FINANCIAL ACCOUNTING - II

FINAL PROJECT

FINANCIAL ANALYSIS OF

PAKISTAN TOBACCO COMPANY

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EXECUTIVE SUMMARY

Pakistan Tobacco Company Limited, the first multinational to start operations in Pakistan is one of the two major players in the tobacco industry and has regained the market leadership in 2005. PTC is the largest excise tax generator in the private sector in Pakistan. With John Player Gold Leaf, Gold Flake and Dunhill being its major brands, PTC contributed Rs19.2 billion to the National Exchequer in 2005.

PTC has been achieving outstanding growth in all areas of the business owing to the heavy investment in restructuring done in 2000. Since then, PTC has attained 192% increase in sales. With a negative after tax profit in 2000, PTC has come a long way to achieving Rs 1,322 million profits in just one year.

Tobacco industry being a controversial industry has always been facing issues worldwide. Here in Pakistan, the major issue concerning the tobacco industry is the illicit trade. In the absence of strong government policies, the tax evaded sector continues to affect the Government revenues adversely besides reducing the market and threatening the long term profitability of the legitimate sector. Government of Pakistan is making continuous efforts to control the tax evasion by strengthening excise rules. This effort of the government has been effective through the full support extended by the local tobacco companies.

Another important issue is the growing concern regarding the ill effects of cigarettes. Anti tobacco campaigns are a great threat for the industry and hamper its progress. This awareness has also forced the tobacco companies to stop advertising in the electronic media.

To minimize the effect of these issues facing the tobacco industry, tobacco companies including PTC should continue supporting government in its efforts against the illicit trade. For the marketing and publicity issue, they must find other means and must prove themselves as socially responsible organizations by showing contributions towards health and safety and taking measures for youth smoking prevention.

Chapter # 1

Introduction to PTC and tobacco industry of Pakistan

PAKISTAN TOBACCO COMPANY

TOBACCO INDUSTRY OF PAKISTAN

Pakistan's tobacco industry has become one of the largest industries of the country with Lakson Tobacco Company and Pakistan Tobacco Company as the major players in this industry. Tobacco industry has the largest yield of any crop in Pakistan, thus contributing 27.5 billion rupees per year to the government income.

PAKISTAN TOBACCO COMPANY

PTC was the first multinational to set up its business in Pakistan in 1947. PTC was formed in 1947 right after independence of Pakistan when it took over Imperial Tobacco of India, which was in operations since 1905. PTC is a part of British American Tobacco which is one of the largest business groups and has been in existence for more than 100 years. It has a position of market leader in more than 50 countries selling over 300 brands. The Group sold and produced 16% share of the global market of cigarettes. PTC generates the largest tax in Private Sector for government in Pakistan. In 2004, PTC paid the government Rs.16 Billion in taxes. This amounts to over Rs. 50 million per day. More than one million people are dependant on the industry. Some of the well-known brands of PTC are: Benson and Hedges, John Player Gold Leaf, Capstan, Gold Flake, Embassy. Dunhill King Size range was also launched in Dec, 2005.

ISSUES FACED BY PTC AND THE TOBACCO INDUSTRY

Tobacco Industry in Pakistan has been growing in the past decades. It is the biggest contributor of excise duty for the government of Pakistan. Since, tobacco industry has also remained a hot debate topic, there are some issues faced by the local tobacco producing companies. Some of these issues are discussed here:

a) Awareness of ill-health affects and publicity issues

The awareness regarding the ill effects of cigarettes and smoking has increased greatly among the public but still the market for industry remains huge. Approximately, 90% of lung cancers are attributable to cigarette smoking. Government was spending $20,000 on Anti-Smoking messages, while Lakson spent around $6.4m on advertising in 1998. However, now in 2005, no more tobacco advertisements are played on TV and radio. Every box of cigarette sold is also labeled with anti-smoking messages. The tobacco firms in Pakistan have also been plagued by bad publicity in relations to the local growers of tobacco. The firm is often accused of buying the bales from influential people rather than poor farmers. This has been reported in news on several occasions.

Lakson and PTC have also been reported to deceive growers, by creating bogey surplus, they have inflicted huge amount of losses on the growers. These factors contribute to publicity issues that the firms will face.

b) Illicit trade

Aslam Khaliq, the director consumer and regulatory affairs of Pakistan Tobacco Company claimed that the Government of Pakistan loses $3bn of revenues due to smuggling. The major factor he cited was the high taxes imposed on the cigarettes. The illicit trade is a major issue for the firm.

Government of Pakistan is taking measures to control evasion and to strengthen the excise rules. These efforts have contributed to increase the government revenues. PTC supports the Government in the sensible regulation of the industry and in its efforts to control illicit trade (*Chairman's review P-10).*

c) Corporate Social Responsibility

Since the tobacco industry is seen as controversial, PTC faces a difficult challenge to prove it a socially responsible organization. According to the Managing Director of PTC, "*the company's culture is rooted in respect for the individuals, the environment and the community. We consider it our fundamental obligation to protect the environment and the communities in which we operate". (Director's Review P-17)*

To fulfill this commitment, PTC has taken some steps as explained under:

- **Afforestation**

  PTC contributes a lot to afforestation, planting 4 million trees every year. They have planted more than 30 million trees since 1981. These plants and trees planted by PTC can be seen at various places in Islamabad. PTC also works with growers to help improve the effectiveness and contributes in agriculture sector. PTC probably has the largest private sector afforestation program.

- **Mobile Doctor Program**

Mobile Medical Units are provided in areas where there are no health facilities. 9 units are operational and provide check up for various ill effects. These are mostly provided in the grower's areas.

- **Learning Resource Centers**

PTC has invested in free Learning Resource Centers in areas where education is not available. LRCs are developed in Gujarat, Mansehra, Yar Hussein and Bunair. An LRC for women has also been established near a factor in Adam Zai. Another objective is to give free IT education to shareholders. These centres can be used for vocational training, generating health and hygiene awareness.

- **Youth Smoking Prevention**

PTC believes children should not smoke and only those adults should smoke who are aware of health risks associated with it. PTC runs a program to tackle underage smoking. Several initiatives have been taken, such as voluntary label on cigarette packs like 'under-age sale prohibited'. Educational programmes have also been taken up to help tackle this problem such as avoiding peer pressure regarding smoking. The firm has also coordinated to put the information regarding smoking in national curricula.

Chapter # 2

Trend analysis of financial statements of PTC

PAKISTAN TOBACCO COMPANY

In this chapter, the financial statements of PTC will be analyzed in light of the company's past performance. The financial statements of FY03 and FY04 are taken for the purpose of analysis.

PROFIT AND LOSS ACCOUNTS

Following are the tables showing the income statements of the company from FY03 to FY05.Table 2.1(a) shows the comparative income statements from FY03 to FY05. Table 2.1(b) illustrates the common size income statements in which every accounting head is calculated as a percentage of net sales. Lastly, Table 2.1(c) gives the trend statements and compares the figures of the three fiscal years by setting the values of FY03 as 100%.

