needs hugely from cash flow from operations. In case of some requirement, it has resorted to short term borrowings.

11. **CFFO/total assets**

The company's CFFO/Total assets has increased over the last 2 years. It has reached a level of about 35% which is a very good return on total assets.

12. **CFFO/sales**

The company's CFFO/Sales has increased over the last 2 years.

13. **Healthy company**

The fact that the company's CFFO is positive and net cash in investing activities is negative in 2017 implies that the company is a healthy company and trying to expand.

5.2 ITC –CFS Analysis

1. **Cash Flow Yield Ratio**

The cash flow yield ratio of the company has been consistently above 1 which implies that its quality of earnings has been very good.

2. Dividend policy

The company has increased its dividend payout in the last 3 years. With the increases in profit, the company has decided to increase the dividends and not withhold extra cash. It has also managed to increase its cash balance which is a plus. However, they have increased the dividends by a lot in 2017 which they can find difficult to manage. This can also show that the management is confident of the company's potential to generate cash flows in future.

3. Capital expenditure – internal growth policy

The company reduced its capital expenditure in 2016 by around 30%. However, in 2017, they brought it back to previous level. There was a 30% increase in 2017 in comparison to 2016. The company has also reduced its sale of fixed assets in 2016 by a 82% in comparison to 2015. In the recently finished financial year, they purchased a lot more assets. This indicates that that the company aims for internal growth by increasing its investment in operating assets. As a result, the depreciation has also increased over the past two years.

4. Depreciation as a percentage of net income

The net income has grown over the past two years. However, depreciation as a percentage of net income has also remained almost constant in 2017. This may be because of the increase in capex.

5. Net capex/depreciation

Net capex/depreciation has also become more than 1 which is vital to keep the company whole. Not only keeping the company whole, it is a good sign that the company wants to grow by investing more in the existing business. In fact, the ratio has become more than 2 in the last 3 years which is a very god sign.

6. Cash flow adequacy ratio

Cash flow adequacy ratio of the company is approximately 1.10 which is more than 1. Thus it is at a sufficient level if we consider the need to spend on fixed asset purchases, inventory additions and cash dividends.

7. Investment in financial assets

The Cash Flow from Investment has decreased over the last 3 years. This implies that the company has reduced investing in operating assets. Though this is not a positive thing, this can be justified by the more negative Cash Flow from Financing.

8. Cash Reinvestment ratio

Cash Reinvestment ratio has been very high in all the three years. This implies that the company is reinvesting back into the business a significant amount of its cash flow from operations after meeting its commitment of dividend payment.

9. Financing needs

The company has met its financing needs hugely from cash flow from operations. They have not depended on short term borrowings much.

10. CFFO/total assets

The company's CFFO/Total assets has reduced over the last 3 years which can be a little worrisome, however not so significant.

11. CFFO/sales

The company's CFFO/Sales has remained almost constant over the last 3 years.

12. Healthy company

The fact that the company's CFFO is positive and net cash in investing activities and financing activities is negative in 2017 implies that the company is a healthy company and trying to expand and clear out its debts.

CHAPTER 6: INTERCORPORATE INVESTMENT

6.1 HUL

- The Company's interest in the Joint Ventures is reported as asset held for sale and is stated at lower of cost or fair value
- All investments in equity instruments classified under financial assets are initially measured at fair value , the group may, on initial recognition, irrevocably elect to measure the same either at FVOCI or FVTPL
- The fair values of investment in treasury bills, government securities and quoted investment in equity shares is based on the current bid price of respective investment as at the Balance Sheet date.
- Share of net loss from JV is recorded using Equity method

Fair Value through profit and Loss	2017	2016	2015
Unquoted Equity Instruments	1	1	1
Unquoted Pref. share	5	5	5
Total	6	6	6
Share in net loss of JV	-	(9)	Not available

Table 6.1

6.2 ITC

- Investment in subsidiaries, associates and joint ventures are carried at cost less accumulated impairment.
- Market prices are not disclosed.

