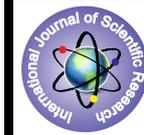


## A Study on Profitability and Sustainable Growth Rate of Larsen and Toubro Company



### Finance

**KEYWORDS :** SGR : Sustainable growth rate, ROE: Return on equity,

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### ABSTRACT

*The primary objective of a business undertaking is to earn profit. A business needs profit not only for its existence but also for expansion and diversification. A business can discharge its obligations to the various segments of the society only through earning profits. In this regard the researcher has probed to find answer for the following questions. Is there any improvement in profitability? & Whether there is efficiency in returns? It refers to the process of determining financial strength and weakness of the firm by establishing strategic relationship between the item of the balance sheet, profit and loss account. The increase in the wealth of the shareholders depends upon a target profit which can be achieved within a reasonable period of time. The easy way to gauge such a situation is by calculating the company's sustainable growth rate (SGR). A company's SGR is the maximum growth rate with the use of internally generated funds without changing its operating and financial policies. The profitability analysis seems to be satisfactory. The firm should take corrective measure to increase the profitability performance. Majority of the ratio are showing the efficiency of the management in dealing with finance. It also analysed that the SGR is greater than AGR which shows a maximum growth rate. Operating efficiency in the running routine business is satisfactory.*

### INTRODUCTION

The main aim of financial analysis is better understanding of firm's position and performance. It refers to the process of determining financial strength and weakness of the firm by establishing strategic relationship between the item of the balance sheet, profit and loss account. According to I.M.PANDEY "Financial analysis is the process of identifying the financial strength and weakness of the firm by properly establishing relationship between the item of the balance sheet and profit and loss account"

Profitability refers to the ability to make profit from optimum utilization of resources by the business concern. They indicate a firm's progress. They are the criterion to judge the effectiveness of management. The status of the company depends on the profitability position of the business concern. Analysis of one of the main important tool to measure the performance of the business firm.

The increase in the wealth of the shareholders depends upon a target profit which can be achieved within a reasonable period of time. The easy way to gauge such a situation is by calculating the company's sustainable growth rate (SGR). A company's SGR is the maximum growth rate with the use of internally generated funds without changing its operating and financial policies. According to Robert C . Higgins , sustainable growth rate represents the maximum sales or asset growth that a firm can support using both internally generated funds and debt. SGR is calculated by multiplying the company's return on equity (ROE) by the proportion of the retained earnings (RE). SGR depends upon the change in the equity in a financial year divided by opening equity without any additional equity introduced during the year. The funds generated through retained earnings increase the net worth of the firm and with the increase in the net worth , the firm can borrow more funds which would enable he firm to increase its asset base.

### NEED FOR THE STUDY

Analysis of profitability of each business is necessary for the business concern to stand in the market. The status of the company depends on the profitability position of the business concern. SGR represents the maximum sales or asset growth that a firm can support using both internally generated funds and debt through retained earnings. Thus, funds generated through retained earnings increases the net worth of the firm and with this increase the firm can borrow more funds which in turn increases its asset base.

### STATEMENT OF THE PROBLEM

The primary objective of a business undertaking is to earn

profit. A business needs profit not only for its existence but also for expansion and diversification. A business can discharge its obligations to the various segments of the society only through earning profits. In this regard the researcher has probed further to find answer for the following questions.

1. Is there any improvement in profitability?
2. Whether there is efficiency in returns?

Growth and cash management are measured by taking the difference between the SGR and annual sales growth rates (AGR), which is referred to as sustainable growth challenge (SGC). If the difference is difference is positive (SGR>AGR), it indicates that there is a cumulative cash surplus. A negative difference (SGR<AGR) means that the firm is in short of cash.

### objectives of the study

- To identify the components of SGR and the efficiency in their usage
- To study the relationship between the SGR and actual growth rate (AGR)
- To analyze the profitability position of the L & T company.

### PERIOD OF THE STUDY

the study is based on the audited financial statements of L&T Company for a period of 10 years (2001 to 2010).

### SCOPE OF THE STUDY

Helps to gain in depth knowledge about the functioning of L & T Company. Helps to gain practice in adopting the tools available and methods and situation to apply those tools. For the company find the area of weakness and indicate their present status. Indicates the key performance area of the company and ability of using the resource. For society it is helpful for shareholders of the company to know the performance of the company. Indicates about company's growth. Helps the employers of the company to know the performance and growth of the company.

