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Impact of Leverage on Profitability-A Study of Different Cement Industries

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ABSTRACT: It is to analyse and understand the impact of leverage and probability of firm. Earning capacity of cement industry or firm is influenced by fixed operating costs and charges. Long term debt ratio to long term capital occurs and positive association between leverage and probability is found which show main main financing option. Both public and private cement industries use different sort of financing and there is debt relationship equity ratio hence leverage has a dominating effect on the profitability of the firm. Indian cement industry is the second largest in the world. Profitability is the ability of a business to earn a profit. A profit is what is left of the revenue a business generates after it pays all expenses directly related to the generation of the revenue, such as producing a product, and other expenses related to the conduct of the business activities. This is one of the major issues for the investors as well as management because it finds out the various ratio-such as Net Profit Ratio; Return on Equity; Return on Capital Employed and Return on Net Worth, related with the investors and management, which make the business comparable to the peer companies of the industry. This paper makes an attempt to provide an insight into the profitability performance of 10 leading cement manufacturers in India. It also makes an effort to observe and test the inter firm's industry position. Profitability ratios are ranked and selected into a uniform boundary to compare their performance. The study is based on secondary data collected from published annual reports cover a five years' period (2013 to 2017). The available data have been analyzed by using important profitability ratios and some statistical tools such as Mean, SD and Rank are also used with the help of SPSS 23 software.

I. INTRODUCTION

Every sector of the economy is playing an important role in the economic development of the country since times immemorial. The economy is broadly categorized into three sectors viz. agricultural sector (Primary Sector), Industrial sector (Secondary Sector) and service sector. Each of the sectors is playing a vital role and is significant for the economic development of every country. Now a days, industrial sector has shaped the economic destiny of various developing countries especially India. With regard to industrial sector, cement industry provides the basic foundation of infrastructural development and providing social overheads in the country. At present the big challenge before the planners of the economy is infrastructural development which can be achieved only through the presence of strong cement industry which provides the basic raw material for construction of roads, bridges and buildings etc.[1,2] Cement is the most essential raw material in any kind of construction activity. Accordingly cement industry plays a crucial role in the infrastructural development of the country. Given the vast geographical size and massive population of the country, various construction activities undertaken by the central Govt., State Govt., Public Sector Undertakings and other organizations, including private sector generate huge demand for cement. Moreover, provision for housing is the first and foremost requirement of every household and therefore, first private cement industry was laid down in the year 1914, when it first started working in Gujarat. The Indian cement Industry is consisted of 20 large cement plants and 365 mini cement plants with an installed capacity of 140 million tonnes. With cement production capacity of nearly 366 million tonnes, as of 2015, India was the second largest cement producer in the world. In 2016, country's cement production capacity has been achieved to 395 million tonnes, which is expected to further increase to 550 million tonnes by 2025. On the other hand, China Produced 2483.18 MT and Consumed 2511 MT of cement in 2016. As India's current per capita consumption of cement (201 kg as of March 2017) is much lesser than the developed and other developing economies, so there is a significant business opportunity to cater to the unmet and rising demand. Out of the total capacity, 98 percent lies with the private sector and the rest with public sector, with the top 20 companies accounting for around 70 per cent of the total production. 210 large cement plants account for a cumulative installed capacity of over 350 million tonnes, while over 350 mini cement plants have an estimated production capacity of nearly 11.10 million tonnes, as of 2016.[3,4] Cement Industry in India is centralised in 3 major state - of Andhra Pradesh, Rajasthan and Tamil Nadu as out of total 210 large cement plants in India, 77 are situated in these three states.

