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FINANCIAL PERFORMANCE EVALUATION - A CASE STUDY OF JK PAPER LTD

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Abstract : This paper is regarding the analysis of the financial performance of a leading paper manufacturing company - J.K paper Limited. The accounting ratios are used to measure the financial locus of a company. A "ratio" is distinguished from the specified quotient of two mathematical expressions and the relationship between two or more items. Ratios are a useful tool for various stakeholders like management, financiers, shareholders, creditors, etc. The data is gathered from the Secondary source of Published Annual Reports of the company for the time period 2016-17 to 2020-21. Two components make up the document. The first is to calculate various ratios to examine the company's financial status, and the second is to compare five-year ratios to analyse the company's performance. The analysis shows that the overall profitability position of the company is healthy and it has tight control over the factors generating revenue for the business. However, the company has enormous potential to increase its revenue further by having constant supervision on payoff of liabilities and the frequency of inventory turnover.

Index Term :- **Ratio, Financial performance, liquidity, leverage, turnover.**

1. INTRODUCTION

The link between two or more items is defined as a "ratio," which is defined as the indicated proportion of two mathematical terminology. A ratio is a point of reference used in financial analysis to evaluate a company's financial position and performance. Ratios aid in the summarization of enormous amounts of financial data and the development of qualitative judgments about a company's financial performance.

Ratio analysis is one of the tools that has redefined the role of financial manager from keeper for the information of accounts to decision maker of solving management problems. Ratio analysis is used to find out the current financial strength and weakness of the company, historical performance and future prospects. In short it helps to analyse the operational efficiency of the business. It also facilitates inter firm comparison.

2. OBJECTIVES

- Perceive the short-term financial position of the firm
- Comprehend the amount of net income or profit generated as a percentage of revenue.
- Measure the long-term financial health of the firm
- Analyse the operating efficiency of the business
- Suggests measure for improving financial performance of the company

3. RESEARCH METHODOLOGY

Analytical research methodology, based on quantitative data is followed in this study. The secondary data are drawn from the annual reports of the company. The time period of the study is five years starting from 2017. The analysis was done using the accounting tool ratio analysis.

4. RESEARCH PROBLEM

The study is based on the ascertainment of the existing condition of JK Paper Ltd's. Ratio analysis is used to evaluate the performance. The goal of this study is to determine the liquidity position, inventory turnover, and leverage position, as well as their determinants' effects. It is also to investigate the relationship between current liabilities and quick or liquid assets and to assess the firm's ability to make and market its manufactured items. This study also helps to look at the company's potential to generate a huge number of sales for a specific amount of cash, to determine the financial leverage of a corporation, and to figure out what percentage of revenue is generated in net income or profit of JK Paper Ltd.

5. RATIO ANALYSIS

Ratio analysis is a tool of financial analysis. It is described as a relationship between two or more things to evaluate the performance of a company. Ratio analysis helps in comparing related information. Instead of absolute figures it depicts data in relative figures. The figures can be expressed as a percentage or as ratios. It becomes a yardstick for evaluating the financial data of a company.

6. TYPES OF RATIOS

Ratios can be classified according to the functions or financial activity that is required to be evaluated. Ratios are therefore analysed according to the followings:

- Liquidity ratios
- Leverage ratios
- Coverage ratios
- Activity ratios
- Profitability ratios

Liquidity ratios

Liquidity ratios analysis the short-term solvency of a company or firm. The reason for evaluating the liquidity ratio is to find out if a firm has adequate funds to pay short-term obligations of one year or less. The important ratios for finding out liquidity of a company are:

a. Current ratio
b. Quick ratio

Leverage ratios

Leverage ratios indicate the debt paying ability of a company or firm. There are two types of debts in a company. These are short term and long-term debts. Leverage ratios calculate the proportion of debt in total financing of a company. The most important ratios under leverage are:

a. Total debt ratio
b. Debt – equity ratio
c. Capital equity ratio
d. Interest coverage ratio

Coverage ratios

Coverage ratios test the debt servicing capacity of a company. This is a part of leverage ratios and the information regarding these ratios is taking from the profit and loss account. These ratios indicate the ability of a firm to meet its interest obligations. The ratios under this category are:

a. Interest coverage charges
b. Fix coverage charges

Activity ratios

The efficient management of assets helps in generating a good volume of sales. This provides a good return to the owners and the creditors of a company. In ratio analysis turnover ratios are used to evaluate the efficiency of the use of assets. These turnover ratios are called activity ratios. The following activity ratios are commonly used to find out the utility of the resources:

a. Inventory turnover ratio
b. No. of days inventory
c. Debtors turnover
d. Assets turnover
e. Working capital turnover

