

"EVALUATING FINANCIAL PERFORMANCE: A RATIO ANALYSIS OF BONDADA ENGINEERING LIMITED, HYDERABAD"

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ABSTRACT

This paper explores the use of ratio analysis as a fundamental tool for financial statement analysis, assessing the performance and financial health of a business. Ratio analysis involves the computation and interpretation of various financial ratios derived from the income statement, balance sheet, and cash flow statement. This study covers the primary categories of ratios: liquidity ratios, which measure a company's ability to meet short-term obligations; profitability ratios, which assess a company's ability to generate profit relative to sales, assets, or equity; leverage ratios, which evaluate the extent of a company's financing through debt; and efficiency ratios, which examine how effectively a company utilizes its assets.

1. INTRODUCTION

Ratio analysis evaluates a company's profitability, liquidity, solvency, and operational efficiency using information from its financial statements. It gives insights into a company's financial performance over time, against an industry benchmark, or compared to another business. Each ratio provides information about a different aspect of a company's financial health. Used in isolation, they can be misleading. But together, they are a powerful tool for identifying strengths and pitfalls. Ratio analysis is a powerful tool of financial analysis. A ratio is defined as "the indicated quotient of two mathematical expressions" and as "the relationship between two or more things." In financial analysis, a ratio is used as a benchmark for evaluating the financial position and performance of a firm. The absolute accounting figures reported in the financial statements do not provide a meaningful understanding of the performance and financial position of a firm.

(Financial analysis is the process of evaluating businesses, projects, budgets, and other finance-related transactions to determine their performance and suitability. Typically, financial analysis is used to analyse whether an entity is stable, solvent, liquid, or profitable enough to warrant a monetary investment.)

Ratios help to summarise large quantities of financial data and to make qualitative judgement about the firm's financial performance. It is calculated by dividing current assets by current liabilities; the ratio indicates a relationship—a quantified relationship between current assets and current liabilities. This relationship is an index or yardstick, which permits a qualitative judgement to be formed about the firm's ability to meet its current obligations.

Standards of Comparison:

The ratio analysis involves comparison for a useful interpretation of the financial statements. A single ratio in itself does not indicate favourable or unfavourable condition. It should be compared with some standard. Standards of comparison may consist of:

- past ratios, i.e., ratios calculated from the past financial statements of the same firm;
- competitors' ratios, i.e., ratios of some selected firms, especially the most progressive and successful competitor, at the same point in time;
- industry ratios, i.e., ratios of the industry to which the firm belongs; and
- projected ratios, i.e., ratios developed using the projected, or proforma, financial statements of the same firm.

Time series analysis the easiest way to evaluate the performance of a firm is to compare its present ratios with the past ratios. When financial ratios over a period of time are compared, it is known as the time series analysis. It gives an indication of the direction of change and reflects whether the firm's financial performance has improved, deteriorated or remained constant over time. The analyst should not simply determine the change, but, more importantly, he/she should understand why ratios have changed. The change, for example, may be affected by changes in the accounting policies without a material change in the firm's performance.

Cross-sectional analysis Another way of comparison is to compare ratios of one firm with some selected firms in the same industry at the same point in time. This kind of comparison is known as the cross-sectional analysis or inter-firm analysis. In most cases, it is more useful to compare the firm's ratios with ratios of a few carefully selected competitors, who have similar operations. This kind of a comparison indicates the relative financial position and performance of the firm. A firm can easily resort to such a comparison, as it is not difficult to get the published financial statements of the similar firms.

Industry analysis to determine the financial condition and performance of a firm, its ratios may be compared with average ratios of the industry of which the firm is a member. This sort of analysis, known as the industry analysis, helps to ascertain the financial standing and capability of the firm vis-à-vis other firms in the industry. Industry ratios are important standards in view of the fact that each industry has its characteristics, which influence the financial, and operating relationships. But there are certain practical difficulties in using the industry ratios. First, it is difficult to get average ratios for the industry. Second, even if industry ratios are available, they are averages-averages of the ratios of strong and weak firms. Sometimes differences may be so wide that the average may be of little utility. Third, averages will be meaningless and the comparison futile if firms within the same industry widely differ in their accounting policies and practices. If it is possible to standardise the accounting data for companies in the industry and eliminate extremely strong and extremely weak firms, the industry ratios will prove to be very useful in evaluating the relative financial condition and performance of a firm.

Proforma analysis Sometimes future ratios are used as the standard of comparison. Future ratios can be developed from the projected, or proforma financial statements. The comparison of current or past ratios with future ratios shows the firm's relative strengths and weaknesses in the past and the future. If the future ratios indicate weak financial position, corrective actions should be initiated.