### METHODOLOGY

Study is purely based on secondary data from published accounts and other information are collected from magazines and certain articles. The study is directed towards analyzing profitability and sustainable growth rate of L&T Company. Ratios are computed to study the profitability position and to predict sickness of the company. The study also makes use of statistical technique like coefficient of variation to analyze the data and form conclusion out of it.

### PROFILE OF THE COMPANY

LARSEN AND TOUBRO a technology-driven engineering and

construction organization, and one of the largest companies in India's private sector. It has additional interests in manufacturing, services and Information Technology. Seven decades of a strong, customer-focused approach and the continuous quest for world-class quality have enabled it to attain and sustain leadership in all its major lines of business.

L&T has an international presence, with a global spread of offices and advanced manufacturing facilities in India, China, Oman and Saudi Arabia. It has an international presence, with a global spread of offices. A thrust on international business over the last few years has seen overseas earnings growing to 18 per cent of total revenue. With factories and offices located around the country, further supplemented by a wide marketing and distribution network, L&T's image and equity extends to virtually every district of India.

L&T was founded in Bombay (Mumbai) in 1938 by two Danish engineers, Henning Holck-Larsen and Soren Kristian Toubro. Both of them were strongly committed to developing India's engineering capabilities to meet the demands of industry. L&T has a global presence. A thrust on international business over the years has seen overseas revenues growing steadily. The company has manufacturing facilities in India, China, Oman and Saudi Arabia. It has a global supply network with offices in 10 locations worldwide, including Houston, London, Milan, Shanghai, Seoul. Customers include global majors in over 30 countries.

**ANALYSIS AND INTERPRETATION**

Financial statement is a judgment process which aims to evaluate the current and past financial position and the result of operation of enterprise. The primary objective is to determine the best possible estimates and predictors about the future. It also aims at management of an opinion with respect to the financial position of the enterprises relationship, to the study of that business in the economical world.

**Profitability ratios**

profit making is the main objective of business. Profits are the goals of every business firm. Profitability ratios are calculated to measure the overall efficiency of the business. Profitability refers to the ability to make profit from optimum utilization of resources by the business concern. They indicate a firm's progress. They are the criterion to judge the effectiveness of management.

The profitability ratios are, Net profit ratio, Operating Profit Ratio, Return on Shareholders' Investment, Return on Investment, Retained earnings ratio and Payout Ratio.

**TABLE 1  
NET PROFIT RATIO (Rs in Crores)**

YEAR	NET PROFIT	SALES	RATIO
2001	341.6	6956.0	4.91
2002	315.0	7378.6	4.26
2003	346.8	7904.9	4.38
2004	433.1	9412.9	4.60
2005	532.7	9645.3	5.52
2006	983.8	13189.7	7.45
2007	1012.1	14776.9	6.84
2008	1403.0	17645.2	7.95
2009	2173.4	24946.1	8.71
2010	3481.6	33856.5	10.28

Source: (annual report of L & T)

The above table indicates that, during 2002 net profit ratio was lesser than the other periods as 4.26. The net profit ratio for the period 2010 was increased to 10.28 when compared with other periods. Therefore it shows a good result since net profit has been increased when compared to previous years. This shows a better operational efficiency of the company.

**TABLE 2  
OPERATING PROFIT RATIO (Rs in Crores)**

YEAR	OPERATING PROFIT	SALES	RATIO
2001	899.8	6956.0	12.9
2002	941.8	7378.6	12.7
2003	925.9	7904.9	11.7
2004	927.2	9412.9	9.8
2005	738.5	9645.3	7.6
2006	1017.8	13189.7	7.7
2007	1284.0	14776.9	8.6
2008	2043.0	17645.2	11.5
2009	3239.2	24946.1	12.9
2010	4140.0	33856.5	12.2

Source: (annual report of L & T)

The above table indicates that, during 2005 operating profit ratio was lesser than the other periods as 7.6. The operating profit ratio for the period 2001 and 2009 was increased to 12.9 when compared with other periods. This shows the operating efficiency in the running routine business operations of the firm.