TABLE 2.1(a) COMPARATIVE INCOME STATEMENTS

	FY05 Rs 000	**FY04** Rs 000	**FY03** Rs 000
Gross Turn Over	30,615,062	25,452,634	22,572,247
Cost of Sales	26,085,458	21,970,013	19,700,706
Gross Profit	4,529,604	3,482,621	2,876,546
Marketing and Distribution Expenses	1,578,656	1,442,356	1,466,095
Administrative Expense	573,285	595,637	395,178
Operating Expense	2,151,941	2,037,993	1,861,273
Operating Profit	2,377,663	1,444,628	1,010,268
Other Income	34,417	14,590	6,717
Other Expenses	284,665	366,637	310,335
	2,127,415	1,092,581	406,650
Finance costs	45,351	36,542	91,955
Profit before Taxation	2,082,064	1,056,039	614,695
Tax Charge	760,145	390,812	293,614
Profit After Taxation	1,321,919	664,227	321,081

TABLE 2.1(b) COMMON SIZED INCOME STATEMENTS (% OF SALES)

	FY05 Rs 000	**FY04** Rs 000	**FY03** Rs 000
Gross turnover	100	100	100
Cost of Sales	85.2	86.32	87.28
Gross Profit	14.7	13.68	12.72
Marketing and Distribution Expenses	5.16	5.66	6.5
Administration Expenses	1.87	2.34	1.75
Total Operating Expense	7.03	8.0	8.25
Operating Profit	7.77	5.68	4.48
Other Income	0.11	0.06	0.03
Other Expense	0.93	1.44	1.37
	6.95	4.29	3.13
Finance Cost	0.15	0.14	0.41
Profit Before Taxation	6.8	4.15	2.72
Tax Charge	2.48	1.54	1.3
Profit After Taxation	4.32	2.61	1.42

TABLE 2.1(C) TREND STATEMENTS (FY03=100%)

	FY05	**FY04**	**FY03**
Gross Turn Over	135.63	112.76	100
Cost of Sales	132.41	111.52	100
Gross Profit	157.74	121.28	100
Marketing and Distribution Expenses	107.68	98.38	100
Administrative Expense	145.07	150.73	100
Operating Expense	115.62	109.49	100
Operating Profit	235.35	142.99	100
Other Income	512.39	217.21	100
Other Expenses	91.73	118.14	100
	301.06	154.61	100
Finance costs	49.32	39.74	100
Profit before Taxation	338.71	171.8	100
Tax Charge	258.89	133.1	100
Profit After Taxation	411.71	207.18	100

ANALYSIS OF THE INCOME STATEMENTS

Following are the analysis of each of the accounting heads in the Tables 2.1(a), (b), (c).

Gross turnover

Sales of PTC increased from Rs 22.57 in FY03 to Rs 30.6 billion in FY05.This sales volume is the highest in the company's history. The key achievement for FY05 is the regain of the market volume leadership after many years. This increasing Sales Volume indicates the efficiency of the company's operations.

Cost of Sales

As shown in trend statement, the cost of sales has also increased from previous years since FY03. the cost of sales in FY05 has increased by 132.41%, but this increase in the cost of sales has not affected the gross profit adversely and the reason is that the cost of sales has been reduced as percentage of sales from 87.28% of total sales in FY03 to 85.20% in FY05 (given in the table 2.1 (b)).

These costs of sales include purchase of raw material, Government taxes and levies & production overheads including salaries, insurance, repair, maintenance, depreciation etc. As the volume of Sales increases, the cost for increasing these sales also increases. What is important is that the increase cost should not reduce the given profit.

Gross Profit

The gross profit has tremendously increased from 12.72% of the total sales in FY03 to 14.70% of the sales in FY05. As seen from the trend statements gross profit for FY05 is 157.74% of that in FY03. This increase is mainly because of the increasing sales volume and decreasing percentage of cost of sales.

Marketing and distribution expenses

The total marketing expenses has grown from Rs 1,442 million in FY04 to Rs1,579 million in FY05. This marketing expense is 157.68% of the expenses in

FY03. The increase in marketing expense is due to immense advertisement for the Dunhill in Dec FY05. PTC launched an international brand in 3 cities Karachi, Lahore, Islamabad. Apart from that, PTC has increased its focus on the campaigning like the House of John Player Gold leaf's launch of the "Taste the world" range and Limited Edition Packs (LEPs) of Benson & Hedges and capstan (*Director's Review P-20*). This increased the marketing expenses of the company as shown in the comparative income statements.

Administration expenses

The administration expenses have decreased slightly as compared to the last year. One of the reasons of this decrease is the SAP implementation done in FY04, which cost the company initially Rs 157 million in FY04. This decrease was offset by the higher donations (Rs24 million) mainly for the earthquake relief activities. (*Director's Review P-20)*

Operating Profit

The operating profit has increased manifold in FY05 from 4.48% of net sales in FY03 to 7.77% of sales in FY05. The operating profit for FY05 is 235% of that in FY03.This is the record operating profit ever achieved by PTC. The main reason of increasing operating profit is increase in gross profit & total decrease in operating expenses (marketing, distribution and administrative expenses) from 8.25% of net sales in FY03 to 7.03% of net sales in FY05.

Miscellaneous income and expenses

Miscellaneous income and expenses have increased and decreased respectively. Other income includes Insurance commission & interest on short term deposits etc. The company has received interest on short term deposits in FY05 which has increased the other income amount. The decrease of Rs 82 million in other expenses represents reduced cost of staff separation offset by higher worker's Profit Participation Fund/ Worker Welfare fund due to higher profits. (*Notes 6 & 7)*

Finance cost

Finance cost includes Bank charges, fees, cost on short term finance and interest on worker's profit participation fund. Finance cost has been decreased greatly as compared to FY03. Finance cost in FY05 is only 49.3% of that in FY03. Thus increase in other income, decrease in other expenses & finance cost has led towards higher profit before Taxation.

Profit after taxation

Due to higher profits, tax charges have also increased however Profit after Taxation has also reached the value of Rs 1,321 million, highest in the history of the company. In FY05, profit after taxation is 4.32% total sales which was only 1.42% in FY03. The profit after Taxation in FY05 is 411% of that in FY03, which is a great achievement for the company.

BALANCE SHEET

After the income statement analysis, balance sheets of the three fiscals are analyzed in the following section with respect to the three tables Table2.2 (a), (b) and (c) which give the comparative, common size and trend statements of balance sheet respectively. In the common sized balance sheets, all the accounts are given as a percentage of total assets while in the trend statements, FY03 is taken as 100% and the values of FY04 and FY05 are calculated on the basis of FY03.