	FY 2017		FY 2016		FY 2015	
In crore Rs.	Quoted	Unquoted	Quoted	Unquoted	Quoted	Unquoted
INVESTMENT IN EQUITY INSTRUMENTS	1042.67	2132.96	988.44	2118.59	1015.56	1675.46
INVESTMENT IN PREFERENCE SHARES	-	58.55	-	-	-	187.00
INVESTMENT IN BONDS	4982.59	-	3593.33	-	-	-

Table 6.2

CHAPTER 7: OFF-BALANCE SHEET FINANCING

7.1 HUL

There is evidence of off-balance sheet financing for HUL as it has Operating leases

	0	1	2	3	4	5	6	7
Lease payments		12	14	14	14	14	14	10
PV Factor (@8.5%)		0.92	0.84	0.78	0.72	0.66	0.61	0.56
PV lease payments		11.05	11.89	10.96	10.10	9.31	8.58	5.64
Total MLP	67.556							

that are non-cancellable for a duration of 9 years.

Interest	5.742274
Current debt	6.257726
Long term debt	61.29844

Table 7.1

7.2 ITC

The Company's significant leasing arrangements are in respect of operating leases for land and building premises (residential, office, stores, godowns etc.). These leasing arrangements which are not non-cancellable range between 11 months and 9 years generally, or longer, and are usually renewable by mutual consent on mutually agreeable terms.

Future MLPS (INR crores)	**FY17**	**FY16**
Not later than one year	15.88	12.74
Later than one year and not later than five years	34.97	15.13
Later than five years	**0**	**0.35**

Table 7.2

CHAPTER 8: FOREIGN CURRENCY TRANSLATION

8.1 HUL

- Functional currency for the company is INR in which the statements are reported
- Items included in the financial statements of the Company are recorded using the currency of the primary economic environment in which the Company operates (the 'functional currency')
- Foreign currency transactions are translated into the functional currency using exchange rates at the date of the transaction
- Foreign exchange gains and losses from settlement of these transactions, and from translation of monetary assets and liabilities at the reporting date exchange rates are recognised in the Statement of Profit and Loss.

8.2 ITC

- The functional and presentation currency of the Company is Indian Rupee.
- Transactions in foreign currency are accounted for at the exchange rate prevailing on the transaction date.
- Gains/ losses arising on settlement as also on translation of monetary items are recognised in the Statement of Profit and Loss.
- Exchange differences arising on monetary items that, in substance, form part of the Company's net investment in a foreign operation (having a functional currency other than Indian Rupee) are accumulated in Foreign Currency Translation Reserve

	FY2017	FY2016	FY2015	FY2014
Foreign currency translations and transactions – Net (In crore Rs.)	5.82	(8.77)	(5.33)	1.76

Table 8.1

CHAPTER 9: CAPITALIZATION

9.1 HUL

- Aggregate of R&D expenditure is shown as Revenue expenditure in P&L statement
- No amount is capitalized

In Crore Rs.	2017		2016	
Location of R&D	Bengaluru	Mumbai	Bengaluru	Mumbai
Rev. expenditure eligible				
Salaries & wages	9	11	10	14
Materials, consumables and spares	1	2	1	5
Utilities	-	0	-	0
Other expenditure	2	3	3	4
Total	12	16	14	23

Table 9.1

9.2 ITC

- To write off all expenditure other than capital expenditure on Research and Development in the year it is incurred.
- Capital expenditure on Research and Development is included under Tangible Assets.

In Crore Rs.	FY2017	FY2016	FY2015
Expenditure on R&D	156.25	155.35	204.19
Total R&D Expenditure as a % of Gross Revenue	0.28%	0.30%	0.41%

Table 9.2

CHAPTER 10: RED FLAGS

10.1 ITC

10.1.1 Sales:

Particulars	2015	2016	2017
Net Sales	38,834.81	39,192.10	42,803.61
Increase in Sales	9%	1%	8%

Table 10.1

The sales of the company have remained stable over the years with a drop in increase in 2016 where increase in sales decreased from 9%(2015) to mere 1%(2016), but again it picked up in 2017 where the company was able to post increase in sales of 8% over the last year.