**TABLE 3  
return on shareholders investment (Rs in Crores)**

YEAR	NET PROFIT AFTER TAX AND INTEREST	SHAREHOLDERS FUND	RATIO
2001	341.6	248.5	1.37
2002	315.0	248.6	1.26
2003	346.8	248.6	1.39
2004	433.1	248.6	1.74
2005	532.7	24.8	21.4
2006	983.8	25.9	37.9
2007	1012.1	27.4	36.9
2008	1403.0	56.6	24.7
2009	2173.4	58.4	37.2
2010	3481.6	117.1	29.7

Source: (annual report of L & T)

The above table indicates that, during 2002 shareholders return was lesser than the other periods as 1.26. The shareholders return for the period 2006 was increased to 37.9 when compared with other periods.

**TABLE 4  
RETURN ON INVESTMENT (Rs in Crores)**

YEAR	OPERATING PROFIT	CAPITAL EMPLOYED	RATIO
2001	899.8	8224.6	10.9
2002	941.8	6851.1	13.7
2003	925.9	6704.2	13.8
2004	927.2	4066.6	22.8
2005	738.5	5197.1	14.2
2006	1017.8	6064.1	16.7
2007	1284.0	7818.1	16.4
2008	2043.0	13113.2	15.5
2009	3239.2	18990.9	17.0
2010	4140.0	23977.4	17.2

Source: (annual report of L & T)

The above table indicates that, during 2001 return on investment was lesser than the other periods as 10.9. The return on investment for the period 2004 was increased to 22.8 when compared with other periods.

**TABLE 4.5**  
**retainING EARNING RATIO (Rs in Crores)**

YEAR	RETAINED EARNINGS	EARNING PER EQUITY SHARE	RATIO
2001	190	341.6	55.6
2002	225	315.0	71.4
2003	194	346.8	54.3
2004	171	433.1	39.4
2005	211	532.7	39.6
2006	276	983.8	28.0
2007	309	1012.1	30.5
2008	543	1403.0	38.7
2009	923	2173.4	42.4
2010	1059	3481.6	30.4

Source: (annual report of L &amp; T)

The above table indicates that, during 2006 retaining earning ratio was lesser than the other periods as 28.0. The retaining earning ratio for the period 2002 was increased to 71.4 when compared with other periods

**TABLE 4.6**  
**DIVIDEND PAYOUT RATIO (Rs in Crores)**

YEAR	EQUITY DIVIDEND	EARNINGS PER SHARE	RATIO
2001	161.8	341.6	47.3
2002	161.8	315.0	51.3
2003	174.3	346.8	50.2
2004	186.8	433.1	43.1
2005	199.0	532.7	37.3
2006	357.2	983.8	36.3
2007	302.2	1012.1	29.8
2008	368.2	1403.0	26.2
2009	495.3	2173.4	22.7
2010	614.9	3481.6	17.6

Source: (annual report of L &amp; T)

The above table indicates that, during 2010 payout ratio was lesser than the other periods as 17.6. The payout ratio for the period 2002 was increased to 51.3 when compared with other periods. Therefore, the company is not efficient in ploughing back of profits of the company and dividends are not paid more in future.

#### COMPONENT WISE ANALYSIS

#### PROFITABILITY ANALYSIS

#### Major cost components (in %)

YEAR	RAW MATERIALS/ SALES	Employee Cost / Sales	Selling & Administration/ sales
2001	0.31	0.07	0.07

#### CALCULATION OF SGR AND AGR

YEAR/ DETAILS	2001	2002	2003	2004	2005	2006	2006	2008	2009	2010	AVG
Sales	7378	7904	9412	9645	13189	12956	14776	17645	24946	33856	1517.7
PAT	58	23	53	77	236	302	366	601	982	1176	387.4
Total Assets	8262	6887	6738	4099	5228	6093	7846	13139	19015	16536	9384.3
Net Worth	3564	3999	3343	3562	2775	3369	4640	5768	9555	12459	5333.4
Dividend	161	161	174	186	199	357	302	368	495	614	301.7
Retained Earnings	190	225	194	171	211	276	309	543	923	1059	410.1
Ratios											
Profit Margin	8262.8	6887.4	6738.5	4099.3	5228.1	6093.7	7846.1	13139.0	19015.7	25362.0	10267.2
ATR	2.16	1.72	2.01	1.13	1.98	1.86	1.70	2.23	1.96	2.01	1.84
Assets/ Networth	2.1	1.7	2.0	1.1	1.8	1.8	1.6	1.3	1.3	1.5	1.62
ROE	0.23	0.09	0.21	0.30	0.10	0.08	0.07	0.09	0.05	0.09	0.131