Profitability ratios

Profitability ratios indicate the operating efficiency of a company by measuring the revenues of the company. Profitability of a company is essential because a commercial enterprise must sustain itself. To measure profitability the ratios can be calculated in relation to sales or investment. The ratios used for calculating of a company are:

i. General Profitability Ratio:

a. Gross Profit Ratio
b. Net Profit Ratio
c. Operating Ratio
d. Operating Profit Ratio
e. Expense Ratio

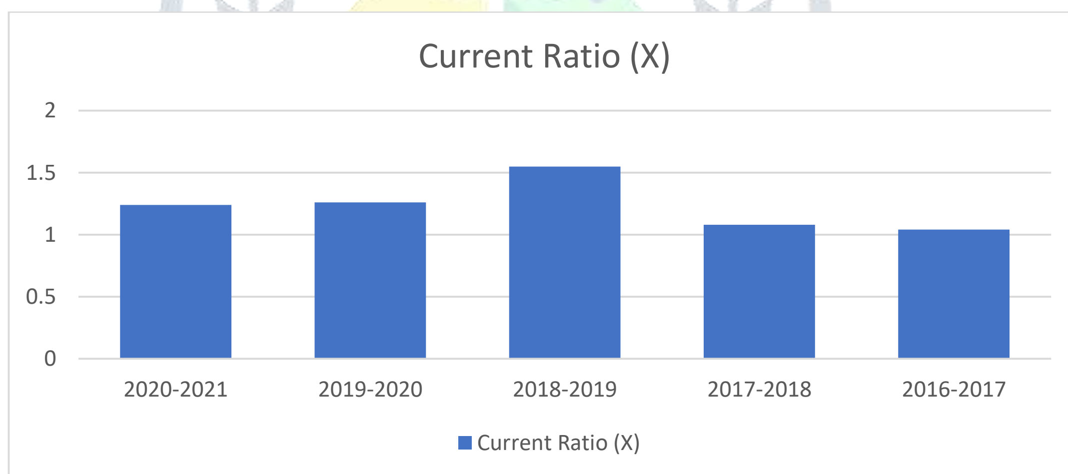
7. CALCULATIONS OF RATIOS

7.1. CURRENT RATIO:

Current ratio is calculated by dividing current assets by current liabilities:

$$\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Current Ratio (X)	1.24	1.26	1.55	1.08	1.04



INTERPRETATION:

As a rule of thumb, a current ratio of 2 to 1 or above is regarded satisfactory. It means that if in any worst situation the value of current assets falls to half, the company will still be able to satisfy its obligations. The current ratio measures the creditor's margin of safety; the higher the current ratio, the better the margin of safety.

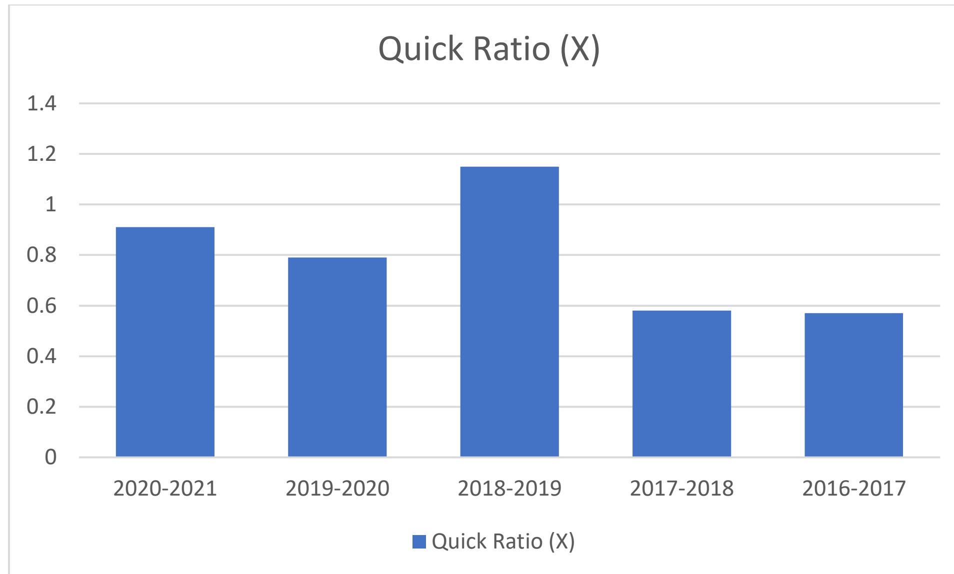
Comment: -According to the above table, JK Paper Ltd.'s liquidity position is more or less steady. Here the current ratio has decreased from 1.55:1 in the year 2019 to 1.26:1 and 1.24:1 in the year 2020 and 2021 respectively. However, the company was not able to achieve the standard current ratio of 2:1 during the period under study.

