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# A Study of the Financial Performance of Essar Oil Limited Based on Profitability and Liquidity Ratios

KEYWORDS: Financial Performance, Profitability Ratio, Liquidity Ratio

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**ABSTRACT** *Profit is an essential part of a business. Every stakeholder of a company takes keen interest to know the financial soundness and profitability of the company. To analyze financial performance of the company, the data for five years from 2009-10 to 013-14 have been considered for the study. The data has been analyzed by using selected profitability and liquidity ratios. From the analysis, it has been concluded that the financial performance of Essar Oil Limited is not stable. Moreover it has been found that the financial position of this company is not good in light of profitability and liquidity ratios.*

**1. Introduction**

Aim of Financial statements is to provide financial information about a business enterprise to decision-makers. These statements provide financial data which require analysis, comparison and interpretation for taking decision by the external as well as internal users. This act is termed as "financial statement analysis". Financial analysis is largely a study of relationship among the various financial factors in a business as disclosed by a single set of statements and a study of these factors as shown in a series of statements. It is the process of determining financial strengths and weaknesses of the firm by studying the relationship between the items of balance sheet, profit & loss account and the other operative data.

The most commonly used techniques of financial statements analysis are comparative statements, common size statements, trend analysis, ratio analysis, fund flow analysis, cash flow analysis etc. Ratio analysis plays an important role in determining the financial strengths and weaknesses of a company relative to that of other companies in the same industry.

**2. Company Profile:**

Essar Oil is a fully integrated oil & gas company of international scale with strong presence across the hydrocarbon value chain from exploration & production to refining and oil retail. Essar Oil has a portfolio of onshore and offshore oil & gas blocks with about 1.7 billion barrels of oil equivalent in reserves & resources. Essar Oil owns India's second largest single site refinery at Vadinar, Gujarat, having a capacity of 20 MMTPA, or 405,000 barrels per day. Vadinar Refinery has a complexity of 11.8, which is amongst the highest globally. The refinery is capable of processing some of the toughest crudes and yet produces high quality Euro IV and V grade products. The refinery has been set up at a very competitive capex of $12,746 /bbl, which is about half the global average.

**2. Literature Review**

Dejan, T. and Andre, D. (2009) have studied on strategic and financial analysis in the oil industry. They have found that Petrobras' strengths by far outmatch its threats and enable the company to deliver value to shareholders in the long-run.

P.D. Erasmus (2010) has found that statistically significant negative relationships between a firm's profitability and its net trade cycle (NTC), debt ratio and liquidity ratio. He has also found that the liquidity and debt ratios appear to play a more important role than the NTC.

B.S. Yogesha and B. Mahadevappa (2011) have studied on Value Added Ratios of Indian Oil Corporation Ltd. They have calculated Value added ratios on the basis of value added statements and analysed. They have concluded that to improve the current accounting practice by restating profit and loss account into value added statement.

Pawan Kumar et al. (2013) have studied on financial performance of Indian Oil Limited. From the analysis, they have concluded that company should concentrate on minimization of the expenses. They have concluded that the company should improve its current and quick ratios.

Olivier Taile Manikom and Charles Guillermet (2014) have found that the crude oil price has a negative relationship with the financial ratios and that the crisis had an impact during that time period on the financial performance of the IOCs. They have also noted that the debt level and the size of IOCs have a strong relationship with their financial performance.

**3. Problem Statement**

Profit is an essential part of a business. Every stakeholder of a company takes keen interest to know the financial soundness and profitability of the company. To survive and grow in the long-run, a company has to earn sufficient profits. When management of a company is keen to measure its operating efficiency through profitability, the shareholders invest their funds in the expectation of reasonable returns. Thus, the operating efficiency of a company and its ability to ensure adequate returns to its shareholders depends ultimately on the profits earned by it (Khan and Jain, 2007). On the bases of this, the problem statement for the research study has been framed that; is Financial performance of ESSAR Oil Limited appears stable?