TABLE 2.2 (a) COMPARATIVE BALANCE SHEETS

	FY05 Rs 000	**FY04** Rs 000	**FY03** Rs 000
Assets			
Property Plant & Equipment	3,798,190	3,564,407	3,410,888
Investment in Subsidiary Company	5,000	5,000	5,000
Long Term Loans	17,782	16,324	16,481
Long term deposits and prepayments	11,365	4,433	6,934
Current Assets			
Stocks	3,780,931	3,074,052	3,227,503
Stores & Spares	125,232	121,464	127,381
Trade Debts	2,894	12,486	145,749
Loans and Advances	32,676	32,273	62,826
Prepayments and other receivables	136,778	155,129	243,875
Cash & Bank Balance	57,605	39,197	48,069
Liabilities			
Interest accrued, Trade & other Payables	2,526,735	2,061,339	2,284,001
Short Term Finance	400,662	996,579	1,335,539
Income Tax Payable	676,969	79,549	-
Net Current Assets	531,750	297,134	39,913
Stockholder's Equity			
Capital Stock	2,554,938	2,554,938	2,554,938
Revenue Reserves	1,084,476	707,885	553,646
Deferred Taxations	724,673	624,475	370,632
Total Stockholder's Equity	4,364,687	3,887,298	3,479,216

TABLE 2.2 (b) COMMON SIZE BALANCE SHEETS (% OF TOTAL ASSETS)

	FY05 Rs 000	**FY04** Rs 000	**FY03** Rs 000
Assess			
Property Plant & Equipment	87.03	91.69	98.04
Investment in Subsidiary Company	0.11	0.13	0.14
Long Term Loans	0.41	0.42	0.47
Long term deposits and prepayments	0.26	0.11	0.20
Current Assets			
Stocks	86.64	79.08	92.77
Stores & Spares	2.87	3.12	3.66
Trade Debts	0.07	0.32	4.19
Loans and Advances	0.75	0.83	1.81
Prepayments and Other Receivables	3.13	3.99	7.01
Cash & Bank Balance	1.32	1.01	1.38
Liabilities			
Interest Accrued, Trade & other Payables	57.90	53.03	65.65
Short Term Finance	9.18	25.64	38.39
Income Tax Payable	15.51	2.05	-
Net Current Assets	12.18	7.64	11.50
Stockholder's Equity			
Capital Stock	56.54	65.73	73.43
Revenue Reserves	24.85	18.21	15.91
Deferred Taxations	16.61	16.06	10.65
Total Stockholder's Equity	100.00	100.00	100.00

TABLE 2.2 (c) TREND STATEMENTS (FY03=100%)

	FY05 Rs 000	FY04 Rs 000	FY03 Rs 000
Assets			
Property Plant & Equipment	111.35	104.50	100.00
Investment in Subsidiary Company	100.00	100.00	100.00
Long Term Loans	107.89	99.05	100.00
Long term deposits and prepayments	163.90	63.93	100.00
Current Assets			
Stocks	117.15	95.23	100.00
Stores & Spares	98.31	95.35	100.00
Trade Debts	1.99	8.57	100.00
Loans and Advances	52.01	51.37	100.00
Prepayments and Other Receivables	56.09	63.63	100.00
Cash & Bank Balance	119.84	81.54	100.00
Liabilities			
Interest Accrued, Trade & other Payables	110.63	90.85	100.00
Short Term Finance	30.00	74.62	100.00
Income Tax Payable	851.01	100.00	-
Net Current Assets	1,332.27	744.45	100.00
Stockholder's Equity			
Capital Stock	100.00	100.00	100.00
Revenue Reserves	195.88	127.86	100.00
Deferred Taxations	195.52	168.49	100.00
Total Stockholder's Equity	124.43	111.73	100.00

ANALYSIS OF BALANCE SHEETS

ASSETS

Company's assets are concentrated in cash, accounts receivables, inventories, investments and property, plant and equipment. Analysis of each of these is given below:

Property plant and equipment

Property, plant and equipment is the most important of all the assets. This amounting head includes Operating fixed assets and capital work in progress. In FY05, the company has invested Rs717 million in fixed assets out of which Rs586 million have been invested in Plant and Machinery for modernizing and automation for manufacturing facilities (*Director's Review P-20).* Capital work in progress includes civil works and buildings, Plant and Machinery, advances to suppliers etc. This has reduced from last year by 98%. As compared to previous year, property plant and equipment constitutes 87% of total assets in FY05 which was 98% in FY03.

Investment in subsidiary company

Investment in subsidiary company represents fully paid ordinary shares of Phoenix (PVT) Limited. This is a wholly owned subsidiary of the company. This investment has been constant for the last three years.

Long term loans

Long term loans increased slightly. They include loans given to directors and executives for the purchase of household furniture, appliances, cars etc. and loans given to other employees. (*Note 15)*

Long term deposits & Prepayments

These include security deposits & prepayments. To remain on the safe side, the company has increased its long term deposits and has made more prepayments as compared to previous years.

CURRENT ASSETS

Stocks

The inventory of the company is categorized into raw materials, raw materials in transit, work in process inventory and finished goods. Since the volume of sales is increasing, the volume of inventory is also increasing. However, the amount of stocks has followed a declining trend from FY03 as a percentage of total assets. Stocks were 92.77% of total assets in FY03 which are 86.64% in FY05 which is a good sign for the company. Since cigarettes are not a customized product, the concept of just-in-time inventory is not followed in PTC. Therefore, finished goods comprise of 20.36% of total stocks.

TABLE 2.2-1 FINISHED GOOD INVENTORY

	FY05	FY04	FY03
Finished goods	20.36%	12.88%	10.06%

The increasing percentage of finished goods shows the effectiveness of production.

Stores and Spares

Stores and spares are small portion of total assets which have shown a declining trend since FY03.

Trade Debts

Trade Debts include amount due from associated companies, BAT Germany and BAT Singapore (*Note19)*. In FY05, trade debts are 1.99% of those in FY03. The debts considered doubtful have remained constant (Rs 2.322 million) since FY03. Thus, the decrease in trade Debts indicates collections from the associated companies.

Loans and Advances

These loans and advances are the current portion of the long term loans. They include loans due from directors, executives, employees and others (*Note 20)*. The decreasing trend of loans and advances due shows collections.

Prepayments and Other Receivables

As described earlier, company has made more prepayments as compared to previous years. The other receivables includes those from subsidiary company (Phoenix Pvt. Ltd), from associated companies (BAT of different countries), claims, Management Provident Fund, Pension funds etc (*Note 21)*. Since these receivables are not from the customers as the company makes all sales on cash, they constitute only a small percentage of the net sales as shown in the Table 2.2(b). Thus, these receivables are not of any significance to the company as they may be for any company which makes credit sales.

Cash and Bank Balances

TABLE 2.2-2 CASH AND BANK BALANCES

	FY03 Rs 000	**FY04** Rs 000	**FY05** Rs 000
On hand	3,143	2,096	1,381
In transit	1,072	1,405	4,018
At banks on current accounts	36,985	23,024	34,005
Security deposits	8,446	7,246	8,665
Cash and bank balances	57,605	39,197	48,069

As shown in Table 2.2-2 company's cash and bank balances have followed an upward trend since FY03.In FY05, company has increased its foreign currency deposits as well as local currency deposits at banks to a large extent. Thus cash and bank balances have increased from 1.01% of total assets in FY04 to 1.32%. In FY05, cash and bank balance are 119.84% of that in FY03.

LIABILITIES

Interest accrued, trade and other payables

These include payables to creditors, sales tax , excise duty, Federal/Provincial taxes , liabilities due to associated companies, unclaimed dividends etc. These liabilities have increased as compared to last year. However when compared with FY03, it is clear that the company has reduced its payables from 65.65% of total assets in FY03 to 57.90% in FY05. Maintaining payables around 60% of total assets is a positive sign for the company.