2002	0.31	0.07	0.07
2003	0.25	0.07	0.13
2004	0.31	0.07	0.12
2005	0.38	0.07	0.06
2006	0.39	0.05	0.06
2007	0.30	0.06	0.06
2008	0.30	0.06	0.06
2009	0.33	0.06	0.05
2010	0.27	0.05	0.05
AVERAGE	0.31	0.063	0.073

The average value of raw materials to sales is 0.31%.

- The average value of employee cost to sales is 0.063%.
- The average value of selling and distribution to sales to sales is 0.073%.

#### COMPONENTS OF CAPITAL EMPLOYED

#### TABLE SHOWING COMPONENTS OF CAPITAL EMPLOYED (% to total capital employed)

YEAR	SHARE CAPITAL	RESERVES & SURPLUS	LOAN	UNSECURED LOAN
2001	248.6	3712.7	3001.9	1261.4
2002	248.6	3058.7	2791.1	752.7
2003	248.8	3279.5	2703.1	472.8
2004	24.8	2717.5	1045.2	279.1
2005	25.9	3312.2	793.7	1065.3
2006	27.4	4583.3	465.7	987.7
2007	56.6	5683.8	245.4	1832.3
2008	58.47	9470.7	308.5	3275.4
2009	117.1	12317.9	1102.3	5453.6
2010	122.1	18141.8	356.9	5356.6

The components of capital employed by the company are presented in above table. The firm have exploited the opportunities to improve their average growth rate (AGR) which enabled them to use the internal funds rather than the funds from external sources.

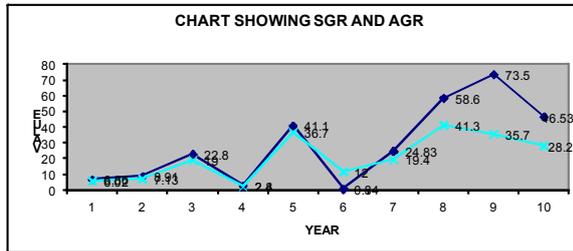
#### CALCULATION OF AVERAGE AND COEFFICIENT OF VARIATION

RATIOS	AVERAGE	CV
Profit Margin	10267.2	0.01
Retention ratio	1.32	7.59
Asset turnover ratio	1.84	4.97
Assets / Net Worth	1.62	6.14

SGR is the maximum growth rate with the use of internally generated funds without changing its operating and financial policies. SGR is calculated by multiplying return on equity (ROE) and retained earnings (RE).

Retention Ratio	1.14	1.25	1.20	1.47	1.12	0.07	1.28	1.42	2.06	1.65	1.32
SGR (ROE*RE)	6.86	8.91	22.8	2.80	41.10	0.84	24.83	58.6	73.5	46.53	28.67
AGR	6.02	7.13	19.0	2.4	36.7	12.0	19.4	41.3	35.7	28.2	20.7

**RT SHOWING THE VALUES OF SGR AND AGR**



From the above it is analysed that the SGR is greater as 28.67 than AGR as 20.7. Therefore it shows a maximum growth rate.

**FINDINGS OF THE STUDY**

- In net profit ratio the company shows an good result since net profit has been increased when compared to previous years. This shows a better operational efficiency of the company.

- Operating profit ratio shows the operating efficiency in the running routine business operations of the firm.
- The company is not efficient in ploughing back profits and dividends are not paid more in future in case of dividend payout ratio.
- In components of capital employed the company had improved their AGR by using internal funds rather than funds from external sources.
- It is analysed that the SGR is greater as 28.67 than AGR as 20.7.

**CONCLUSION**

The profitability analysis of the LARSEN AND TOUBRO COMPANY seems to be satisfactory. The firm should take corrective measure to increase the profitability performance. Majority of the ratio are showing the efficiency of the management in dealing with finance. It also analysed that the SGR is greater than AGR which shows a maximum growth rate. Operating efficiency in the running routine business is satisfactory.

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