

"A man is
great by
deeds, not by
birth"
-Chanakya

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Case Study

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VWC Limited: Analysis of Accounting

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VWC Limited: Analysis of Accounting

By Dr. Rachappa Shette,

Indian Institute of Management Kozhikode, India.

“Current price should not be more than 1.5 times the book value last reported. However, a multiplier of earnings below 15 could justify a correspondingly higher multiplier of assets. As a rule of thumb we suggest that the product of the multiplier times the ratio of price to book value should not exceed 22.5. (This figure corresponds to 15 times earnings and 1.5 times book value. It would admit an issue selling at only 9 times earnings and 2.5 times asset value, etc.)”

-Benjamin Graham

Mr. Spandan, a qualified professional in equity research and fund management company, is a fund manager of a small-cap mutual fund of an Asset Management Company (AMC). He followed the principles of Prof. Benjamin Graham, the founder of value investing, and Mr. Warren Buffet. When the P/B ratio and P/E ratios of a company are less than 1.5 times and 15 times or when the product of these two multiples is less than 22.5, Mr. Spandan treats them as a value company and considers such a company for possible investment. In addition to Graham's two rules, he also uses the following checklist of ratios to invest in a value company:

1. The current ratio should be above 1.25 times,
2. The debt-to-equity ratio should be below 0.50 times,
3. Interest coverage ratio (ICR) should be more than five times and
4. Profitability ratios should be positive.

In the first week of June 2020, Mr. Spandan got to know from his professional friends that VWC Limited, a listed company on the National Stock Exchange (NSE) of India, is possibly an undervalued company. First, Mr. Spandan could collect information related to the history and nature of the company. The company was established in 1988. It produces guar gum using guar seeds as raw material. The company is one of the major guar gum producers in India. The company's output is exported to Western countries. The guar gum is used in making products like processed food, medicines, textiles, oil, and gas. Guar gum is one of the essential raw materials of corporate users of this material. In the end, Mr. Spandan was convinced by the nature of VWC Ltd's product.

As he was convinced with the nature and business of the company, he could collect the financial statements of VWC Ltd from its website, as presented in Exhibit-1, and compute its financial ratios, presented in Exhibit-2. He could also collect the financial ratios of VWC Ltd's competitor, Rama Gur Industries (India) Ltd, as shown in Exhibit 3. Mr. Spandan found that VWC Ltd's current ratio, D/E ratio, ICR, and profitability ratio meet the benchmark ratios required for investment requirements. However, he was not confident of VWC Ltd's financial performance and condition compared to its competitor.

Later, Mr. Spandan could collect the following additional information to compute the P/E and P/B ratios of VWC Ltd.

- Average market price per share in June 2020: INR 5.00,

- The number of shares outstanding as of March 31, 2020, is 20,44,39,600 (face value of Rs 1 per share).

He needs to compute P/E and P/B ratios to understand whether VWC Ltd is undervalued or overvalued and make investment decisions as per Benjamin Graham's principle.

Thus, Mr. Spandan could collect information related to VWC Ltd's financial statements and ratios along with information about its competitor, the nature of the business, market price, and number of shares, and select accounting notes information given in Exhibit-4. Using all this information, he needs to understand the company's financial performance and financial condition and identify one or two major drivers of their performance. He also needs to compute the P/E and P/B ratios to make investment decisions on the line of Benjamin Graham's principle. To justify his investment decision, he also needs to find strong possible reasons for the over or undervaluation of VWC Ltd.

Mr. Spandan called his intern from a reputed management institute and assigned him to the additional computations and analysis required for investment decisions.