Short-term finance

Short-term finances are under mark-up arrangements with banks and are secured by the stocks of raw materials and finished goods. The mark-up (4.75%-12.34%) is payable quarterly (*Note 24)*. Sort-term financing has decreased greatly since FY03, when it was 38% of total assets while in FY05, it is only 9% of the total assets. One possible reason of this decrease can be the increasing profitability and cash balance of the company. It shows that the company is self sufficient and does not require financing.

STOCKHOLDERS' EQUITY

Capital stock

Company has 255,493,792 shares outstanding, out of which 25,136,724 were given as bonus shares. Since 2000, the company has not issued any further shares. The largest shareholding in PTC is by the Holding company, British American Tobacco with 94.34% shares of the company.

Revenue reserves and Dividends

Revenue Reserves have tremendously increased since 2000 as shown in the following table:

TABLE 2.2-3 REVENUE RESERVES (RS MILLION)

FY05	FY04	FY03	2002	2001	2000
1,084	708	554	233	17	(337)

This increase is the clear indication of the profitability of the company. PTC has come a long way from 2000 (with a negative balance) to now in FY05 when it has reported Rs 1,084 million in its revenue reserves. Therefore, PTC has been paying dividends to its shareholders. In FY05, the company has declared a final dividend of 25% (*Director's Review P-21).*

CASH FLOW STATEMENTS

Following the balance sheets are the cash flow statements of the company and their analysis. Tables 2.3(a), (b) and (c) show the comparative, common size and trend statements of cash flows respectively. In common size statements all the values are calculated as a percentage of net sales while in the trend statements, FY03 is taken as 100%.

TABLE 2.3(a) COMPARATIVE CASH FLOW

	FY05 Rs.000	**FY04** Rs.000	**FY03** Rs.000
Cash Receipt from Customers	30,624,654	25,585,897	22,519,584
Cash paid to Govt for Fed. Excise Duty, Sales tax and other levies	(19,126,208)	(16,021,304)	(14,309,453)
Cash paid to suppliers	(7,795,529)	(6,450,403)	(5,534,395)
Cash paid to employees & recruitment fund	(1,400,619)	(1,465,490)	(1,266,329)
Income Tax paid	(62,527)	(53,370)	(46,299)
Other cash receipts/payments	33,637	42,369	(28,693)
Net Cash Inflow from Operating Act ivies	2,273,408	1,637,699	1,334,415
Purchase of property, plant & equipment	(716,852)	(597,702)	(854,107)
Proceeds from Sale of operating fixed assets	42,815	38,027	23,585
Net Cash Inflow from Investing Act ivies	(674,037)	(559,675)	(830,522)
Repayment of Long term loans	-	(200,000)	(370,000)
Dividends Paid	(943,649)	(507,378)	(203,960)
Financial Charges Paid	(32,531)	(42,656)	(120,863)
Long Term loans, deposits & prepayments	(8,390)	2,685	1,479
Cash Paid to subsidiary company	(476)	(620)	(539)
Net Cash outflow from financing activities	(985,046)	(747,936)	(693,883)
Net increase in Cash Equivalents	614,325	(330,088)	(189,990)
Cash & Cash Equivalents as at Jan,01	(957,382)	(1,287,470)	(1,097,480)
Cash and Cash Equivalents as at Dec 31	(343,057)	(957,382)	(1,287,470)

TABLE 2.3(b) COMMON SIZE CASH FLOWS (%OF NET SALES)

	FY05 Rs.000	FY04 Rs.000	FY03 Rs.000
Cash Receipt from Customers	100.03	100.52	99.77
Cash paid to Govt for Fed. Excise Duty, Sales tax and other levies	(62.47)	(62.95)	(63.39)
Cash paid to suppliers	(25.46)	(25.34)	(24.52)
Cash paid to employees & recruitment fund	(4.57)	(5.76)	(5.61)
Income Tax paid	(0.20)	(0.21)	(0.21)
Other cash receipts/payments	(0.11)	0.17	(0.13)
Net Cash Inflow from Operating Activities	7.43	6.43	5.91
Purchase of property, plant & equipment	2.34	(2.35)	(3.78)
Proceeds from Sale of operating fixed assets	0.14	0.15	0.10
Net Cash Inflow from Investing Activities	(2.20)	(2.20)	(3.68)
Repayment of Long term loans	-	(0.79)	(1.64)
Dividends Paid	(3.08)	(1.99)	(0.90)
Financial Charges Paid	(0.11)	0.17	0.54
Long Term loans, deposits & prepayments	(0.03)	0.01	0.01
Cash Paid to subsidiary company	(0.01)	(0.002)	(0.002)
Net Cash outflow from financing activities	(3.22)	(2.94)	(3.07)
Net increase in Cash Equivalents	2.01	1.30	(0.84)
Cash & Cash Equivalents as at Jan,01	(3.13)	(5.06)	(4.86)
Cash and Cash Equivalents as at Dec 31	(1.12)	(3.76)	(5.70)

TABLE 2.3(C) TREND STATEMENTS (FY2003=100%)

	FY05 Rs.000	FY04 Rs.000	FY03 Rs.000
Cash Receipt from Customers	135.99	113.62	100.00
Cash paid to Govt for Fed. Excise Duty, Sales tax and other levies	(133.66)	(111.96)	100.00
Cash paid to suppliers	(140.86)	(116.55)	100.00
Cash paid to employees & recruitment fund	(110.60)	(115.73)	100.00
Income Tax paid	(135.05)	(115.27)	100.00
Other cash receipts/payments	-	-	-
Net Cash Inflow from Operating activities	170.37	122.73	100.00
Purchase of property, plant & equipment	(83.93)	(69.98)	100.00
Proceeds from Sale of operating fixed assets	181.53	161.23	100.00
Net Cash Inflow from Investing activities	(81.16)	(67.39)	100.00
Repayment of Long term loans	-	(54.05)	100.00
Dividends Paid	(462.66)	(248.73)	100.00
Financial Charges Paid	(26.92)	(35.29)	100.00
Long Term loans, deposits & prepayments	-	179.72	100.00
Cash Paid to subsidiary company	(88.31)	(115.03)	100.00
Net Cash outflow from financing activities	(141.96)	(107.79)	100.00
Net increase in Cash Equivalents	186.11	-	-
Cash & Cash Equivalents as at Jan,01	(87.23)	(117.31)	100.00
Cash and Cash Equivalents as at Dec 31	(26.65)	(74.36)	100.00

ANALYSIS

Cash flow from operating activities

From the comparative cash flow statements, it is clear that the company has increased its cash receipts from customers since FY03. This is mainly because the company has greatly increased its sales volume as shown in Table 2.1(a) and since these receipts are almost 100% of the total sales (Table 2.3(b)), it shows that all the sales are done on cash. This is because cigarettes are a consumer product of very low price so most of the sales are done on cash basis.

With the increase in sales, the cash paid for federal exercise duty, sales tax and other levies are also increasing. These payments in FY05 are 135% of that in FY03. However, as given in the common sized statements, the amount is almost constant at approximately 63% of total sales. Cash paid to suppliers is the cash paid for purchasing raw materials. This payment has also increased with the increasing sales volume. It has become 140.86% in FY05 as compared to that in FY03. Cash payments to suppliers have also increased as a percentage of sales from 24.52% of sales in FY03 to 25.46% in FY05.

