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Profitability Analysis of the Steel Industry in India

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Abstract: *With a view to examine the profitability of the Indian Steel Industry with the help of various profitability ratios, the bonus issues, and the dividend paid by it to its shareholders, the study has focused towards concluding the efficiency of the public as well as the private sector companies. For this purpose, one of the leading steel manufacturers from each sector has been selected, viz; Tata Steel Ltd and the Steel Authority of India. The analysis revealed that the profitability of the private sector steel companies have been better than the public sector steel companies. The bonus issue and dividend payment in case of the TSL and the dividend payment in case of the SAIL have positively affected the share prices of both the companies. But the effect was much more efficient in case of the TSL. Hence, it can be concluded that the profitability of the private sector steel companies has been more efficient as compared to the public sector steel companies. Necessary measures needs to be taken by the public sector enterprises in this regard because this type of performance is not expected by the SAIL which is amongst the five Maharatnas of the public sector enterprises.*

Keywords: *Profitability ratios, Bonus Issues, Dividend Payments, Share prices.*

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Introduction

Profitability means the profit earning capability of a company which can easily be examined with the help of various profitability ratios. The major profitability ratios used for studying the profitability of a firm are the gross profit ratio, net profit ratio, return on equity, return on capital employed, earning per share, dividend pay-out ratio, and price earning ratio. Profitability analysis examines the profit earning capacity as well as the profit earning pattern of a firm. Two companies have been selected for the study, one each from the public and the private sector. Both the companies are the leaders in steel in those sectors. Tata Steel Ltd. is a part of the Tata Group, India's largest industrial conglomerate. Tata Steel was founded in India in 1907. Since 2004 the Company has expanded globally, acquiring Asian steel producers NatSteel and Millennium Steel (now called Tata Steel Thailand) as well as Europe's second largest steel producer Corus (now called Tata Steel Europe Limited). Tata Steel Limited is one of the cost efficient steel companies in the world. Tata Steel is a top ten global steel maker and the world's second most geographically diversified steel producer. Steel Authority of India Limited (SAIL) is the leading steel-making company in India. The paid-up capital of the company was Rs.4130.40 crore as on 31st March, 2010, out of which 85.82% is held by the Government of India and the balance 14.18% by the financial institutions/GDR-holders/banks/employees/individuals etc. It is a fully integrated iron and steel maker, producing both basic and special steels for domestic construction, engineering, power, railway, automotive and defence industries and for sale in export markets. SAIL is also among the five Maharatnas of the country's Central Public Sector Enterprises.

Objective, Scope and Methodology

The main aim of the study is to examine the profitability of the steel industry in India from both public and private sectors. For this purpose, two companies have been selected (one from each sector). Indian steel sector's contribution has grown by 12.5 per cent in the last three years. Examining the profitability of this prominent industrial sector of the economy is important. Moreover, the comparison between the public and private sector will help in drawing inferences about the efficiency of both the sector. The study will definitely help the readers in enhancing their knowledge about the steel sector in India.

For the purpose of comparison, profitability ratios of both the companies have been compared.

The ratios which have been used for comparison are:

1. **Return on Investment:** The return on investment is the ratio of net profits to the net worth. It measures the overall efficiency of the firm. This ratio is of utmost importance for the investors while comparing between two companies for investment.

2. **Gross Profit Ratio:** The gross profit ratio is the relation between the gross profit to net sales. It indicates the extent to which the selling prices of goods per unit may decline

without resulting in losses on operations of a firm. It points towards the efficiency. The higher the ratio, the higher is the profitability.

3. **Net Profit Ratio:** The net profit ratio is the relation between the net profit and the net sales. It indicates the profitability after tax and excluding the non-operating incomes and expenses. The higher the ratio, the higher is the profitability.

4. **Earnings per Share:** The earning per share is calculated by dividing the net profit after taxes and preference dividend by the total number of equity shares. It is one of the good measures of profitability.