**4. Significance of the Study**

This study focuses on the financial performance of Essar Oil Limited. The financial performance has been measured on the bases of profitability and liquidity ratios which will spotlight on the financial position of this company since past five years. So, the investors as well as the stakehold-

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ers and management can get an idea about the stability of financial position of the company which will be useful to take decision.

**5. Objectives of the Study**

1. To know the stability of the company based on the profitability and liquidity.
2. To give useful suggestions in light of profitability and liquidity.

**6. Hypothesis of the Study**

1. **$H_{0}$:** Financial Performance of Essar Oil Limited is not stable in light of profitability and liquidity.
2. **$H_{1}$:** Financial Performance of Essar Oil Limited is stable in light of profitability and liquidity

**7. Limitations of the Study**

1. The study is limited to Essar Oil Limited only.
2. The study has covered profitability and liquidity aspects only.
3. The study has covered the period of five years only.

**8. Research Methodology**

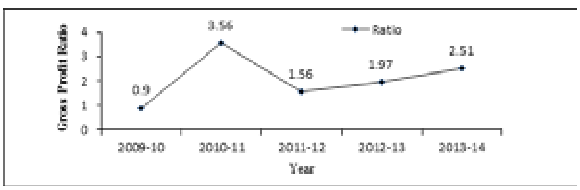
As the study is related to the analysis of financial performance of the company, secondary data is essential part of it. Secondary data has been collected from the annual report of Essar Oil Limited. The data has been considered for a period of last five financial years from 2009-10 to 2013-14. The data has been analyzed by applying the basic ratios of profitability and liquidity. Gross profit ratio, Net Profit Ratio, Return on Capital Employed (%), Current Ratio, Quick Ratio, Debt Equity Ratio and Earnings per Share have been considered for the study.

**9. Analysis and Interpretation**

Data has been analyzed by applying selected profitability and liquidity ratios. It has been presented in table also. Following is the analysis and interpretation of the data.

**1. Gross Profit Ratio**

**Figure No. 1.1** Gross Profit Ratio (percent)



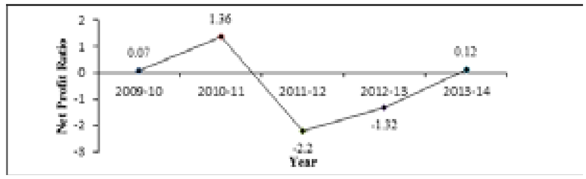

**Interpretation**

Gross Profit Ratio is a profitability ratio that shows the relationship between gross profit and total net sales revenue. It is a popular tool to evaluate the operational performance of the business. The ratio is computed by dividing the gross profit by net sales.

From the above figure no. 1.1, it is clear that there is no stability in gross profit of the company. In 2009-10 the ratio was 0.90% and increased to 3.56 % in 2010-11 which can be said satisfactory position but company could not maintain its position next two years of the study and ratio decreased to 1.56% in the year 2011-12 and 1.97 % in the year 2012-13 which cannot be said satisfactory position from the investors point of view. No doubt company improved it in year 2013-14 when gross profit reached to 2.51%. The fluctuation in gross profit is because of the amount of gross profit. So it can be concluded that company has failed to stable its gross profit ratio during the period of study which is not good for the company's financial health.

**2. Net Profit Ratio**

**Figure No. 1.2 Net Profit Ratio (percent)**



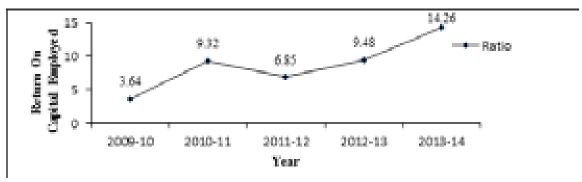

**Interpretation**

Net Profit Ratio is a ratio of net profits after taxes to the net sales of a firm. This ratio also gives the firm's capacity to face adverse economic conditions such as price competition, low demand etc. Obviously higher value of this ratio indicates good position.