Cash paid to employees and retirement funds have increased from Rs1,266 million in FY03 to Rs1400 million in FY05 with an increase of 110.6% from FY03. As a percentage of sales, this cash payment has shown a declining trend from 5.6% to 4.6% in FY05.

Cash paid to employees includes provident fund, pension fund and gratuity fund. The change in these benefit funds and gratuity schemes is because of the actuarial valuation carried out at 31st December of every year, taking in amount the expenses and liabilities (*Note 28)*.

Other cash receipts/payments have been changing since FY03. In FY03, they were cash payments of Rs28 million while in FY04 and FY05 cash has reached to the amount of Rs42 million and Rs33 million respectively.

The percentage of income taxes paid has remained constant however the rupee value has increased with the increasing sales volume.

Cash flows from investing activities:

Investing activities of PTC include purchases and sales of operating fixed assets. Since FY03, cash from investing activities has been a negative value that is; more payments have been done to purchase the assets as compared to the sale of these assets. However these payments have been decreasing since FY03 as the purchases have decreased while sales have increased. The purchases of property, plant and equipment decreased from Rs854 million in FY03 to Rs716 million in FY05 reducing these payments as a percentage of sales from 3.78% in FY03 to 2.34% in FY05. This may be because of the fact that the company has now established itself and thus, it concentrates now on increasing sale rather than investing more. The proceeds from sales have increased from Rs23 million (FY03) to Rs42 million (FY05) decreasing the overall negative value of cash flows from investing activities.

Cash effect from financing activities:

The net cash flow from financing activities has been a net outflow since FY03. This total amount has increased 317% as compared to last year. Company has been paying long term loans till FY04 which was approximately 1% of total sales. In FY05 the company did not pay this loan. This reduction has been offset by the payment of dividends. In FY03 and FY04 company paid only 0.90% and 1.92% of total sales as dividends. In FY05, however, they paid Rs 943 million cash as dividends which is 462% of the dividends paid in FY03.

Another factor leading to this high outflow of cash from financing activities is the long-term loan, deposits and prepayments. In FY03 and FY04 company has been depositing however, in FY05, company made payments of Rs 8 million. Financial changes and cash paid to subsidiary have been reducing since FY03.

The net effect is that cash and cash equivalents have been greatly increasing since FY03. In FY03, it was a negative value while in FY05; this company has been able to make an increase in the net cash and cash equivalents of Rs614 million. At 31st December, 2005; the company has cash and cash equivalents of Rs. (343 million). This negative figure is because company has invested its cash in short term finances and has paid Rs 400 million for these liabilities as opposed to Rs 57 million of cash and cash equivalents.

As a conclusion to this analysis, it can rightly be said that the company is progressing a lot and it has a great potential to perform even better in the coming years.

Chapter # 3

Ratio Analysis

PAKISTAN TOBACCO
COMPANY

Ratios are particularly important in analyzing financial statements because they permit us to compare information from one financial statement with information from another financial statement. This chapter deals with the analysis of the company through financial ratios. They are categorized into ratios measuring short term liquidity, long term credit risk and profitability.

MEASURES OF SHORT TERM LIQUIDITY

Table 3.1 gives the liquidity ratios of the company from FY03 to FY05 and is followed by the analysis of these ratios.

TABLE 3.1 RATIOS OF SHORT TERM LIQUIDITY

Ratio	Formula	FY05	FY04	FY03
Current ratio	Current Assets/ Current Liabilities	1.1	1.1	1.0
Quick Ratio	Quick Assets/ Current Liabilities	0.05	0.06	0.08
Working Capital	Current Assets - Current Liabilities	Rs 531,750,000	Rs 297,134,000	Rs 39,913,000
Receivable Turnover rate	Net sales/Av. Accounts receivable	211.97	122.33	-
Days to collect average accounts receivable	365/ Receivable turnover rate	1.72 ~ 2	2.98 ~ 3	-
Inventory Turnover Ratio	COGS / Avg. Inventory	7.61	6.97	-
Days to sell average inventory	365/inventory turnover ratio	47.96 ~ 48	52.37 ~ 52	-
Operating Cycle	Days to sell Av inventory	48	52	-
Cash flow from operations to current liabilities	Cash from operation /current liabilities	63%	52%	35%
Net cash provided by operating activities	From cash flow statement	Rs 2,273,408,000	Rs 1,637,699,000	Rs 1,334,415,000
Free cash flow	Operating cash flow-cash from investing activities & dividends	Rs 655,722,000	Rs 570,706,000	Rs 299,933,000

Current ratio

Current ratio of the company has increased from 1.0 (FY03) to 1.1 (FY05). This current ratio of 1.1 shows that for every 1 rupee of current liability, the company has 1.1 rupees of current assets i.e. the total current assets cover 110% of the current liabilities. Since the company has a strong financial position, it should have a relatively higher amount of current assets as compared to current liabilities. However, even at this ratio of 1.1, company does not pose a risk of liquidity.

Quick ratio

Quick ratio has been decreasing from 0.08 (FY03), 0.06 (FY04) to 0.05 (FY05). it is not even equal to 1 which means that the most liquid asset (including cash and accounts receivables) are not sufficient to cover all the current liabilities. The high current ratio suggests that the company has large amount of inventory and excluding the inventory, the quick assets are less than the current liabilities. From FY03, the receivables of the company have decreased from Rs201 million in FY03 to Rs 104 million in FY05. Moreover, loans and advances have also shown a declining trend since FY03 leading to a lower quick ratio. The quick assets were worth Rs 312 million in FY03 because of high receivables, loans and advances while in FY05, quick assets are only Rs 195 million. Since the receivables of the company are not from the customers but from the executives and directors, they are only a small percentage of the total assets (3.13%). Thus, the quick assets of the company are not sufficient to cover the current liabilities. It shows that the company highly depends upon its inventories to pay off its current liabilities.

Working capital

With the increasing current ratio, the working capital has also been increasing tremendously from Rs 39 million in FY03 to Rs531 million in FY05 showing that current assets are more than the current liabilities. This increase is a good sign for the short-term creditors.

Days to collect average accounts receivables

Days to collect average accounts receivables have decreased from 3 days in FY04 to 2 days in FY05. These receivables include those from executives, employees and associated companies. This declining trend is due to increasing receivable turnover rate from FY04 to FY05 and shows ability of the company to collect its receivables at a relatively shorter time period from the last year.

As explained earlier in chapter 2, these receivables are not from the customers and do not hold any significance.

Days to sell average inventory

The days to sell average inventory have also decreased as compared to FY04. The number of days to sell average inventory in FY04 were 52 days which have decreased to 48 days in FY05 showing company's high performance in selling inventory.

Operating cycle

Since the receivables of the company are not from the customers thus, the days to collect average accounts receivables cannot be counted as part of the operating cycle. Thus, the operating cycle constitutes of only the days to sell average inventory which have decreased from the previous year as explained earlier.

Cash flow from operations to current liabilities

The increasing trend here shows the increasing ability of the company to cover the currently maturing obligations from its operations. This increase from 35% (FY03) to 63% (FY05) is favorable and shows that in future, the company will be able to pay back maximum of its current liabilities through cash from operations.