5. **Price Earnings Ratio:** The price earnings ratio represents the relation between the market price of per equity share and the earning per share. It is one of the ratios used by the investors for investment decisions.

6. **Return on capital Employed:** The return on capital employed shows the relation between the profits and the capital employed. It helps in concluding the overall efficiency of the firm as well its departments.

With the measurement of the profitability, the effect of bonus issues and dividend paid these companies upon their share prices have also been measured so that relation between the profitability, bonus issues, dividends, and share prices can be concluded. For this purpose, one bonus issue and dividend payment by both the companies have been considered and the effect on share prices for the periods pre and post bonus issue and the pre and post dividend have been examined. The daily returns for both the companies have been calculated for the pre and post period. The effect has been studied for a T-30 days and T+30 days period.

Quantitative Analysis

In this section we have compared various profitability ratios of the two companies. Table 1 below depicts the six profitability ratios which have been considered for the study for both the companies. All these ratios have been compared separately for each of the companies. Let us go through the discussion.

Table 1: Profitability Ratios of the SAIL and the TSL since 2001-02

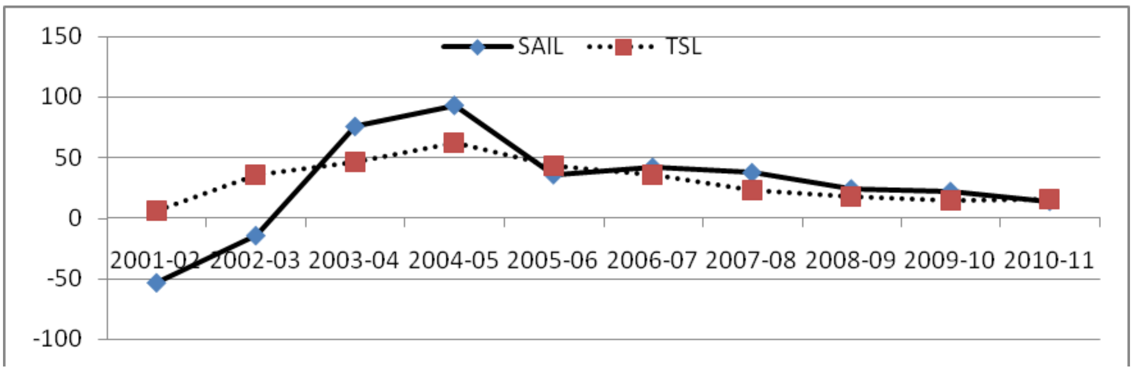
	ROI		Gross Profit		Net Profit		EPS		P/E Ratio		ROCE	
Year	**SAIL**	**TSL**	**SAIL**	**TSL**	**SAIL**	**TSL**	**SAIL**	**TSL**	**SAIL**	**TSL**	**SAIL**	**TSL**

2001-02	-53.22	6.38	5.72	16.87	-12.63	3.51	-4.13	5.51	-1.19	17.72	-9.66	6.35
2002-03	-14.35	35.88	12.89	24.34	-1.88	14.48	-0.74	27.44	-11.94	4.87	-1.88	16.29
2003-04	75.57	46.28	29.30	31.82	12.34	24.83	6.08	31.55	5.31	12.16	16.55	28.02
2004-05	92.94	62.01	62.91	41.89	32.83	36.34	16.50	62.77	3.81	6.39	53.09	49.43
2005-06	35.84	42.90	35.28	40.35	20.48	34.44	9.72	63.35	8.56	8.47	27.27	40.81
2006-07	41.95	36.09	46.41	41.34	27.78	35.68	15.02	65.28	7.53	6.89	39.88	32.37
2007-08	37.51	22.84	48.05	41.93	29.03	33.70	18.25	66.80	10.12	10.38	42.54	20.53
2008-09	24.13	18.33	33.66	38.83	21.75	30.09	14.94	69.45	6.46	2.97	29.77	16.12
2009-10	21.98	15.12	31.11	39.19	24.99	28.83	16.35	60.26	15.44	10.50	26.56	14.25
2010-11	13.94	16.04	21.70	41.58	16.84	33.26	11.87	75.63	14.30	8.2	17.26	15.52