10.1.2 Selling and Administrative Expenses:

Particulars	2015	201	2017
Selling and Administration Expenses	3,876.19	4,261.78	4,179.74
Increase In S&A Exp.	15%	10%	-2%
S&A Exp. as % of Net Sales	10%	11%	10%

Table 10.2

The S&A expenses have been stable as percentage of sales over the last three years but the increase in the selling and administrative expenses in negative in 2017 over 2016.

S&A expenses are discretionary expenses which the managers have control over, and a decrease in overall expenses over the last year even when the sales have increased by as much as 8% raises a red flag. The company may have done this to maintain the profitability of the company.

10.1.3 Assets:

Particulars	2015	2016	2017
Gross Block of Assets	23,361.47	16,175.72	18,094.43
% Change	0.14	-0.44	0.11

Table 10.3

The company has dumped a huge chunk of assets during 2016 where its net block of assets goes down by a huge 44% over 2015. Investment in asses have been made as the gross block of assets have increased by 11%, which shows that the company is getting rid of obsolete machinery and is replacing it by new machinery.

But, one point to be noted is that the value of gross block is still than 2015 figure, which raises the question whether the company will be able to sustain the growth and deliver.

10.1.4 Investments:

Particulars	2015	2016	2017
Investments	6,942.77	11,747.59	17,026.38
% Increase	-5%	69%	45%

Table 10.4

ITC has made huge investment in the last two years from ~7000 cr. In 2015 to ~17000 cr. in 2017. This investment will earn interest for the company but the issue is that rather than investing in the operating assets, the managers chose to invest in the investments. Thus, income from other sources is bound to increase in the coming years will affect the quality of earnings in the coming years.

10.1.5 Change in Trade Payables:

Particulars	2015	2016	2017
Change in Trade Payables	72.27	628.12	266.33

Table 10.5

The company has made huge changes in its trade payable over the last three years, where it first decreased it by ~72 cr. in 2015 and then increased it by ~630 cr. in 2016 and then again decreased it to `260 cr. in 2017. These huge changes may be a result of two things, one is that the company has not been able to fix terms with the suppliers and due to this the value of trade payables are changing or two that the company is trying different strategies.

10.1.6 Cash Flow Realization Ratio:

CRR	1.061427	0.571162	0.583909

Table 10.6

Cash Flow realization ratio checks for the quality of earnings of a company. In case of ITC it was greater than 1 which was an indicator of good quality of earnings but it decreased in subsequent years where its value is less than 1 which is not good.

10.2 HUL

10.2.1 REPORTED PAT

(All figures in INR crores)

It can be seen that the PAT has grown over the last year by a very minimal percentage of about 2%. The growth percentage in PAT in 2016 was a double-digit figure. This shows that the growth in PAT hasn't been at a stable rate.

10.2.2 TOTAL REVENUE

The total revenue growth rate has been steady & at a very small rate. This shows

	2014-15	2015-16	2016-17
Total revenue	30805.6	31060.9	31890
% growth		0.8%	2.7%

Table 10.7

that the business of the company has matured (apparent from the huge total revenue figures). So there will be a stable growth rate in revenues in future also until & unless the company comes up with a breakthrough technology or product.

10.2.3 CFFO/Net Income

	2014-15	2015-16	2016-17
CFFO	3583.9	1437.7	4619.5
Net Income	3651	4167.9	4249
CFFO/Net Income	0.98	0.34	1.09

Table 10.8

We see that the earning quality has improved a lot in 2017 as CFFO/Net Income is greater than 1. The earnings quality deteriorated heavily in 2016 but it has recovered in 2017. It also implies that the earnings level of 2017 can be sustained.