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(www.ibef.org) The Union Budget 2016–17 has been favourable for the infrastructure sector, mainly for roads, which would eventually influence the cement industry of the country. In the budget, the Government of India, allocated a total of USD 8.22 billion for the development of roads & highways of India, bracing the cement industry of India. Housing sector is considered to drive the cement industry in India to a great extent, which held nearly 67 per cent of the total cement consumption in India. (Source: Union Budget 2016–17, Emkay Global Financial Services) Thrust on infrastructure development and Housing for all with 2 crore houses in Urban areas and 4 Rural areas is likely to revive the demand for cement sector. These sectors are considered to drive the cement industries in India to a great extent, which held nearly 67 per cent of the total cement consumption in India.[5,6]

II. MATERIALS AND METHODS

The present study is based on 10 listed cement manufacturing firms in India. The study covers a period of 5 years i.e. from 2012-13 to 2016-17. The secondary data obtained from the audited balance sheets and profit & loss accounts part and parcel of annual reports of the selected companies. The data so collected, have been analyzed by using various Profitability indicators such as Operating Profit Margin, Profit before Interest and Tax, Net profit Margin, Return on Capital Employed, Return on Equity, Return on Long-term Fund, Earning per Share and Dividend per Share. An attempt has been made to measure the profitability performance of major cement manufacturers in the light of said financial indicators.[7]

Profitability Ratio

Profitability ratios replicate the final result of business operations. There are two types of profitability ratios: profit margin ratios and rate of return ratios. Profit margin ratios show the relationship between profit and sales. Since profit can be measured at different stages, there are several measures of profit margin. The most popular profit margin ratios are: operating profit margin, and PBIT Margin. Rate of return ratios reflects the re1ationship between profit and investment. The important rate of return measures are: return on assets, earning power, return on capital employed, and return on equity. These ratios are very useful for the management as well as for the investors, present and future.[book,1]

III. DISCUSSION

OBJECTIVES OF THE STUDY

The main objective of the present work is to appraise the performance in respect of profitability on selected cement manufactures in India and its profitability ratios are compared with its immediate competitors.

More specifically, it seeks to do well upon mainly the following issues:

1. To assess the profitability position with the help of widely used financial ratios of the selected companies;
2. To observe the profitability performance of companies under the study;
3. To compare the performance of selected companies based on overall profitability with the help of statistical tools.

Net Profit Margin

This ratio establishes the relationship between net profit and net sales. It indicates managements' efficiency in manufacturing, administering and selling the product. A firm with high net profit margin would be in an advantageous position to survive in the face of falling selling prices, rising cost of production or declining demand for the product. It is calculated as a percentage of sales. It is computed as under: Net Profit Ratio = Net profit / Net Sales × 100

Return on Capital Employed

Return on capital employed is the indicator of the operational efficiency of the company. It measures how much investors are earning on the capital they have invested in that business. Return on Capital Employed is a performance measure and it indicates how much return is generated from Invested Capital. The return on capital Employed is defined as: ROCE = [Profit after Tax + Interest] / Net Capital Employed ×100

Return on Equity

The Return on Equity ratio is perhaps the most important of all the financial ratios to investors in the company. It measures the return on the money the investors have put into the company. In general, the higher the percentage, the better, with some exceptions, as it shows that the company is doing a good job using the investors' money. The return on net worth is defined as: ROE = Net Profit / Share Holders Fund ×100

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Return on Long-Term Funds

Return on Long-term funds establishes the relationship between net profit and the long-term funds. It tells us that earning of the company which reflects operating condition of the firm. The term long-term funds refer to the total investment made in business for long-term. It is calculated by dividing earnings before Interest and Tax (EBIT) by the total long term funds. The return on Long-term funds is defined as: Return on Long term fund = EBIT / Long-term Fund ×100

Earnings Per Share: Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability. In a given fiscal year, a publicly-traded company's profit divided by the number of shares outstanding. This is considered the single most important aspect in determining a share's price and value, because the calculation of earnings per share shows the amount of money to which a shareholder would be entitled in the event of the company's liquidation. In general, earnings per share apply only to common shares.

It is calculated: Earnings per Share = (Net Income – Preference Dividends) / No. of Equity Shares Outstanding or Issued[book,2]

IV. CONCLUSION

The companies selected for the study shows that the industry is somewhat doing well as far as profitability ratios are concerned. It is notable that Ultratech Cement, Shree Cement, ACC, and Ambuja Cement are the top performer of the industry. Shree Cement is the star performer in this group of companies under study and Ultratech Cement ranked second in the course of performance. Prism Cement and Heidelberg Cement performed badly and ranked 9 and 10 in most of the parameters. .Ultratech Cement is the most consistent company under study, whereas Mangalam Cement and Heidelberg Cement performed badly and ranked 9 and 10 in the course of consistency.

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