From the above figure no. 1.2, it is clear that company also failed to stabilize its net profit. In 2009-10 the ratio was 0.07% which cannot be said satisfactory but company improved ratio in 2010-11 to 1.36% but failed to maintain its position in 2011-12 and ratio decreased to -2.2% and remains negative in 2012-13 with 1.32%. In 2013-14 company recovered from this situation and net profit ratio increased to 0.12%. This trend cannot be said satisfactory from the point of view of investors, creditors, lenders etc.

**3. Return on Capital Employed (%)**

**Figure No. 1.3** Return on Capital Employed (percent)




**Interpretation**

Return on Capital Employed Ratio is computed by dividing the net income before interest and tax by capital employed. It measures the success of a business in generating satisfactory profit on capital invested. It also helps to asses a company's return relative to its capital investment risk, since riskier investment is expected to yield higher return.

From the above figure no. 1.3, it is clear that in the year 2009-10 ratio is 3.64% and improved to 9.32% in 2010-11. But company could not maintain it in next year of study, ratio decrease to 6.85% in 2011-12 and then again increase to 9.48 % and 14.26% in the year 2012-13 and 2013-14 respectively, which is the highest during the period of the study. The return on capital employed is increasing every year except the year 2011-12. So the company is unable to maintain Earnings before interest and tax with respect to capital employed.

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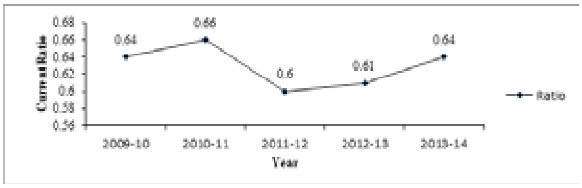
**4. Current Ratio**

**Figure No. 1.4** Current Ratio



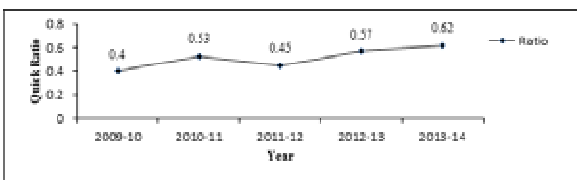

**Interpretation**

Current ratio shows the proportion of current assets to current liabilities. Current ratio is also known as working capital ratio**.** It is a popular tool to evaluate short-term solvency position of a business. Short-term solvency refers to the ability of a business to pay its current liabilities (also known as short-term obligations) when they become due. Current liabilities are the liabilities payable within a short period of time, usually one year.

In case of Essar Oil Limited the average current ratio of the study period is 0.63 and company could not achieved ideal ratio (2:1) in any year during the study period and company is so far from standard which shows that the liquidity position of the company is not satisfactory and company could not maintain proper level of current assets to meet its current liabilities. In 2009-10 the current ratio was 0.64:1 which slightly improved to 0.66:1 in 2010-11 and it goes down to 0.60:1 in 2011-12. Then it goes slightly up to 0.61:1 in 2012-13 and 0.64:1 in 2013-14. So it can be concluded that company has failed to stable its current ratio during the period of study which is not good for the company's financial health and also be the bothered moment for the creditors and short term lenders.

**5. Quick Ratio**

**Figure No. 1.5 Quick Ratio**



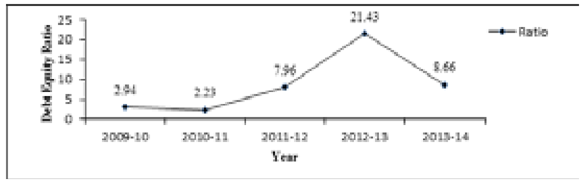

**Interpretation**

Acid-test ratio (also called quick ratio and cash ratio) is the ratio of a company's cash and cash equivalent assets to its total liabilities. Cash ratio is a refinement of quick ratio and indicates the extent to which readily available funds can pay off liquid liabilities. Potential creditors use this ratio as a measure of a company's liquidity and how easily it can service debt and cover short-term liabilities. The ideal quick ratio of company should be 1:1.