1. Return on Investment (ROI)

The return on investment is a good measure of profitability. The ROI of the SAIL was negative in 2001-02 and 2002-03 but has grown significantly thereafter. Again a slowdown has been noticed in the return since 2005-06. The ROI of the TSL has been growing significantly for the first four years but the slowdown begins in 2005-06. It is seen that the ROI of both the companies started declining since 2005-06. Although the first two year profitability of the SAIL was negative, but later on it revived and it can be seen that it was comparatively higher than the TSL during the period 2003-04 to 2010-11. The ROI express that the public sector steel companies have been more profitable than the private sector companies. The trend of the ROI for both the companies has been depicted in the figure 1 below.

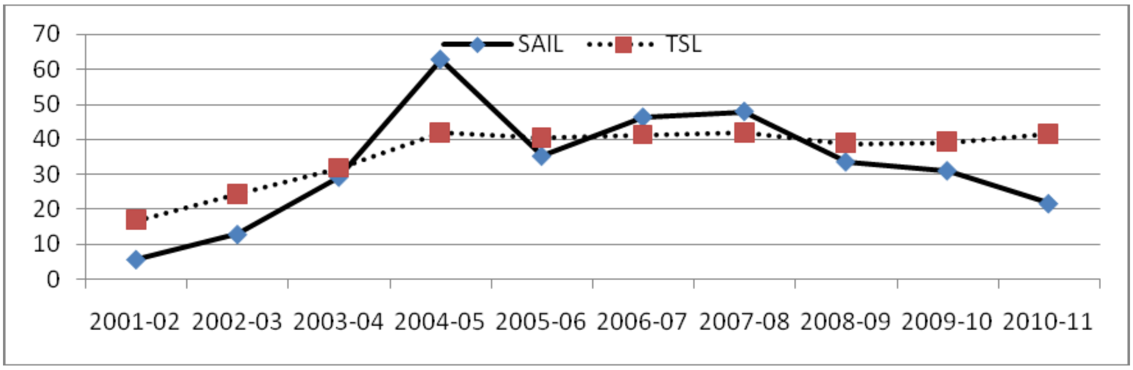
Figure 1: Return on Investment



2. Gross Profit Ratio

The gross profit ratio is the general profitability ratio and the comparison between the gross profit ratios of the two companies depicts that the gross profit ratio of the SAIL has been much volatile as more ups and downs are experienced by it during the period 2001-02 to 2010-11. On the other side, the gross profit ratio of the TSL has been much more stable than that of SAIL. Both these companies have experienced a growth in the gross profit ratio during the period 2001-02 to 2004-05. The downfall thereafter has been experienced by both companies but it was not much fluctuating in case of the TSL. The gross profit ratio depicted in figure 2 concludes that the profitability of the private sector steel companies has been more stable than that of the public sector steel companies.