Questions:

1. Based on the ratios of VWC Ltd, compared to the ratios of its competitor Rama Gur Industries (India) Ltd, what is your evaluation of VWC Ltd on 5 to 1 point scale, with two main reasons, concerning:
 - a. Financial Performance (5 is for strong and 1 is for weak financial performance).
 - b. long-term financial condition (5 is for strong and 1 is for weak financial condition).
2. Should Mr. Spandan invest in VWC Ltd Co?
3. What are the possible reasons for the difference between the market value and book value of VWC Ltd?
4. Do the financial statements of VWC Ltd give a true and fair view of the company? Why?
5. If not, correct the financial statements of VWC Ltd for 2019-20 and recompute the ratios based on the corrected financial statements of VWC for 2019-20.

Exhibit 1: Financial Statements of VWC Ltd
Balance Sheet of VWC Ltd As on March 31, 2020 (INR in lakhs)

	Note No	As at March 31,2020	As at March 31,2019	
Assets				
Non-Current Assets				
a)	Property, Plant and Equipment	3	63,406.03	66,839.79
b)	Capital Work in-progress	3	1,156.33	1,109.28
c)	Other intangible assets	3	1.03	2.72
d)	Financial Assets	4		
	i) Other financial Assets		266.08	266.08
e)	Other non-current assets	5	28,330.38	28,329.38
Total Non-Current Assets			93,159.85	96,547.25
Current Assets				
a)	Inventories	6	7,303.17	10,099.78
b)	Financial Assets	7		
	i) Trade receivables		60,560.79	52,525.12
	ii) Cash and cash equivalents		106.18	56.99
	iii) Bank balances other than ii) above		77.92	77.92
c)	Other Current Assets	8	7,966.91	7,753.74
Total Current Assets			76,014.97	70,513.55
TOTAL ASSETS			1,69,174.82	1,67,060.80
EQUITY AND LIABILITIES				
Equity				
a)	Equity share capital	9	2,044.40	2,044.40
b)	Other Equity	10	1,12,462.63	1,10,472.61
Total Equity			1,14,507.03	1,12,517.01
Liabilities				
Non-Current Liabilities				
a)	Provisions	11	788.31	576.47
b)	Deferred tax liabilities (net)	12	-604.19	46.56
Total non-current liabilities			184.12	623.03
Current Liabilities				
a)	Financial Liabilities	13		
	i) Borrowings		13,564.91	15,529.26
	ii) Trade Payables		7,727.98	9,022.88
	iii) Other financial liabilities		10,219.00	7,097.75
b)	Other current liabilities	14	20,178.88	19,951.23
c)	Provisions	15	22.75	19.94
d)	Current tax liabilities	15	2,770.16	2,299.66
Total Current liabilities			54,483.68	53,920.72
Total Liabilities			54,667.80	54,543.75
TOTAL EQUITY AND LIABILITIES			1,69,174.83	1,67,060.76

Source: Annual Report of VWC Ltd

Statement of Profit and Loss of VWC Ltd for the year ended March 31, 2020

INR in Lacs

Particulars	Notes	March 31, 2020	March 31, 2019
Income			
Revenue from operations	16	75,762.81	79,997.99
Other income	17	-	4.22
Other gains	17	0.08	3,012.28
Total Income		75,762.89	83,014.49
Expenses			
Cost of material consumed	18	67,167.31	68,688.82
Change in inventory of finished goods	19	254.90	-46.41
Excise duty on sale of goods	20	-	-
Employee benefit expenses	21	2,167.25	3,503.19
Finance costs	22	416.27	2,107.61
Depreciation and amortisation expense	23	3,435.45	3,454.48
Other expenses	24	401.33	670.21
Total Expenses		73,842.51	78,377.90
Profit/ (Loss) before tax		1,920.38	4,636.59
Income tax (credit)/expense	25		
-Current tax[Minimum Alternate Tax (MAT)]		470.49	1,325.80
-MAT credit entitlement		-	-
-Deferred tax		-684.94	-1,381.37
Profit/(Loss) for the year		2,134.83	4,692.16