Types of Ratios- Several ratios, calculated from the accounting data, can be grouped into various classes according to financial activity or function to be evaluated. As stated earlier, the parties interested in financial analysis are short- and long-term creditors, owners and management. Short-term creditors' main interest is in the liquidity position or the short-term solvency of the firm. Long term creditors, on the other hand, are more interested in the long-term solvency and profitability of the firm.

Similarly, owners concentrate on the firm's profitability and financial condition. Management is interested in evaluating every aspect of the firm's performance. They have to protect the interests of all parties and see that the firm grows profitably. In the view of the requirements of the various users of ratios, we may classify them into the following four important categories:

- Liquidity ratios
- Leverage ratios
- Activity ratios
- Profitability ratios.
- Liquidity ratios measure the firm's ability to meet current obligations;
- leverage ratios show the proportions of debt and equity in financing the firm's assets;
- activity ratios reflect the firm's efficiency in utilising its assets, and
- profitability ratios measure overall performance and effectiveness of the firm.

2. NEED FOR STUDYING RATIO ANALYSIS

Understanding ratio analysis is like having a compass in the complex landscape of business. It's not just about crunching numbers; it's about gaining insights into the health, efficiency, and potential of a company. Imagine you're a doctor examining a patient. Ratios are like vital signs, offering clues about the financial well-being of a business. By studying them, you can diagnose strengths, weaknesses, and areas for improvement. Ratio analysis helps in making informed decisions, whether it's assessing the profitability of investments, evaluating the performance of a company over time, or identifying trends that could impact its future. It's not just a tool for finance professionals; it's a skill that empowers anyone interested in understanding the heartbeat of businesses and making smarter choices in the world of commerce.

Objectives:

- To study the financial position of the company Bondada Engineering Limited.
- To understand the Liquidity position of Bondada Engineering Limited.
- To analyse the profitability position of Bondada Engineering Limited to uncover potential issues or opportunities for improvement.
- To evaluate the risk exposure and growth potential in Bondada Engineering Limited.

Tools for Ratio Analysis:

The use of secondary data is very crucial in providing analysis of the growth and financial health of an Organisation.

Statistical Tools:

1. Profitability ratios
2. Liquidity ratios
3. Leverage ratios
4. Activity ratios

- 1. Profitability Ratios:** These ratios measure the company's ability to generate profits relative to its revenue, assets, or equity. Examples include Return on Equity (ROE), Return on Assets (ROA), and Gross Profit Margin.
- 2. Liquidity Ratios:** Liquidity ratios assess the company's ability to meet short-term obligations using its liquid assets. Common liquidity ratios include the Current Ratio and the Quick Ratio (also known as the Acid-Test Ratio).
- 3. Leverage Ratios:** Leverage ratios indicate the extent to which a company is using debt financing relative to its equity. These ratios include the Debt-to-Equity Ratio, Debt Ratio, and Equity Multiplier.
- 4. Activity Ratios:** Activity ratios measure how efficiently a company manages its assets to generate revenue. Examples include Inventory Turnover Ratio, Accounts Receivable Turnover Ratio, and Total Asset Turnover Ratio.

3. DATA ANALYSIS

Liquidity Ratios

Ratio	2019	2020	2021	2022	2023
Current Ratio	1.375	1.325	1.425	1.405	1.421
Quick Ratio	0.932	0.950	0.947	0.990	1.058
Absolute Ratio	0.104	0.009	0.042	0.001	0.007

Leverage Ratios

Ratio	2019	2020	2021	2022	2023
Debt-Equity Ratio	0.403	0.151	0.160	0.044	0.055
Interest Coverage Ratio	11.119	6.861	3.256	4.375	4.739
Capital Gearing Ratio	2.760	7.939	7.909	26.368	20.607
Proprietary Ratio	0.269	0.278	0.289	0.380	0.328

Profitability Ratios

Ratio	2019	2020	2021	2022	2023
Gross Profit	0.638	0.691	0.750	0.521	0.467
Net Profit	0.050	0.044	0.032	0.034	0.046
Earnings Per Share	Rs.138.948	Rs.124.82	Rs.114.31	Rs.124.590	Rs.10

Activity Ratios

Ratio	2019	2020	2021	2022	2023
Total Asset T. O. Ratio	2.094	1.638	1.717	1.950	1.475
Working Capital T. O. Ratio	2.446	1.819	1.814	2.303	1.587
Fixed Asset T. O. Ratio	16.07	17.627	62.395	55.322	25.290
Debtors T. O. Ratio	6.224	3.695	3.611	3.876	3.577

(T. O. = Turn Over)

Interpretation:

Liquidity Ratios

1. Current Ratio:

Current ratio over five years typically reflects good liquidity management and operational stability, but the actual value of the ratio should be analyzed to assess the overall financial health of the company.

2. Quick Ratio:

A gradually increasing quick ratio over five years suggests a positive trend in liquidity and financial management, but the relatively low values indicate that the company still has room for improvement in enhancing its short-term financial resilience.