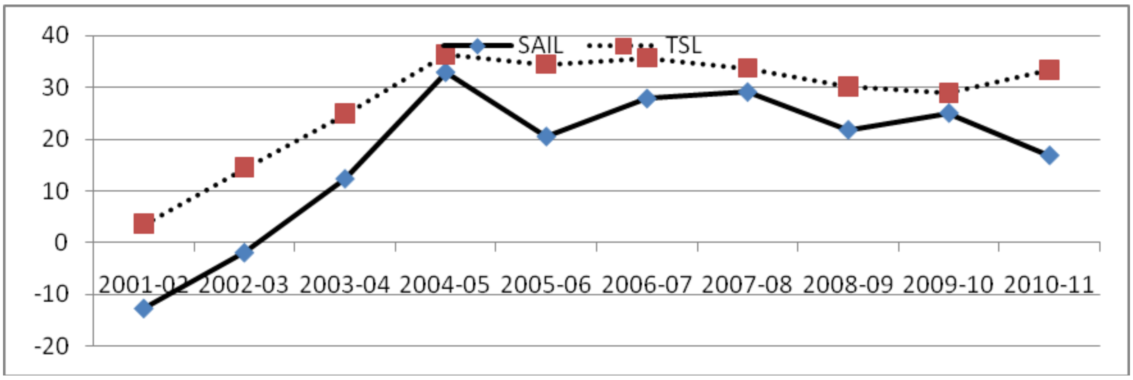
Figure 2: Gross Profit Ratio



3. Net Profit Ratio

The net profit ratio of both the companies have been following the same trend in ups and downs till 2009-10 but in the year 2010-11 the net profit ratio of the SAIL has declined while that of the TSL has increased. The net profit ratio of the SAIL has been negative during the first two years period under review. Again in this case, the downfall started after the year 2005-06 but the profitability of the TSL was more stable. It can be seen in the figure 3 below.

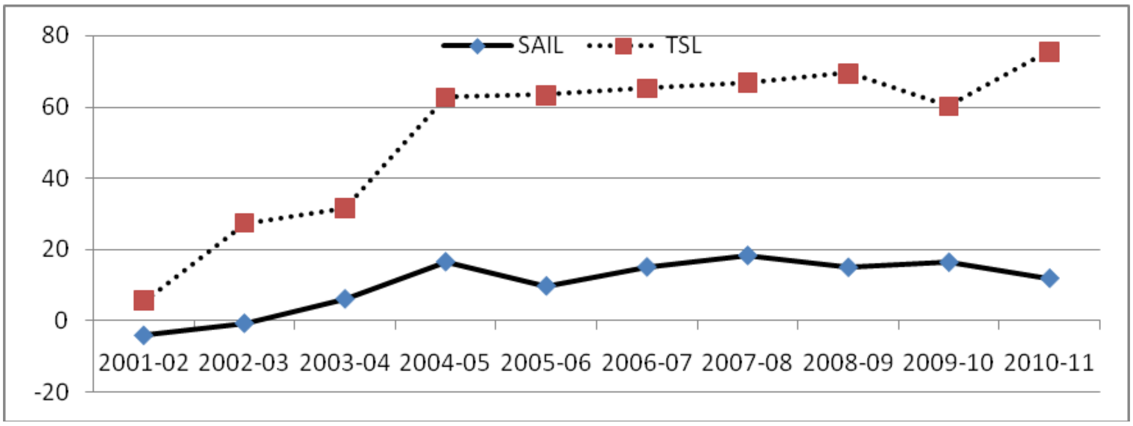
Figure 3: Net Profit Ratio



4. Earning Per Share (EPS)

The earning per share is a good measure used by the investors while comparing the profitability of two companies for investment. The EPS of the TSL has been an impressive one. It is much more than the SAIL. Also we can see that the EPS of the SAIL being negative in 2001-02 was not able to go upto the level of TSL. Figure 4 clearly depicts the real picture. After 2004-05 a slowdown has been noticed for the EPS in case of both companies.