Source: Annual Report of VWC Ltd

Exhibit 2: Ratios of VWC Ltd

Ratios				2020 March	2019 March	
Profitability Ratios:						
1	Return on Equity	Profit after Tax*100	Total Equity	1.86	4.17	%
2	Return on Investment	Profit after Tax*100	Total Assets	1.26	2.81	%
3	NI Ratio	Profit after Tax*100	Sales Revenue	2.82	5.87	%
Efficiency Ratios:						
1	TA Efficiency ratio	Sales Revenue	Total Assets	0.45	0.48	times
2	NCA Efficiency	Sales Revenue	Total Non-Current Assets	0.81	0.83	times
3	CA Efficiency	Sales Revenue	Total Current Assets	1.00	1.13	times
4	Inventory Efficiency	Sales Revenue	Inventory	10.37	7.92	times
5	A/R Efficiency	Sales Revenue	Receivables	1.25	1.52	times
6	Inventory holding days	Number of Days in a year*	Inventory Efficiency	34.70	45.45	days
7	Receivables Collection Days	Number of Days in a year*	Receivables Efficiency	287.76	236.37	days
Liquidity Ratios:						
1	Current Ratio	Current Assets	Current Liabilities	1.40	1.31	times
Solvency Ratios:						
2	D/E Ratio	Total Liabilities	Total Equity	0.48	0.48	times
3	Leverage	Total Assets	Total Equity	1.48	1.48	times
4	Interest Coverage Ratio	Profit before Interest and Tax	Interest	5.61	3.20	times

Source: Author's own work. *The number of days in a year is assumed as 360 days.

Exhibit 3: Ratios of VWC Ltd's competitor Rama Gur Industries (India) Ltd

		Rama Gur Industries -2020 March	
Profitability Ratios:			
1	Return on Equity	10.18	%
2	Return on Investment	3.58	%
3	Net Income Ratio	1.17	%
Efficiency Ratios (Activity or Turnover Ratios):			
1	Total Assets Efficiency ratio	3.06	times
2	Non-Current Assets Efficiency	25.76	times
3	Current Assets Efficiency	3.48	times
4	Inventory Efficiency	8.17	times
5	Receivables Efficiency	8.06	times
6	Inventory holding days	44.09	days
7	Receivables Collection Days	44.68	days
Liquidity Ratios:			
1	Current Ratio	1.36	times
Solvency Ratios			
1	Leverage	3.06	times
2	Debt-to-Equity Ratio	1.84	times
3	Interest Coverage Ratio	3.32	times
*Number of days in a year are assumed as 360 days.			

Source: Author's own work

Exhibit 4: Select Notes extracted from the published annual report (INR in Lacs)**Note 5: Other Non-Current Assets**

	As at 31 March, 2020	As at 31 March, 2019
5 Other Non-Current Assets:		
Capital advances	20.43	19.43
Service tax deposited under protest	509.95	509.95
Advances other than capital advances		
-Claim receivable (refer note 32)	27,800.00	27,800.00
	28,330.38	28,329.38

Note 7: Receivables

	As at 31 March, 2020	As at 31 March, 2019
7 Financial assets:		
(i). Trade receivables#		
Unsecured, considered good otherwise stated		
Debts recoverable	60,560.79	52,525.12
	60,560.79	52,525.12

#includes dues from related parties (refer note 34)

Note 8: Other Current Assets

	As at 31 March, 2020	As at 31 March, 2019
8 Other Current Assets:		
Advances other than capital advances:		
Unsecured, considered good otherwise stated		
Advance to suppliers^	6,992.54	6,865.78

^includes dues from related parties (refer note 34e)

Note 32: Settlement Claim

November 2013 for non-performance of purchase orders issued by Economy Polymers. During the year 2014-15, the Company had entered into a settlement for USD 80 Million, Equivalent Rs.494,82.62 lacs with Economy Polymers against their claim for compensation. The Company had recognized Rs.474,46.08 lacs in the Statement profit and loss and balance of Rs. 2036.54 lacs has been adjusted against outstanding receivable for seed distribution from Economy Polymers as per the settlement agreement. In turn, to discharge to the Company's liability towards non-performance of agreements for purchase of material for Economy Polymers, the Company had settled with suppliers for Rs.385,00.00 lacs. The same had been recognized in the statement of profit and loss during the financial year 2014-15 on accrual basis.

