

APPENDIX D

Comprehensive Test: VIP Chaddi¹ Pe Vaddi² Offer ...

Note: In an effort to make understanding annual reports easier, we have included a comprehensive review test using annual reports. This review test is based on the annual reports of the Maxwell Industries Limited for the financial year 2004 and 2005. The above company's annual reports are available in our online web resources (at McGraw Hill website). Thus, please go to the website and download the annual reports and then take this paper.

INSTRUCTIONS

This is a closed book test. You are not allowed to borrow books, calculators, etc. Answer all questions using the annual reports provided. Please read all footnotes (some of them might contain crucial information).

The students of the college had just completed their classes for the semester. They were all busy preparing and giving their examinations. After a tough Organization Behaviour test ... Junta³ was having another round of jalebis-cum-samosa's at the college canteen. In a corner was the recently married Ankit Jain. Ankit was married to Ankita by his parents at gun point. His FIL⁴ told him that he would get his booty (a.k.a. Dahej) worth Rs. 1 crore only if he comes up with good finance competencies. Since, Ankita came from Mumbai; she took a promise from Ankit that the amount will be invested only in a Mumbai-based organization.

Ankit decided to restrict his investments in only large firms with well known innerwear brands and that too after completely looking at their financials. During his first visit to Mumbai, Ankit finds that there is only one firm fitting the bill – namely, Maxwell Industries Limited (MIL).

Ankit decided to appoint one investment consultancy firm known as OMAXI led by its fire brand CEO Aditi Chand to advice him. On a fine morning, after finishing a second round of Idli & Dosa as breakfast, Aditi calls all her employees and distribute them a copy each of the annual report of MIL for FY2004 and 2005.

Finally, a meeting is held by OMAXI in Ahmedabad. Being a dry region, every OMAXI member is provided with a mug of Sambar⁵ instead of traditional Somras. In the meeting Fin-stud Tikmani came with a big smile (knowing that his finacc fundaes were better ...). He was also happy about some other reason. Jaichandar probed him further and asked the reason for his happiness. He said he was happy because he was a VIP man.⁶

Sipping Sambar, Neha Ramchandani announced that she was a not a VIP woman.⁷ Meanwhile one student (majoring in Marketing) came and announced that *VIP makers Maxwell Industries Limited (MIL) was the most admired innerwear brand* and they have launched a fantastic marketing strategy by going in for VIP Chaddi pe Gaddi Offer. To this another student (majoring in Finance) argued that *Maxwell Industries Limited (MIL) had destroyed investor's wealth and was having most pathetic finances*. The two argued and they were joined by their

¹ Innerwear

² Big

³ a.k.a. People

⁴ Father-in-Law

⁵ The south brigade members such as Premod Verghese Eapen, Vidya Iyer, Selvanayagam Ramalingam and Kailash Sankaranarayanan were touched with this move ... and hazaar impressed. They decided to make Ahmedabad their destination for all future OMAXI meetings.

⁶ meaning he owned a lot of shares of Maxwell Industries Limited

⁷ meaning she owned a lot of shares of VIP's competitor Rupa & Co

respective friends i.e., marketing-majors and finance-majors. The argument went to the extent that the new OMAXI head had to make a committee to look into the issue.

The committee of students decided to do a analysis of MIL's available annual reports and come out with its conclusions. They would also simultaneously look into making a report for Ankita. The committee had rich experience of facing typical DIL-MIL⁸ problems:

During the meeting, members of OMAXI discussed and also agree on the following.

- ❖ Ian: The par value of each MIL share is Rs. 10/-
- ❖ Vartika: Ian you may be Class Representative. But, you should not just look at the par value of each MIL share. I have seen the historical share price chart of MIL. The average price was Rs. 100 and Rs. 30 for FY2004 and FY2005 respectively.
- ❖ Shamit: Vartika, you are always looking at the past share prices. Why don't you tell the current share prices to the Junta around?
- ❖ Jose: The current share prices of MIL are not to be found in any pink paper⁹.
- ❖ Sagar: This scrip is traded on the BSE and OTCEI¹⁰.
- ❖ Aditi: Come on, let us not waste time and come to some broad conclusions before we do the analysis
- ❖ Pawan: All secured and unsecured loans including Deferred Tax Liabilities will be treated as long-term in nature
- ❖ Bharath: assuming no large changes, we will use all-year end balance sheet figures to compute ratios (instead of using average values during the year)
- ❖ Ganesh: Sales would be taken as 'net sales' i.e., net of excise duty and would be adjusted for the change in stocks (if any)
- ❖ Sumana: The prior period tax adjustments are being ignored for all ratio computations
- ❖ Aditi: Correct and we will stick to this. Let us proceed with the analysis ...

Based on the above information provided, you are to answer all the multiple-choice and other questions below and help Aditi and her team in the decision making process.

SECTION I

On a 1 to 5 scale you have to rate MIL using its 'Statement of Cash Flows'. Where a rating of '1' would indicate 'Likely to Declare Bankruptcy (lot of problems noted)' and a rating of '5' would indicate 'Outstanding cash flow (few problems)'. The rating you would give would be:

Scale	1	2	3	4	5
Maxwell Industries					

Overall Assessment (in less than 50 words):

SECTION II

- | | |
|---|----------------------|
| 1. Accounts Receivable has been a source in the last two years | Yes / No / Can't Say |
| 2. Inventories has been a use in the last two years | Yes / No / Can't Say |
| 3. Accounts Payables has been a source in the last two years | Yes / No / Can't Say |
| 4. In FY2005, the cash flow from operations covered both the capital expenditures and the firm's dividend payments, if any? | Yes / No / Can't Say |

⁸ Daughter-In-Law (DIL) - Mother-In-Law (MIL) problems.