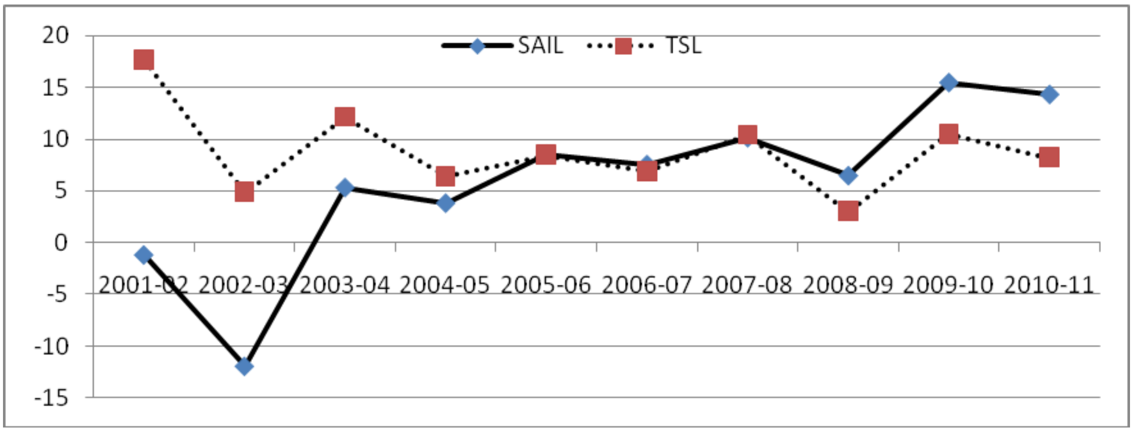
Figure 4: Earning Per Share



5. Price Earning Rati (P/E Ratio)

To exhibit higher profitability, the price earning ratio must be higher. It is most attractive for the investors. A progressive trend is noticed in case of the SAIL when we compare the P/E ratio of both the companies, while there is a downward trend in case of TSL. But the overall trend discloses that both the companies have followed the same pattern of ups and downs in their P/E ratio. This can be seen in figure 5.

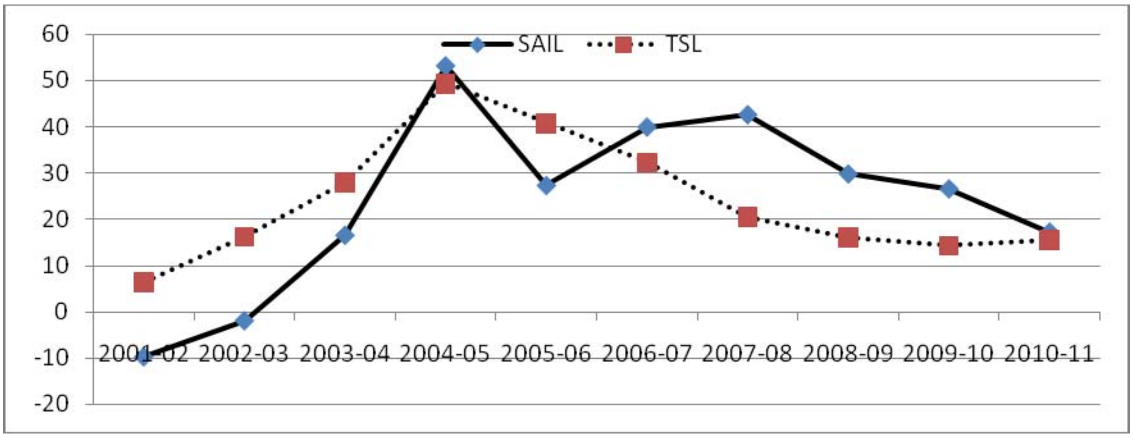
Figure 5: Price Earning Ratio



6. Return on Capital Employed (ROCE)

One of the most important part of the profitability analysis is the return on capital employed which very easily describes the overall efficiency and profitability status of the companies. Again we can see that the ROCE in case of the TSL has been impressive. The ROCE in both cases have moved upward till 2004-05 and then a downfall in both cases but a much volatile situation in case of the SAIL. If the overall status is measured, the SAIL have been more profitable than the TSL because the rate of growth in the ROCE is much higher it this case. Figure 6 clearly explains the situation.

Figure 6: Return on Capital Employed



The table 2 below is a summary of the descriptive statistics regarding the profitability ratios which will help in concluding the profitability analysis of both the companies. It describes the mean, maximum, minimum, standard deviation, skewness and the kurtosis.