From the above figure no. 1.5, it is clear that in the year 2009-10 quick ratio is 0.40:1 and improved to 0.53:1 in 2010-11. But company could not maintain it in next year of study, ratio decrease to 0.45:1 in 2011-12 and then again increase to 0.57:1 and 0.62:1 in the year 2012-13 and 2013-14 respectively which is the highest during the period of the study. This ratio is increasing every year except the year 2011-12. So, it can be concluded that company has failed to stable its current ratio during the period of study. It indicates that quick assets are not able to meet current liabilities and this is a matter of worry to company.

**6. Debt Equity Ratio**

**Figure No. 1.6 Debt Equity Ratio**



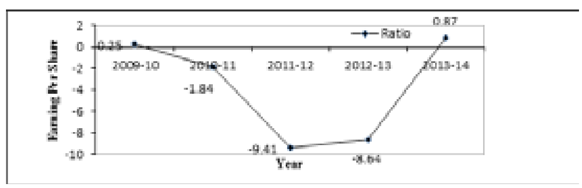

**Interpretation**

The Debt-to-Equity Ratio is a financial ratio indicating the relative proportion of entity's equity and debt used to finance an entity's assets. This ratio is the key financial ratio and is used as a standard for judging a company's financial standing. A ratio of 1 or 1: 1 means that creditors and stockholders equally contribute to the assets of the business. A less than 1 ratio indicates that the portion of assets provided by stockholders is greater than the portion of assets provided by creditors and a greater than 1 ratio indicates that the portion of assets provided by creditors is greater than the portion of assets provided by stockholders.

From the above figure no. 1.6, in 2009-10 the ratio was 2.94:1 which goes down to 2.23:1 in 2010-11 and it increased to 7.96:1 in 2011-12. In the year 2012-13, it increased to 21.43:1 which is the highest for the study period. It was decreased to 8.66:1 in the year of 2013-14. It can be seen from the analysis that ratio remains all time up to the ideal ratio. It indicates that the company uses more borrowed capital to finance its long term assets. So it can be concluded that company has failed to stable its debt equity ratio during the period of study and looking at the dangerous trend.

**7. Earnings per Share**

**Figure No. 1.7 Earnings per Share**




**Interpretation**

Earnings per Share, also called net income per share, is a [market prospect ratio]() that measures the amount of net income earned per share of stock outstanding. Higher earnings per share are always better than a lower ratio because this means the company is more profitable and the company has more profits to distribute to its shareholders.

From the above figure no. 1.7, in 2009-10 the ratio was 0.25:1 which goes down to –1.84, -9.41 and -8.64 for the year 2010-11, 2011-12 and 2012-13 respectively. It was increased to 0.87 which is the highest for the study period. This situation is not looking sound for the company. It can be concluded that company has failed to stable its Earnings per share during the period of study.

**10. Conclusion and Suggestions**

From the analysis, it has been concluded that the financial performance of Essar Oil Limited is not stable. Moreover it has been found that the financial position of this company is not good in light of profitability and liquidity ratios. Gross profit ratio and Net Profit Ratio are not looking good as these are the main indicators of the financial strength of the company. With respect to Return on Capi-

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tal Employed Ratio, it has been concluded that the fluctuation in return on investment is because of the earning before interest and tax. So the company is unable to maintain earnings before interest and tax. It has been also found that company has failed to stable its Current Ratio and Quick Ratio during the period of study which is not good for the company's financial health and also be the bothered moment for the creditor and short term lenders. It has been found that Debt Equity Ratio remains all time up to the ideal ratio which represents the dangerous situation for the company. It has been also found that company has failed to stable its earnings per share during the period of study.

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