3. Absolute Ratio:

The values over the 5 years indicate a metric that starts high, drops significantly in the second year, has a partial recovery in the third year, and then declines again in the fourth and fifth years. This suggests significant variability, with an overall trend of decline after an initial peak.

Leverage Ratios

1. Debt-Equity Ratio:

The Debt-Equity Ratio has significantly decreased from 0.403 in 2019 to 0.055 in 2023. This indicates that the company has reduced its reliance on debt financing relative to equity. The company has become less leveraged, implying lower financial risk and potentially lower interest obligations.

2. Interest Coverage Ratio:

The Interest Coverage Ratio has fluctuated over the years, with a significant drop from 11.119 in 2019 to 3.256 in 2021, followed by a slight improvement in 2022 and 2023. Despite the fluctuations, the ratio indicates that the company is still able to cover its interest expenses comfortably, though less so than in 2019.

3. Capital Gearing Ratio:

The Capital Gearing Ratio has increased substantially from 2.760 in 2019 to 20.607 in 2023, peaking at 26.368 in 2022. This indicates that the company's capital structure has become more heavily weighted towards debt financing, which can increase financial risk, especially if earnings do not grow accordingly.

4. Proprietary Ratio:

The Proprietary Ratio has generally increased from 0.269 in 2019 to 0.328 in 2023, with a peak at 0.380 in 2022. This indicates an improvement in the company's financial stability, as a higher ratio suggests a greater proportion of the company's assets are financed by equity rather than debt, reducing financial risk.

Profitability Ratios

1. Gross Profit Ratio:

The Gross Profit Ratio shows the company's efficiency in producing goods or services compared to its revenue. From 2019 to 2021, the ratio increased, indicating improved efficiency and profitability. However, there is a significant decline in 2022 and 2023, suggesting rising production costs or pricing pressures.

2. Net Profit Ratio:

The Net Profit Ratio reflects the overall profitability after all expenses. This ratio decreased from 2019 to 2021 but slightly improved in 2022 and 2023. Despite the fluctuations, the overall ratio remains relatively low, indicating tight profit margins.

3. Earnings Per Share (EPS):

EPS measures the profit allocated to each outstanding share. There is a noticeable decline in EPS over the years, with a drastic drop in 2023. This suggests that the company's profitability per share has significantly decreased, which could be due to lower net income or an increase in outstanding shares.

Activity Ratios

1. Total Asset Turnover Ratio:

This ratio indicates how efficiently the company uses its assets to generate sales. The ratio has been decreasing overall, with a peak in 2022. The declining trend in 2023 suggests reduced efficiency in using assets to generate revenue.

2. Working Capital Turnover Ratio:

: This ratio measures how effectively the company uses its working capital to support sales. The ratio has fluctuated, with a drop in 2020 and 2021, an increase in 2022, and another drop in 2023. The inconsistencies indicate varying efficiency in managing working capital.

3. Fixed Asset Turnover Ratio:

This ratio reflects how well the company generates sales from its fixed assets. There was a significant increase from 2019 to 2021, suggesting better utilization of fixed assets. However, the ratio declined in 2022 and further in 2023, indicating reduced efficiency in using fixed assets to generate revenue.

4. Debtors Turnover Ratio:

This ratio measures how efficiently the company collects revenue from its customers. The ratio decreased from 2019 to 2021, slightly improved in 2022, and dropped again in 2023. The overall decline indicates that the company is taking longer to collect its receivables, which could affect its liquidity.

4. LIMITATIONS

- Ratio analysis information is historic – it is not current.
- The Analysis is only permitted to annual reports with are provided by the company.
- The study is conducted within a short span of 45 days which makes it difficult to complete the whole Ratio Analysis.

- The company recently underwent an initial public offering (IPO) and became publicly traded, due to that few of the Ratios are not considered.

5. CONCLUSION

Ratio analysis serves as a pivotal tool in financial analysis, providing insights into a company's operational efficiency, liquidity, profitability, and solvency. By systematically evaluating financial statements through various ratios, stakeholders can make informed decisions regarding investments, credit, and management practices. The utility of ratio analysis extends beyond mere numerical assessment; it offers a comparative perspective against industry benchmarks and historical performance, thereby facilitating strategic planning and risk management. As financial landscapes continue to evolve, the relevance of ratio analysis remains indispensable, underscoring its role in fostering transparency and informed decision-making within the corporate sector. It is important to acknowledge that ratio analysis has limitations. It relies on historical data, which may not always predict future performance accurately. External factors such as economic conditions, market dynamics, and regulatory changes can also impact the efficacy of ratio analysis. Therefore, while ratio analysis is a powerful tool, it should be used in conjunction with other financial analysis methods and qualitative assessments. Ratio analysis remains an indispensable tool in financial management and analysis. It provides critical insights that drive informed decision-making, strategic planning, and overall financial health assessment.

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