10.2.4 Advertising expenses – discretionary expenses being reduced

	2014-15	2015-16	2016-17
Advertising expenses	3872.40	4526.17	3470
Growth %		16.88%	-23.34%

Table 10.9

We can see that the company has reduced its advertising expenses to a huge extent. The company may be reducing this discretionary expense in order to inflate its profit.

10.2.5 Exceptional items – one-time items used to inflate its profit

	2016-17
Profit on disposal of surplus properties	164
Profit on disposal of business/subsidiary	19
Decrease in liability on account of plans amendment basis actuarial valuation	115
Total	**298**

Table 10.10

The company is using the one-time sale of subsidiary & sale of unproductive assets like “sale of surplus properties” to inflate its profit. This may imply that the company is trying to increase its profits by non-recurring activities & hence this level of profits will not be sustainable in future.

The company may also be using its discretion to influence the actuarial valuation in order to book profits.

10.2.6 Increase in non-operating income

	2014-15	2015-16	2016-17
Interest income	197.99	226.78	262
Growth %		14.54%	15.53%
Dividend income	118.23	165.72	178
Growth %		40.16%	7.41%

Table 10.11

The company is using non-operating sources of income to inflate its profit as we can see by the growth of interest income & dividend income in the past 2 years.

10.2.7 Increase in capex

	2014-15	2015-16	2016-17
Gross PPE	5411.8	3595	5171
Capex		-1816.81	1576
Growth %		-33.57%	43.84%

Table 10.12

The huge growth rate in capex in year 2016-17 may imply that the company may have intentionally capitalized some revenue expenditures in order to inflate its profit for 2016-17.

10.2.8 Increase in non-operating assets

	2014-15	2015-16	2016-17
Long-term investments	3025.1	2592	3794
Growth %		-14.31%	46.37%
Short-term loans & advances	731.5	786	976
Growth %		7.46%	24.17%

Table 10.13

The sharp increase in non-operating assets like long-term investments & short term loans & advances in 2017 may imply that the company is not investing much in its operating activities. Rather it is diverting the funds generated to invest in non-financial assets. This may mean that the company is not finding enough opportunities to invest in its core operations & is trying to derive a major portion of its income from non-operating activities.

10.2.9 Increase in long-term debt

	2014-15	2015-16	2016-17
Long-term debt	43	177	277
Growth %		311.24%	56.50%

Table 10.14

The company has raised the amount of its debt financing to a great extent in the last 2 years. This may pose a risk to the company in terms of its debt servicing capacity in future if the company goes on increasing debt at such an abnormal rate.

10.2.10 Increase/(Decrease) in working capital

	2014-15	2015-16	2016-17
Increase/(Decrease) in working capital	-2816	24950	-4375

Table 10.15

The company may have manipulated its current assets/liabilities so as to have a positive cash flow effect from its working capital needs in 2017 after such a huge increase in working capital needs in 2016 which would have drastically reduced its cash flow from operations in 2016.

Thus we see that Cash Realization ratio i.e. CFFO/Net income reduced heavily in 2016 to be at a level of 0.34. In 2017 it increased drastically to be at a level of 1.09. This implies that there might have been some manipulation to raid the working capital items in order to increase the CFFO.

CHAPTER 11: CONCLUSION AND RECOMMENDATIONS

The comparison of the two companies has led to the following conclusions:

- HUL shows better operational efficiency as its ATO is higher than that of the ITC. HUL generates high sales for every unit of investment in operating assets.
- Whereas ITC has a better profit margin as compared to HUL. Low turnover for ITC may be due to the other businesses it is in which requires high investment in operating assets.
- HUL earns very high on its assets as its RNOA is very high when compared to ITC. It can be due to better usage of operating efficiency.
- Financial Leverage of ITC is low when compared to HUL in absolute terms which indicate that it invests less in financial assets as compared to HUL. Also, ITC generates better returns on its financial investments.
- Overall ROCE for HUL is high than ITC's ROCE which shows that HUL is able to produce better results for the equity shareholders.

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