Net cash provided by operation activities

The cash from operating activities has increased greatly since FY03 when it was 5.9% of total sales while in FY05, it is 7.4% of total sales. The major portion of cash is coming from the operating activities, which is a healthy sign.

Free cash flow

Free cash flow shows the excess of operating cash flow over basic needs. Free cash flow has also shown an increasing trend since FY03. This shows strong cash position of the company as far as its operating and basic needs are concerned.

Overall, from the point of view of short term investors, PTC seems to be a good credit risk as its current ratio and working capital have been increasing since FY03. Its operating cycle has also shown improvement since last year. Since the company does not have receivables due from the customers, its quick ratio is relatively less. Other than that, increasing trends in cash flow from operating activities and free cash flow are a proof of the strong cash position of the company.

MEASURES OF LONG TERM CREDIT RISK

After the liquidity ratios, the ratios measuring the long term credit risk of the company are given below in the Table 3.2 followed by their analysis.

TABLE 3.2 RATIOS OF LONG TERM CREDIT RISK

Ratio	Formula	FY05	FY04	FY03
Debt ratio	Total liabilities/total assets	45.23%	44.66%	52.33%
Interest coverage ratio	Operating income/annual interest expense	52.43	39.53	10.99

Debt ratio

The debt ratio or the percentage of assets financed by debt decreased from FY03 to FY05 from 52% to 45%. This is a favorable change for the long term creditors because the debt burden including required interest payments is less in FY05 and FY04 as compared to FY03 thereby making the claim of each creditor more secure.

Interest coverage ratio

Interest coverage ratio has been increasing from 10.99 in FY03 to 52.43 in FY05. This is a favorable increase for the company as well as the creditors. An interest coverage ratio of 52% shows that for every one rupee liability of interest payables, the company has 52 rupees. This increase in the interest coverage ratio is basically because of two reasons. Firstly, as given in Table 2.1(b), the operating profit has been increasing as a percentage of net sales from 4.48% in FY03 to 7.77% in FY05. Secondly, company has reduced its finance cost (annual interest expense) from 0.41% in FY03 to only 0.15% in FY05. As explained earlier in chapter 2, finance cost in FY05 is only 49.3% of that in FY03, thus increasing the interest coverage ratio.

After considering the favorable trends in both the ratios, it is evident that the claims of long term creditors are secured and the company has enough potential to pay the interest expenses. Thus, the company is a good credit risk for long term creditors.

MEASURES OF PROFITABILITY

In the following table, the ratios and trends showing the profitability of the company are given followed by their analysis.

TABLE 3.3 RATIOS OF PROFITABILITY

Ratio	Formula	FY05	FY04	FY03
Gross profit rate	Gross profit/net sales	15%	14%	13%
Operating expense ratio	Operating expenses/net sales	7.03%	8.0%	8.25%
Net income as a % of net sales	Net income/net sales	4.32%	2.61%	1.42%
Earning per share	Net income/average number of shares outstanding	5.17	2.60	1.26
Return on Assets(ROA)	Operating income/ average total assets	31.72%	19.36%	-
Return on equity(ROE)	Net income/ average total equity	38.30%	20.88%	-

Gross profit rate

Gross profit rate of the company has been increasing since FY03 from 13% to 15%. It shows that after deducting the cost of sales, 15% of the total sales is there as gross profit fro the company. This increasing trend in gross profit rate shows the decreasing percentage of cost of sales. Apart from this, the company has also been able to increase its net sales which in FY05 are 135% of the net sales in FY03. Both these factors have led towards higher gross profit rate in FY05 as compared to previous years.

Operating expense rate

Operating expense rate has been decreasing from 8.25% (FY03) to 7.03% (FY05). This is because of the slight increase in operating expenses (marketing, distribution and administration expenses) and a dramatic increase in net sales.

As given in Table 2.1(c) operating expenses in FY05 are 115% of that in FY03.However, net sales of FY05 are135% of the net sales in FY03. This has led to a decrease in the operating expense ratio which is a good sign fro the company.

Net income as a percentage of net sales

Net income as a percentage of net sales has increased from 1.42% in FY03 to 4.32% in FY05 which shows high profitability of the company.

Earning per share (EPS)

EPS has also shown an increasing trend since FY03. A jump from 1.26 (FY03) to 5.26 (FY05) is a good sign for the shareholders. The number of shares outstanding has remained constant at 255 million. The factor leading to increased EPS is the increase in net income which has increased from Rs 321 million in FY03 to Rs 1,321 million in FY05.

Return on assets (ROA)

Return on assets has increased from 19% in FY04 to 31% in FY05. This is a favorable increase showing management's ability to earn a handsome return on funds supplied from all sources. The average total assets have remained almost constant for two year (Rs 7,496 million (FY05) and Rs 7,461 million (FY04)). The major increase is seen in operating income which has increased from Rs 1,444 million (FY03) to Rs 2,377 million (FY05) thus increasing the ROA.The cost of borrowing for the three years is given in the following table:

TABLE 3.3 (a) COSTS OF BORROWING

FY05	FY04	FY03
8.85%	3.47%	6.72%

These figures show that the ROA of the company for all the three years is clearly higher than the cost of borrowing. This shows that the business is well managed and has good future prospects.

Return on Equity (ROE)

The return on equity has increased from 20.88% in FY03 to 30.30% in FY05. This shows that the stockholders' equity of the company is earning increasing profits. The average equity has increased slightly from FY04 to FY05. However, the major increase in net income has led towards the higher returns on the equity. The net income as given in Table 2.1 (a) has increased from Rs 1,444 million (FY03) to Rs 2,377 million (FY05) thus increasing the return on equity.

This analysis of the profitability of the company shows favorable trends. Gross profit, net income, EPS, ROA and ROE has increased tremendously while the operating expense ratio has decreased from the last year thus, showing high profitability of the company.

Chapter # 4

Comparison of PTC with Lakson Tobacco Company

PAKISTAN TOBACCO COMPANY

Tobacco industry is growing in the developing world. Soon after the implementation of stringent regulations by the developed world, the market base of this industry is shifting towards third world Asian, Latin American and African countries. This trend is evident in the Pakistani market as well. In all, Pakistan has a very limited number of tobacco companies. The two big names in this industry are Lakson Tobacco and Pakistan Tobacco Company. These two are the market leaders and have the major share of all the market.

To comment on the efficiency of one, we have to compare it with the other. Therefore, in this chapter, the financial as well as operating performance of PTC is compared with that of Lakson Tobacco Company.

COMPARATIVE BUSINESS PERFORMANCE

The two companies can firstly be compared by considering their business performance in the current fiscal year. The following Table 4.1 shows the operating highlights of both the companies.

TABLE 4.1 COMPARATIVE BUSINESS PERFORMANCES

Financial indicators	PTC FY05 Rs million	PTC FY04 Rs million	LAKSON FY05 Rs million	LAKSON FY04 Rs million
Turnover	30,615	25,453	20,585	17,308
Gross profit	4,530	3,483	4,080	3,149
Operating profit	2,378	1,445	2,581	1,948
Profit before tax	2,082	1,056	2,572	1,929
Profit after tax	1,322	665	1,685	1,277

As seen from the table, the turnover or the net sales of PTC are greater in amount as that of Lakson. However, the gross profit amounts are almost equal (approximately Rs 4,000 million). This shows that although PTC has greater sales, its cost of goods sold is also higher than Lakson thus, the gross profit margin of Lakson is higher than PTC as will be explained in the next section of the chapter.