Table 2: Descriptive Statistics

	ROI		Gross Profit		Net Profit		EPS		P/E Ratio		ROCE	
Des. Stat.	**SAIL**	**TSL**	**SAIL**	**TSL**	**SAIL**	**TSL**	**SAIL**	**TSL**	**SAIL**	**TSL**	**SAIL**	**TSL**
Mean	27.63	30.19	32.70	35.81	17.15	27.52	10.39	52.80	5.84	8.86	24.14	23.97
S.D.	41.45	17.29	16.99	8.73	14.40	10.67	7.69	22.97	7.91	4.16	19.43	13.45
Kurtosis	0.79	-0.53	-0.09	1.37	0.82	1.99	-0.14	0.41	2.16	1.37	-0.28	-0.18
Skewness	-0.41	0.46	0.14	-1.55	-1.21	-1.61	-1.03	-1.24	-1.23	0.87	-0.42	0.80
Minimum	-53.22	6.38	5.72	16.87	-12.63	3.51	-4.13	5.51	-11.94	2.97	-9.66	6.35
Maximum	92.94	62.01	62.91	41.93	32.83	36.34	18.25	75.63	15.44	17.72	53.09	49.43

The greater the mean the better is the profitability. We can see that the mean of TSL in all cases except the ROCE is higher than that of the SAIL. This depicts that the TSL has been more profitable than the SAIL. The standard deviation measure the dispersion from the mean and hence the volatility. The volatility in TSL is less in all cases except in the EPS than the SAIL. This represents that the profitability of the TSL has been more stable than the SAIL. Positive skewness and a less negative skewness in case of TSL represent that the profitability is better in this case. Similar conclusion is in the case of kurtosis. Kurtosis represents the volatility of the volatility in values. The kurtosis value of the TSL ratios depict that the profitability has been in better condition. The minimum results show that the minimum values in case of TSL has been much higher than that of the SAIL. The maximum values of the SAIL in case of ROI, gross profit ratio and the ROCE is more than the maximum values of the TSL. However, the overall results show that the TSL has been much more profitable than the SAIL.

7. Share Price changes by the Bonus issues and Dividend payments

There has been no bonus issue by the SAIL during the period of study, it just had dividend payments. In case of TSL, there has been both, a bonus issue and a dividend payment. But in both cases only single bonus issue and single dividend payment has been considered. The shares prices for a period 30 days pre and 30 days post bonus issue and dividend has been collected and accordingly the average return for the period has been calculated. The bonus issue and dividend by the TSL was announced in the year 2006 and 2002 respectively. The dividend in case of the SAIL was announced in the year 2002. The announcement leads to price changes and hence the announcement effect has been measured.

Table 3: Pre and Post Bonus issue and Dividend Period Average Returns

Company (Bonus/Dividend)	T-30 days	T+30 days
TSL (Bonus)	-0.136	0.041
TSL (Dividend)	-0.211	1.386
SAIL (Dividend)	-0.13	-0.04

Table 3 depicts the pre and post period average returns for both the companies. It can be seen that the average returns have increased in the case of bonus issue and dividend payment by the TSL as well as in case of dividend payment by the SAIL. Hence, it can be concluded that the bonus issue and dividend payment by the TSL has positively affected the share prices and the dividend payment by the SAIL, too, has positively affected its share prices. But there was a magnificent change in case of the TSL as compared to the SAIL.

Conclusions and Suggestions

Indian steel industry is growing very faster. We have seen that both public and private sector steel companies have been performing well but the performance of the private sector has been much more impressive. The study of the effect of bonus issue and dividend payment by the companies on their share prices reveals that the investors have considered the Tata Steel Ltd as more profitable than the Steel Authority of India Ltd. It can be said because although the prices were positively affected but it was far better in case of the Tata Steel Ltd. It means that public reacted actively to the bonus and dividend announcements of the Tata Steel Ltd as compared to the Steel Authority of India Ltd. One of the reasons behind this is the negative and lower ratios in the year before and the year in which the announcements were made. Hence, it can be concluded that a company cannot attract the investors just by bonus issue and dividend unless it's past performances reveals it to be more profitable. The private steel sector being more profitable reveals that there is some gap which is affecting the performances of the public sector steel companies. There is a need for some revival strategies which can help the public sector steel companies in a much better way.

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