7.2. QUICK RATIO:

The quick ratio measures the relationship between liquid assets as well as current liabilities. An asset can be regarded as liquid if it is converted into cash within a short period or without a loss of value. To find quick ratio inventories are deducted from current assets, as it is considered to be less liquid

$$\text{Quick ratio} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Quick Ratio (X)	0.91	0.79	1.15	0.58	0.57



INTERPRETATION:

A quick ratio of 1:1 is considered adequate in most cases. The more accurate measure of liquidity is quick ratio when compared with current ratio. It provides a better picture of the firm's short-term financial position.

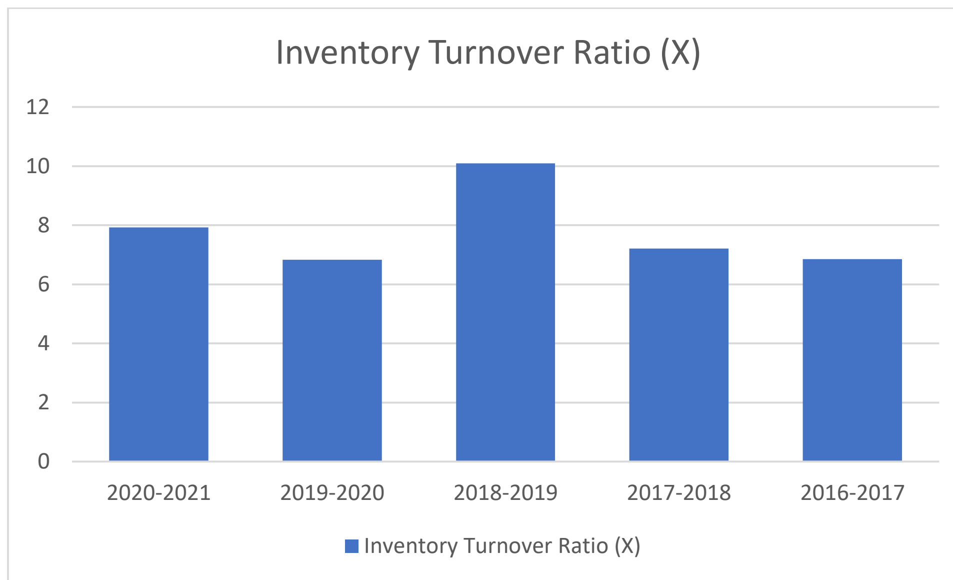
Comment: -In comparison to 2019, JK Paper Ltd's quick ratio has reduced in 2020 and 2021. This indicates that the current asset of the company is not able to fully pay off its current liabilities in the short term.

7.3. INVENTORY TURNOVER RATIO:

It indicates the competence of the firm in converting its stocks into sales. It is calculated by dividing Sales by average inventory.

$$\text{Inventory Turnover Ratio} = \frac{\text{Sales}}{\text{Average Inventory}}$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Inventory Turnover Ratio (X)	7.93	6.83	10.1	7.21	6.86



INTERPRETATION:

This ratio reveals how effectively the supply has been utilised. It demonstrates how quickly supply is turned into sales. The higher the ratioindicates that the product of the company is having high demand and converted into cash quickly. As a result,more profit can be earned by reducing inventory management costs.

Comments: - JK PaperLtd's inventory turnover ratio shows an increasing trend till 2019. After that it has deceased in the year 2020 and in 2021 it has increased. Except in the year 2020, the firm shows an increasing trend in managing its inventory.

7.4. ASSET TURNOVER RATIO:

This ratio measures the effectiveness of the firm's assets in generating revenue for the business. A firm'soperating performance is said to be sound if produces a large volume of sales for a given sum of net assets

$$\text{Asset Turnover Ratio} = \frac{\text{Sales}}{\text{Net Assets}}$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Asset Turnover Ratio (%)	45.43	64.39	76.87	78.83	73.14

INTERPRETATION:

This ratio indicates the company's operating performance and its ability to deliver a huge volume of sales for a known amount of net assets. Unused or underutilized assets will increase the maintenance and upkeep costs for the company and hence fixed assets must be optimally utilized.