The operating profit of Lakson is again higher than PTC and so is the Profit before tax and after tax. It shows that although PTC has a higher sales volume, its expenses are more as compared to Lakson. This is a good sign for Lakson that it can earn higher profits not with increasing its sales but by controlling its expenses and managing its resources efficiently.

As far as the trends are concerned, it is clear that both the companies have improved as compared to last year. The issues of the tobacco company are common for both the companies. However, with the increasing opportunities provided by the government of Pakistan, both the companies have a high potential of improvement.

The detailed analysis of liquidity, profitability and market conditions of both the companies is given in this section of the chapter.

MARKET CAPTURING

Market share

Lakson and PTC are the two biggest players in the market. Other two companies listed on the Karachi Stock exchange are Khyber Tobacco and Sarhad Cigerette but their share prices are very low and their contribution to the tobacco industry is not significant

Lakson controls about 56% of the market share, rest is mostly taken up by PTC and a minor part by local firms. Lakson gets the Volume leadership by attracting the public through low cost cigarettes, while PTC gets value leadership by their more popular brand Gold Leaf.

Share price

As of June 29th, 2005, the closing market price of Lakson's share was Rs 258.3 while at Dec 31st, 2005, the closing share price of PTC was Rs 68.95. Today, on 7th June, 2006 the share prices of PTC and Lakson are Rs 71 and Rs 298 respectively.

One of the factors of the high share price of Lakson is because of the high expectations of the shareholders from the company.

Marketing

It is said that the tobacco companies are the highest payers for marketing. In 1998 Lakson was the third largest advertiser in Pakistan spending $6.4m on publicity. This is mainly because of the facts that in many countries, the anti tobacco campaigns make it essential for the tobacco companies to attract the smokers as well as the non smoking public to smoke and to use their brand. So to keep the tobacco industry going, the tobacco companies market their products extensively as compared to any other industry.

In this regard, PTC has been able to capture the market greatly through advertisements. Most of the public is aware of the brands of PTC but not of Lakson. The brands of PTC are considered to be a status symbol since PTC is a multinational and quality of its cigarettes is far better than that of Lakson.

The marketing expenses as a percentage of net sales say it all. PTC has spent Rs1,119 million for marketing this year which constitutes 3.66% of its net sales.

In 2005, no more advertisements are played on the electronic media. As explained in the first chapter, tobacco industries are now finding other ways of publicizing their products. Since, tobacco industry produces a large percentage of excise taxes, it cannot be said that this industry will be dissolved that easily. In the future, high prospects are expected from the tobacco industry and this provides a good potential for both Lakson as well as PTC to prosper in Pakistan.

MEASURES OF SHORT TERM LIQUIDITY

The following table shows the short term liquidity ratios of both the companies followed by their comparative analysis.

TABLE 4.2 RATIOS OF SHORT TERM LIQUIDITY

Ratio	Formula	PTC	LAKSON
Current ratio	Current Assets/ Current Liabilities	1.1	2.6
Quick Ratio	Quick Assets/ Current Liabilities	0.05	1.13
Working Capital	Current Assets - Current Liabilities	Rs 531,750,000	Rs 2,173,278,000
Receivable Turnover rate	Net sales/Av. Accounts receivable	211.97	170.51
Days to collect average accounts receivable	365/ Receivable turnover rate	1.72 ~ 2	2.14 ~ 2
Inventory Turnover Ratio	COGS / Avg. Inventory	7.61	12.84
Days to sell average inventory	365/inventory turnover ratio	47.96 ~ 48	28.42 ~ 28
Operating Cycle	Days to sell Av inventory	48	28
Cash flow from operations to current liabilities	Cash from operation /current liabilities	63%	106%
Net cash provided by operating activities	From cash flow statement	Rs 2,273,408,000	Rs 1,446,803,000
Free cash flow	Cash provided by operating activities- net cash flow from investing activities and dividends	Rs 655,722	Rs 182,583

Current ratio

Current ratio of Lakson is 2.6 while that of PTC is 1.1. The reason is that the liabilities of PTC are much higher than those of Lakson. One reason may be this that PTC has accrued interest as well as short term finances as liabilities whereas Lakson does not have such payable accounts. Higher current ratio of Lakson shows a better liquidity position as compared to PTC.

Quick ratio

Higher quick ratio of Lakson as compared to PTC is due to higher quick assets and lower current liabilities. The quick assets of both the companies include only cash and receivables. The receivables are almost equal but there is a large difference between the cash and bank balances. Lakson has Rs 1,401 million cash while PTC has only Rs 57 million. As far as the current liabilities are concerned, PTC has more current liabilities due to accrued interest and short term financing. Thus, on the whole quick ratio of Lakson is higher than PTC showing that Lakson has more liquid assets to cover its current liabilities as compared to PTC.

Working capital

Since the current ratio of PTC is lower than Lakson, the current assets of PTC more than its current liabilities are less as compared to Lakson. This shows that Lakson has more current assets to pay off its current liabilities.

Days to collect average accounts receivables

Days to collect average accounts receivables are almost equal to 2 days. These receivables are from executives, employees and associated companies in case of PTC and from statutory authorities in case of Lakson. Since cigarettes are sold on cash, these receivables are not from the customers. Thus, the days to collect average receivables don’t hold great significance for both the companies.

Days to sell average inventory

Days to sell average inventory for Lakson are 28 days while for PTC, they are 48 days. This difference is basically because of the high inventory turnover of Lakson (12.84) as compared to PTC (7.61). As explained in the chapter 2, PTC has decreased its stocks (inventories) from 92.77% of total assets in FY03 to

86.64% in FY05 (Table2.2 (b)). Still it has not been able to increase its inventory turnover as much as Lakson has. Both the average inventory and the cost of goods sold of PTC are higher than those of Lakson. Low cost of goods sold and even lower average inventories of Lakson have led to its higher inventory ratio and in turn lesser no of days to sell average inventory.

Operating cycle

Since the receivables of both companies are not those from customers, the days to collect average receivables are not included in the operating cycle. Thus, the operating cycles of both PTC and Lakson constitute of only the average days to sell inventory which are 28 for Lakson and 48 for PTC. This difference shows the better productivity and management of Lakson as compared to PTC as explained in the last paragraph.

Cash flows from operations to current liabilities

The cash flows from operations to current liabilities are 63% for PTC and 106% for Lakson. Current liabilities of PTC are of Rs 3,604 million (82.6% of total assets) while that of Lakson are Rs 1.365 million (24% of total assets). As explained earlier in the analysis of current ratio, the greater current liabilities of PTC are because of short term finances and accrued interest. Lakson does not have any such liabilities. The cash flows from operations of PTC are Rs2,273 million while that of Lakson are Rs 1,446 million which are almost 7% of total sales for both the companies. Thus, the high current liabilities of PTC reduce this ratio as compared to Lakson.

