

Comparative Financial Analysis of Construction Companies in India

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Abstract— In this study, the comparative financial analysis of construction companies of India is carried out. This analysis is done with the help of various financial ratios. These ratios will help in determining the performance of the companies with respect to the construction industry average of the country. Ratio Analysis presents a failure prediction model for the company based on the previous business data available. It is anticipated that Construction Company will be able to prevent business failures by using the result from the research. The Ratio Analysis on the construction companies of India has been performed, and their performances have been compared based on the standard ratios and Industrial performances over the years. The selection of the companies is based on their total assets, for the firms of "Construction & Contracting – Civil" category, which are HNB Engineers Pvt. Ltd., Gondwana Engineers Ltd. and Evergreen India Pvt. Ltd. Company's performance has been compared on the basis of their financial performance taken from their balance sheets over the last 5 years. Their performances are then analyzed based on the financial ratios considered and thereby interpretations and recommendations are given. For a construction company, the fulfillment of short term obligations, their assets and liabilities lot depends on the availability of funds, which ultimately depends on the work, results and efficiency of the company. It overall showcases the causes of lack in financial performances of the company. Based on the interpretations from the analysis made, recommendations to companies has been given, clearly stating how the company should work on their non-performance in certain areas, which would help them in taking certain measures for their future progress and stability.

Keywords- *Financial analysis; Ratio analysis; Industrial performance*

I. INTRODUCTION

Indian construction industry has witnessed drastic changes in the last two decade. With large number of projects involving infrastructure, power generation, water supply, oil and gas projects etc. Indian construction companies have been brought to a level to test their extraordinary management skills, financial management techniques, manpower etc. With huge capital involved in all projects at various stages, the management has to keep an eye on each aspect like assets, liabilities, funds flow, liquidity, profitability, operating expenses etc. It is also important that, while executing management skills, the construction projects taking care of the cost over runs and time delays which is the root cause of the struggling construction sector in the country at present scenario.

India is on the verge of witnessing a sustained growth in infrastructure build up. The construction industry has been witnessing a strong growth wave powered by large spends on housing, road, ports, water supply, rail transport and airport development. While the construction sector's growth has fallen as compared to the pre- 2008 period, it has picked up in the recent past, which is having 11% share in Gross Domestic Product of country (Updated 1st June 2016). Its share as a

percentage of GDP has increased considerably as compared to the last decade. To put things in perspective, the total investment in infrastructure - which in this case also includes roads, railways, ports, airports, electricity, telecommunications, oil gas pipelines and irrigation is done, which was made around Rs. 70,000 Crores in the Financial Budget of 2015-16. The Planning Commission of India has proposed an investment of around US\$ 1 trillion in the Twelfth five-year plan (2012-2017), which is double of that in the Eleventh five-year plan.

The construction sector is a major employment driver, being the second largest employer in the country, next only to agriculture. This is because of the chain of backward and forward linkages that the sector has with other sectors of the economy. About 250 ancillary industries such as cement, steel, brick, timber and other building materials are dependent on the construction industry. A unit increase in expenditure in this sector has a multiplier effect and the capacity to generate income as high as five times.

A financial tool which helps the management of the company to handle all these elements together is Ratio analysis. Ratio analysis is done using company's Annual reports. Ratio analysis allows shareholders, creditors,

Government and analysts to make an evaluation of firm's performance. Ratios provide an easy way to compare present performance with the past. Analysis of different financial ratios shows how the company performs in each department and helps to predict the expected future outcome using past and present performance.

This ratio analysis would also help companies in further taking future decisions depending on various aspects such as taking up a new project or not, or expansion of the company etc. Therefore, it is essential that companies perform financial analysis periodically so as to take necessary strategies for their survival as well as performance improvement.

II.OBJECTIVES

The main objectives of study area are as follows:

1. To study the financial ratios of construction companies.
2. To perform ratio analysis of construction companies by determining various financial ratios.
3. To compare results of the ratio analysis of the companies and highlighting the performance of each company.
4. To give suitable recommendations on the performance of companies.