Comments: -A high fixed turnover ratio indicates efficient utilization of fixed assets in generating sales in JK Paper Ltd. Here, the fixed asset to net worth ratio is increasing from 73.14 in 2017 to 78.83 in the year 2018. But there was a decrease in the ratio in the years 2020 and 2021 when compared with 2019. This indicates the underutilization of the capacity of the assets.

7.5. DEBTORS TURNOVER RATIO:

The Debtors Turnover Ratioalso called as Receivables Turnover Ratio shows how quickly the credit sales are converted into the cash. This ratio measures the efficiency of a firm in managing and collecting the credit issued to the customers.

$$\text{Debtors Turnover Ratio} = \frac{\textbf{Net Credit Sales}}{\textbf{Average Account Receivable}}.$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Debtors Turnover Ratio	3.43	4.08	4.21	2.60	2.37

INTERPRETATION:

This shows the number of times debtors are turned over in a year. A higher ratio is preferable. It indicates the efficiency of the management, in collecting the debts. Similarly, low debtor turnover implies inefficient management and less liquidity. A very high debtors turnover ratio is dangerous because it may imply a firm's inability due to lack of resourcesthereby losing sales and profits.

Comments: -In the year 2017 and 2018 debtors turnover ratio was less when compared to 2018 and 2019. The company had a better efficiency in managing the debtors in the year 2018 and 2019. But in 2021, the ratio decreased by3.43.

7.6. CREDITORS TURNOVER RATIO:

The creditor's turnover ratio is one of the accounting liquidity metrics. It can be used in evaluating the ability of the company to pay off its creditors. The ratio shows the number of times a company pays its average accounts payable in a given period (typically 1 year). This ratio can demonstrate the effectiveness of the company in handling its outgoing payments

$$\text{Creditors turnover ratio} = \frac{\textbf{Net Credit Purchase}}{\textbf{Average Account Payable}}$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Creditors Turnover Ratio	4.03	4.24	6.32	6.29	6.69

INTERPRETATION:

Generally, the lower the ratio, the better is the liquidity position of the firm, and the higher the ratio, the less liquid is the position of the firm. But a higher pay period also implies a greater credit period enjoyed by the firm and consequently larger the benefit reaped from credit suppliers.

Comments: -In the year 2017, 2018 and 2019 creditors turnover ratio was more when compared to 2020 and 2021. The company had a better efficiency in managing the creditors in the year 2020 and 2021.

7.7. TOTAL DEBT/EQUITY RATIO:

The ratio used to evaluate the financial leverage of the company is the debt-to-equity (D/E) ratio. It can be calculated by establishing a relationship between a company's total liabilities by its shareholder equity.

$$\text{Total Debt/Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Total Shareholders' Equity}}$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Total Debt/Equity (X)	0.8	0.48	0.54	0.64	1.08

INTERPRETATION:

The debt-to-equity (D/E) ratio compares a company's total obligations to its shareholder equity, and it can be used to determine how much leverage it has. Higher leverage ratios typically imply a company or stock that poses a greater risk to investors. It is recommended that the debt-to-equity ratio not exceed 2.0.

Comments: -In the year2017 the debt equity ratio is high. So the firm is considered more risky to investors and creditors. In the years 2018 to 2020 the ratio has shown decreasing trend and indicates the investor's preference towards the company. In the year 2021 the firm has borrowed more funds from creditors to give maximum benefit to the investors.

7.8. GROSS PROFIT RATIO:

The gross profit ratio depicts the percentage of sales revenue, over all direct costs associated with the business. It is calculated by subtracting direct expenses from net revenue, and dividing the result by net revenue and multiplying by 100%.

$$\text{Gross profit ratio} = \frac{\text{Net sales} - \text{Cost of goods sold}}{\text{Net sales}} * 100$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Gross Profit Ratio (%)	20.29	26.17	23.01	16.06	12.19

INTERPRETATION:

This ratio indicates an average gross margin earned on a sale of 100, the limit beyond which the fall in sales prices will definitely result in losses, and, what portion of sales is left to cover operating expenses, and non-operating expenses, to pay dividend and to create reserves. Higher the ratio, the more efficient the production and/or purchase management.