⁹ A.k.a. Financial Newspaper

¹⁰ OTCEI [Over the Counter Exchange of India] is another stock exchange like NSE, BSE.

5. In FY2004, the firm invested the excess cash from operations in interest payments and/or repayment of borrowings? Yes / No / Not Applicable
6. In FY2004, (other than cash flow from operations) there were no other sources of cash the firm used to pay for the capital expenditures and/or dividends? Yes / No / Not Applicable
7. In FY2005, the cash flow from operations covered both the capital expenditures and the firm's dividend payments, if any? Yes / No / Can't Say
8. In FY2005, the firm invested the excess cash from operations in interest payments and/or repayment of borrowings? Yes / No / Not Applicable
9. In FY2004, the firm invested the excess cash from operations in interest payments and/or repayment of borrowings? Yes / No / Not Applicable
10. In FY2005, (other than cash flow from operations) there were no other sources of cash the firm used to pay for the capital expenditures and/or dividends? Yes / No / Not Applicable
11. In FY2005, compared to FY2004 – we can say that the cost of goods sold increased but its operations and other expenses decreased Yes / No / Can't Say
12. In FY2004, the company used its unsecured borrowings to repay its secured borrowings Yes / No / Can't Say
13. In both the years, the cash cover for daily expense is less than 2 days Yes / No / Can't Say
14. In both the years, the quick asset for daily expense is less than 4 months Yes / No / Can't Say
15. In FY2004, the current assets cover for daily expense has increased Yes / No / Can't Say
16. As a manager inside the company, one should be happy with the companies average collection period figures (compared to the past) Yes / No / Can't Say
17. As a regular customer, one should be happy with the companies average collection period figures (compared to the past) Yes / No / Can't Say
18. As a regular supplier, one should be happy with the companies average payables period figures (compared to the past) Yes / No / Can't Say
19. One Rupee invested in the operating cycle of the company would typically take more than 220 days in FY2004 Yes / No / Can't Say
20. One Rupee invested in the operating cycle of the company would typically take less than 180 days in FY2005 Yes / No / Can't Say
21. The company's annual report for FY2005 would have been quite depressing to its long-term lenders Yes / No / Can't Say
22. In FY2005, the Net Gain from borrowed funds for the company is more than Rs 37 Lakhs Yes / No / Can't Say
23. In FY2004, the Net Loss from borrowed funds for the company is more than Rs 37 Lakhs Yes / No / Can't Say
24. For both the years, Gearing for this company would have been negative Yes / No / Can't Say
25. In FY2005, the company's Equity Multiplier has decreased (compared to FY2004) Yes / No / Can't Say
26. In both the years, the company's book value per share has been above Rs 60 Yes / No / Can't Say
27. In FY2005, most of the ratios related to 'efficiency of use of assets' have given a bad signal (compared to FY2004) Yes / No / Can't Say
28. In FY2005, the Return on Investment ratio 'operating profit to operating assets' has given a bad signal (compared to FY2004) Yes / No / Can't Say
29. In FY2005, most of the 'Margin on Sales' ratios have improved (compared to FY2004) Yes / No / Can't Say
30. In FY2005, shareholders would have been pleased with the company's performance (compared to FY2004) Yes / No / Can't Say
31. After your overall assessment of MIL. You would agree with
 - a) Finance-majors
 - b) Marketing-Majors;
 - c) Both (a) and (b)
 - d) None of the above
32. If you were the CEO of MIL's competitor (say, Rupa & Co.), you would be pleased with the FY2005 annual report of MIL Yes / No / Can't Say
33. The deferred tax liability is due to the company providing low depreciation on books (compared to rates allowed by tax authorities) Yes / No / Can't Say
34. No board of directors resigned during FY2005 Yes / No / Can't Say
35. Three board of directors were seeking re-appointment in the AGM Yes / No / Can't Say
36. The dividend for the year FY2005 was paid on 31-August-2005 Yes / No / Can't Say
37. The company's inventory valuation was based on the principle of 'First In First Out' Yes / No / Can't Say
38. The company's depreciation policy was based on 'written down value' basis Yes / No / Can't Say
39. The company had large number of related party transactions Yes / No / Can't Say

SECTION III

If you were given complete powers to remake the annual report for FY2005 (including remaking its financial statements, if needed) – what all things you would change or do (to ensure transparency, better governance, and also better compliance with rules/regulations):

Please give your answer point-wise (in the space provided):

For example, the company should have provided the detailed share price trading information on the relevant stock exchange (say, monthly high-low and volume of shares traded).

OR,

Detailed reasons for not providing the share-price trading data.

Suggested Changes

- 1.
- 2.
- 3.
- 4.

If you were given complete powers to remake the annual report for FY2004 (including remaking its financial statements, if needed) – what all things you would change or do (to ensure transparency, better governance, and also better compliance with rules/regulations):

Please give your answer point-wise (in the space provided):

Suggested Changes

- 1.
- 2.
- 3.
- 4.
- 5.
- 6.
- 7.

SECTION IV

1. In FY2005 annual report, if it is known that the loss on sale (or discard) of asset mentioned in schedule 17 is related to only one item i.e., disposal of plant and machinery then the journal entry/entries for the sale of the asset would have been

2. What would have been the journal entry when the company issued bonus shares (in one of the past periods)

Note: The key to this comprehensive test is made available in our online web resources (at McGraw Hill website).