Failures have been transpired in the construction industry not only in developing countries but worldwide. Construction company failures are not only extremely disruptive to the industry but it may pose a threat to the economy of the nation. Construction companies are vulnerable to bankruptcy due to fluctuations in construction volume, fragmented nature of the industry, inflation, high competition, the uncertainty and the risk involved. The earliest determination of any potential failure will protect the company from becoming a victim.

Business failure rarely depends on a single factor but it mostly occurs at critical situation as a consequence of a complex process. Following points have been identified for the distress of Construction Companies, they are:

- (i) Bank line of credit constantly borrowed to the limit,
- (ii) Poor estimating and/or job cost reporting,
- (iii) Ineffective financial management system,
- (iv) Poor project management,
- (v) No comprehensive business plan and,
- (vi) Communication problem.

The first four are directly proportional to the financial management of a company.

III.METHODOLOGY

The research methodology adopted for comparative analysis of construction companies is ratio analysis. When it comes to investing, understanding financial statement information (also known as quantitative analysis) is one of, if not the most important element in the fundamental analysis process. At the same time, the massive amount of numbers in a company's financial statements can be wildering and intimidating to many investors. However, through financial ratio analysis you will be able to work with these numbers in an organized fashion.

A financial ratio or accounting ratio is a relative magnitude of two selected numerical values taken from an enterprise's financial statements. Often used in accounting, there are many standard ratios used to try to evaluate the overall financial condition of a corporation or other organization. Financial ratios may be used by managers within a firm, by current and potential stakeholders of a firm, and by a firm's creditors. Financial analysts use financial ratios to compare the strengths and weaknesses in various companies.

Ratios can express as a decimal value, such as 0.10, or given as an equivalent per cent value, such as 10%. Some ratios are usually quoted as percentages, especially ratios that are usually or always less than 1, such as earnings yield, while others are usually quoted as decimal numbers, especially ratios that are usually more than 1, such as P/E ratio; these latter are also called multiples. Given any ratio, one can take its reciprocal; if the ratio was above 1, the reciprocal will be below 1, and conversely. So, among the dozens of financial ratios available, I've chosen 9 most relevant to the investing process and organized them into 4 main categories.

Ratio-analysis means the process of computing, determining and presenting the relationship of related items and groups of items of the financial statements. They provide in a summarized and concise form of fairly good idea about the financial position of a unit. They are important tools for financial analysis.

IV. THEORETICAL CONTENTS

A. Classification of Ratios

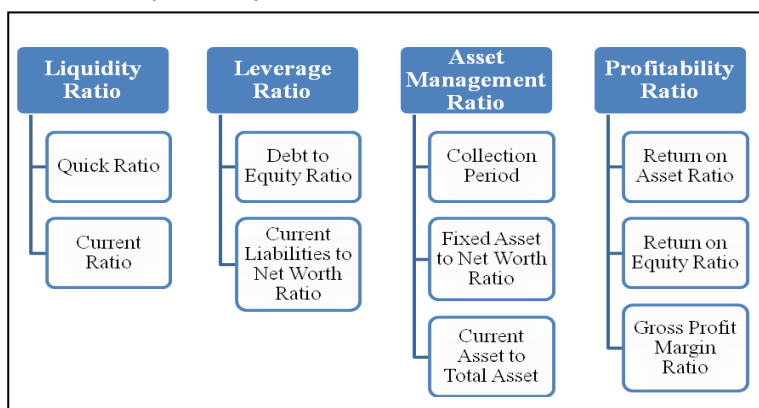


Fig.Classification of Ratios

B. Company Information

HNB ENGINEERS PVT. LTD., an ISO 9001: 2015 and ISO 14001: 2015 Company is a conversion of a well-known firm H. N. Bhat & Co. This firm was established in 1973 with the intentions to execute quality civil works by technically sound persons, having Head Office at Pune, Maharashtra, India. They are "Turnkey / EPC" Contractors engaged in the fields of water and Waste water Treatment. They have in-house capabilities to execute Civil, Mechanical (which consist manufacturing of pollution Control Equipments, Non Clog and Process Pumps), Electrical and Instrumentation works which facilitates their ability to deliver "Turnkey Solutions". The annual turnover of the company is more than 100 crores. Data collected from company is as follows:

1. Balance sheet
2. Profit and Loss account
3. Cash Flow statement
4. Solvency Certificate

C. Liquidity Ratio

• Quick Ratio

Generally, a quick ratio of 1 of 1 is considered to represent a satisfactory current financial condition. A company with a high value of Quick Ratio can suffer from a shortage of funds if it has slow paying, doubtful and long- duration outstanding debtors. On the other hand, a company with the low value of Quick Ratio may really be prospering and paying its current obligation in time if it has been turning over its inventories efficiently.

• Current Ratio

The Current Ratio is measure of the firms short- term solvency. It indicates the availability of current assets in rupees for every rupee of current liability. A ratio of greater than one means that the firm has more current assets than current claims against them. As a conventional rule, a Current Ratio of 2 to 1 or more is considered satisfactory. Higher the Current Ratio, the greater the margin of safety; the larger the amount of current assets in relation to current liabilities more the firm's ability to meet its current obligation.

D. Leverage Ratio

• Debt to Equity Ratio

It clearly indicates that how much company is dependent on debt's to expand its business i.e. the proportion of equity and debt the company is using in financing its assets.

• Current Liabilities to Net Worth Ratio

A measure of the extent to which the enterprise is using creditor funds versus their own investment to finance the business. A ratio of 0.5 or higher may indicate inadequate owner investment or an extended accounts payable period.

Care should be taken not to offend your vendors (creditors) to the extent it affects your ability to conduct day to day business.

E. Asset Management Ratio

• Fixed Asset to Net Worth Ratio

Fixed Asset to Net Worth Ratio measures the amount of company's worth in fixed assets. The standard Fixed Asset to Net Worth Ratio generally adopted is 0.75.

• Current Asset to Total Asset Ratio

It indicates the extent of total funds invested for the purpose of working capital and throws light on the importance of current assets of a firm. It should be worthwhile to observe that how much of that portion of total assets is occupied by the current assets, as current assets are essentially involved in forming working capital and also take an active part in increasing liquidity. This ratio depicts the asset which the company is holding for less than a year like inventories and so on. The standard adopted is 0.56 or less.

F. Profitability Ratio

• Return on Asset Ratio

It is an indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as "return on investment".

• Return on Equity Ratio

Return on Equity indicates how well the firm has the resources of company. This ratio is one of the most important relationships in financial analysis. The earning of a satisfactory return is the most desirable objective of a business. The returns on owner's equity of the company should be compared with ratios for other similar companies and the industry average. This will reveal the relative performance and strength of the company in attracting future investments.

V. CONCLUSION

Based on literature survey conducted, various financial ratios useful for construction companies are determined. They are Liquidity Ratio, Leverage Ratio, Asset Management Ratio and Profitability Ratio.

Further, data of last five years have been collected from HNB ENGINEERS PVT. LTD. and analyzed in detail. The average result of last five years ratios are as follows:

- A. Liquidity Ratio
 1. Quick Ratio = 0.981
 2. Current Ratio = 1.613
- B. Leverage Ratio

1. Debt to Equity Ratio = 2.003
 2. Current Liabilities to Net Worth Ratio = 0.932
- C. Asset Management Ratio
1. Fixed Asset to Net Worth = 0.278
 2. Current Asset to Total Asset Ratio = 0.723
- D. Profitability Ratio
1. Return on Asset Ratio = 0.044
 2. Return on Equity Ratio = 0.091

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