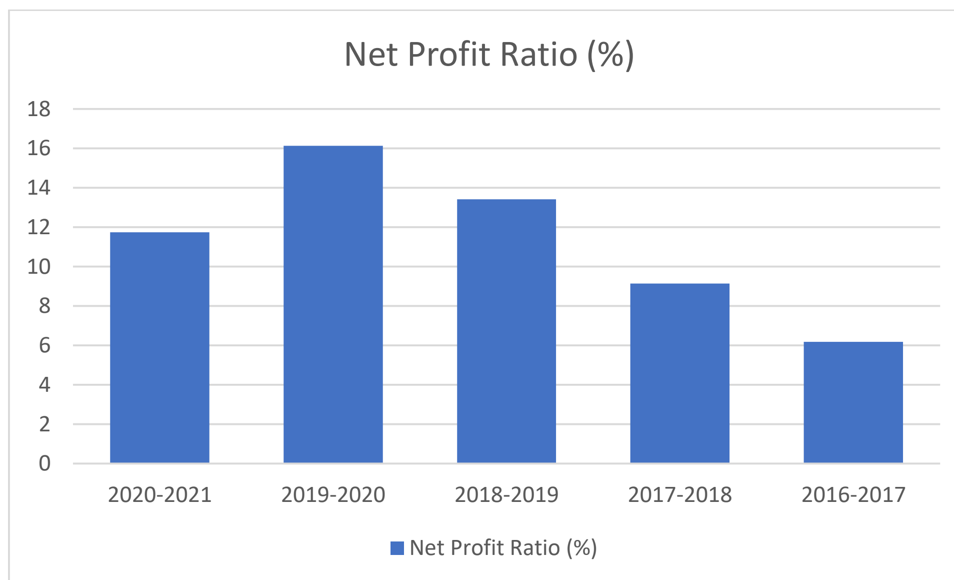
Comments: -The companies Gross profit ratio shows an increasing trend from the year 2017 t0 2020. But in the year 2021 there is a slight change in the trend, which require due care.

7.9. NET PROFIT RATIO:

The net profit measures the volume of profit arrived at after meeting all operating expenses as a percentage of revenue. In simple words it is the ratio of net profits to revenue.

$$\text{Net Profit Margin Ratio} = \frac{\text{Net Profit}}{\text{Net Sales}} * 100$$

Year	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017
Net Profit Ratio (%)	11.75	16.13	13.42	9.14	6.19



INTERPRETATION:

Net Profit Ratio is calculated by dividing income by revenues. The purpose of this ratio is to determine how profitable a firm or business activity is. It can be expressed in percentage, to show the extend of profit for every rupee of sales.A high net profit ratio indicates the efficiency of the firm in controlling its cost and sell goods or services higher than its cost.

Comments: -In the year 2017 to 2020, the company's net profit has been steadily increasing but there was a slight decrease in the year 2021. Even though there is decrease in the percentage, it is above 10% and be the sign of healthy profitability.

8. FINDINGS

The analysis of the study based on the secondary data from various sources reveals the following.

- JK Paper Ltd's liquidity position is augmenting steadily. However, the company was not able to achieve the standard current ratio of 2:1 during the period under study.
- In compared to 2019, JK Paper Ltd.'s quick ratio has reduced in 2020 and 2021. Although the quick ratio is a more acute measure of liquidity than the current ratio, it should be used with caution, as not all debtors are liquid, and cash may be needed right soon to cover operating costs.
- JK PaperLtd inventory turnover ratio indicates that till 2019 there was a proper outflow of supplies and that holdings did not remain in the go down for a lengthy period of time. However, there is a downward tendency in 2020 and 2021.
- A high fixed asset turnover ratio indicates efficient utilization of fixed assets in generating sales. In JK Paper Ltd, the fixed asset to net worth ratio shows increasing trend and indicates that the investment in fixed assets has been judicious.
- Debtors turnover ratio shows increasing trend in all the years except 2020. It indicates that that firm's operational efficiency retains quality customers.
- The debt-equity ratio for the period under study shows that the company is capable of attracting external investors and could maximise the return to its owners.
- The net profit ratio shows that the earning capacity of the company is healthy and also the company is having control over all the factors that contribute to the generation of profit.

9. CONCLUSION

- Thefinancial performance of the JK Paper Ltd was sound in all aspects rather it needs to concentrate more on to improve the liquidity position. It is recommended through this study that the firm should take measures to increase sales, the inventory turnover, pay off liabilities and improve the invoice collection period.

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