63% of operating cash flows to current liabilities shows that for every one rupee of current liability, the company has 63 rupees from the operating cash flows. As compared to PTC, Lakson’s position is excellent as for every 1 rupee of current liability, Lakson has 106 rupees.

Net cash provided by operating activities

The cash from operating activities is Rs 2,273 for PTC and Rs 1,446 for Lakson. As explained in the previous analysis, the cash flows from operating activities of both the companies are almost equal to 7% of total sales. Although the cash figure for PTC is higher than that of Lakson, this same percentage of 7% shows that cash flows of both the companies are managed similarly.

Free cash flows

Free cash flow shows the excess of operating cash flows over the basic needs of the company. As given in the Table 4.2, PTC has Rs 655 million free cash while Lakson has Rs182 million. The free cash flow of PTC is 190% of cash and cash equivalents at the end of the year while that of Lakson is 13%. This is because PTC has a negative cash balance. Thus, the free cash flow is very high as compared to that of Lakson.

This analysis of the liquidity positions of both the companies shows that in all the ratios calculated above, Lakson is at a better position. Although the cash figures of PTC are higher in some cases but the percentages are low. The higher percentages of Lakson show that the company is in a more stable position as compared to PTC Thus, from the liquidity point of view, short term creditors would go for Lakson than PTC.

MEASURES OF LONG TERM CREDIT RISK

TABLE 4.2 RATIOS OF LONG TERM CREDIT RISK

Ratio	Formula	PTC	LAKSON
Debt ratio	Total liabilities/total assets	45.23%	27%
Interest coverage ratio	Operating income/annual interest expense	52.43	185.6

Debt ratio

The debt ratio of Lakson is 27% as compared to PTC with 45%. The debt ratio shows the percentage of assets financed by debt. The lower debt ratio of Lakson is favorable for the long term creditors because the debt burden including required interest payments is less as compared to PTC thereby making the claim of each creditor more secure. The higher debt of PTC is due to short term financing done by the company which is not there in case of Lakson. These short term finances are secured against stocks of the company and the interest is payable quarterly (*Note-24).*

Interest coverage ratio

The interest coverage ratio of Lakson is 185.6 as compared to 52.43 of PTC. Individually, both the companies are at a safer position by having more than 50% of interest coverage ratio. These ratios show that for each one rupee of interest liability, PTC has 52 rupees while Lakson has 185 rupees. The lower interest coverage ratio of PTC as compared to Lakson is due to short term financing done by PTC as explained earlier.

Overall, both PTC and Lakson are at a stable long term credit position by having less than 50% debt ratios and more than 50% interest coverage ratios. However, when compared with Lakson, PTC has relatively more credit risk due to the short term financing.

MEASURES OF PROFITABILITY

TABLE 4.3 RATIOS OF PROFITABILITY

Ratio	Formula	PTC	LAKSON
Gross profit rate	Gross profit/net sales	15%	19.82%
Operating expense ratio	Operating expenses/net sales	7.03%	12.27%
Net income as a % of net sales	Net income/net sales	4.32%	8.19%
Earning per share	Net income/average number of shares outstanding	5.17	32.84
Return on Assets(ROA)	Operating income/ average total assets	31.72%	48.17%
Return on equity(ROE)	Net income/ average total equity	38.30%	46.55%

Gross profit rate

Gross profit rate of Lakson is 19.82% while that of PTC is 15%. One of the main reasons is the reduction of cost of sales by both companies. Lakson decreased its overall cost of good sold by 1.6% over the last year (*Directors' report P-30)* while PTC reduced by 1.1%. Although the turnover of PTC is higher than that of Lakson, its gross profit is almost equal to that of Lakson thus, reducing its gross profit margin. As explained in the liquidity analysis, the cash figure of PTC is higher than Lakson but the percentage is low.

Operating expense ratio

Although the gross profit margin is higher for Lakson, its operating expenses are more than that of PTC making the operating expense ratio 12.27% as opposed to 7.03% of PTC. Both the companies have almost equal operating expenses (Rs 2,525 million (Lakson) and Rs 2,151 million (PTC)). However, the net sales of

PTC are much higher as compared to Lakson. Thus, the percentage of operating expenses to net sales for PTC is less than Lakson.

Net income as a percentage of net sales

The net income as a percentage of sales of Lakson is higher than that of PTC (8.19% (Lakson) and 4.32% (PTC)). The operating profit as a percentage of sales of Lakson is 12.53% while that of PTC is 7.77%. although the operating expenses of Lakson as a percentage of sales are higher than that of PTC, the "*other income"* for Lakson is higher than PTC which leads to a higher operating profit percentage. Moreover, the finance cost of Lakson is less than PTC. Thus, the overall effect of more "other income" and less finance cost is that the net income as a percentage of sales is higher than PTC.

Earnings per share (EPS)

The EPS of Lakson is very high (32.84) as compared to PTC (5.17). One of the reasons is the higher net income of Lakson (Rs 1,685 million) as compared to PTC (Rs 1,321 million).

The higher EPS of Lakson shows high profitability per share and therefore, makes Lakson more attractive for shareholders.

ROA

ROA of Lakson is 48% while that of PTC is 31%. The operating profit of Lakson is Rs 2,581,029 (12.53% of net sales) while that of PTC is Rs 2,377,663 (7.77%.of net sales). The average total assets of Lakson are of Rs 5357635.5 while those of PTC are of Rs 4125692.5. it is evident from the figures that if the operating profit of Lakson is higher, its average total assets are also slightly greater than those of Lakson. Overall, the return on assets (or capital invested) is higher for Lakson which is a good sign for the company and shows its high profitability.

Return on equity (ROE)

There is a remarkable difference between the ROE of Lakson (46.55%) and PTC (38.30%). The net incomes of Lakson and PTC are Rs 1,685,037 and Rs 1,321,919 respectively while average total equity is of Rs 3619562.5(Lakson) and Rs 3451118.5 (PTC). By looking at these figures, it is evident that the average equity is almost equal so, the factor leading to high ROE is the high income of Lakson.

After comparing these measures of profitability, it is clear that Lakson although having low sales has more profitability. Although Lakson has higher operating expenses as a percentage of sales, it has a higher net income percentage as well. So the higher expenses are offset by higher profits. It can't be said that PTC is not profitable. Gross profit rate of 15%, 31% ROA and 38% ROE show good profitable condition of the company. However, the figures of Lakson are much better as compared to PTC. So when, compared it is clear that Lakson is more profitable than PTC.

CONCLUSION

After a detailed analysis of PTC with its previous performance as well as with its major competitor Lakson Tobacco, it shows that PTC is in a good position as far as the liquidity, profitability and credit risk is concerned. The performance of PTC has been continuously increasing from the past years. From a negative profit in FY00 to a huge profit of Rs 1,322 million, PTC has come a long way. When compared with Lakson, it is clear that the sales volume of PTC is much higher than that of Lakson however, gross profit and profit after tax of PTC is lesser than Lakson. This shows better performance of Lakson as compared to PTC.

In the end, it can be said that the sales volume of PTC is going great. The only area of concern is to increase the gross profit margins and profit after taxation to further increase its profitability in the future. Due to government's support in eradication of illicit trade, there is a great potential for PTC being the market leader, to excel and provide even higher excise duty to the government of Pakistan.