However, subsequent to payment of USD 40 million (Equivalent INR 24965.80 lacs, in July 2015 Economy Polymers stopped paying the balance instalments due as per the aforesaid settlement agreement. Consequently, due to non-recovery of the said dues to the extent of USD 40 million approximately INR 26,028.00 lacs, the Company has filed a court case against Economy Polymers in United States District court for the Southern District of Texas Houston Division, for recovery of balance

USD 40 million (Equivalent INR 26028.00 lacs). Considering the ongoing litigation the receivable has been classified under other non-current assets.

Note 33(a)i: Interest on borrowings

The Company has been availing various export credit facilities amounting Rs.12,151.28 lacs (previous year Rs.14128.18 lacs) for Export from Punjab National Bank, Union Bank of India and Bank of India under consortium. The aforementioned credit facilities of the Company were classified as Non-Performing Assets (NPA) in June 2016. However, during the current year, the Company has repaid loan Rs. 19.76 lacs to Punjab National Bank. In accordance with the prudential norms for banks by the Reserve Bank of India, the lender banks have not charged interest on aforementioned export credit facilities extended to the Company upon the classification of the export credit facilities of the Company as NPA. Accordingly, the Company is not making provision for interest on bank borrowings.

Note 34: Related Party Disclosures (select notes from this section):

Transactions with related parties are summarized below:

Transactions which have taken place during the year

Transactions with related parties

(a) sales/purchases of goods and services

The following are the sales and purchase during the reporting period in relation to transactions with related parties:

Entities controlled by key management personnel	INR in Lacs	
	For the year ended March 31,2020	For the year ended March 31, 2019
Sales:		
-Vikas Chemi Gums (India) Limited	22,743.03	39,436.54
-Vikas Dall and General Mill	12,447.68	19,697.90
	<u>35,190.71</u>	<u>59,134.45</u>
Purchase of raw material:		
-Vikas Chemi Gums (India) Limited	45838.38	31904.01
-Vikas Dall and General Mill	6753.40	14554.10
	<u>52,591.78</u>	<u>46458.11</u>
(b) Salary #		
Mr. BD Agarwal	36.60	36.00
Mrs. Bimla Devi Jindal	9.00	9.00
Mrs. Kamini Jindal	12.00	12.00
Mr. Gunjan Kumar Karn	11.85	6.00
Mr. Umesh Bansal	12.00	12.00
	<u>80.85</u>	<u>75.00</u>
(c) Interest free unsecured loans from director		
- Mrs. Bimla Devi Jindal	913.63	901.08
(d) Trade receivables		
-Vikas Proppant & Granite Limited	8856.26	8856.26
-Vikas Chemi Gums India Ltd	1134.28	26120.97
-Vegan Colloids Limited	917.21	917.21
-Vikas Dall and General Mill	7118.64	1417.02
Total receivables from related parties	<u>18026.39</u>	<u>37311.46</u>

e) Advances to suppliers

-Vikas Chemi Gums India Ltd	4205.66	4205.66
-Vikas Proppant & Granite Limited	<u>2250.00</u>	<u>2250.00</u>
	<u>6,455.66</u>	<u>6,455.66</u>

(f) Payables

Mr. B.D. Agarwal	33.91	10.76
Mrs. Bimla Devi Jindal (includes unsecured loan)	928.85	916.30
Mrs. Kamini Jindal	42.09	31.29
Mr. Gunjan Kumar Karn	9.26	-
Mr. Umesh Bansal	<u>20.98</u>	<u>10.45</u>
	<u>1,035.10</u>	<u>968.80</u>

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