Message from the Chairman, Board of Studies

Dear Students,

It is my pleasure to share with you that this newsletter has completed 10 years of its publication. The newsletter in your hand is the first issue in its eleventh year. During this one decade of existence it has become an inseparable part of the lives of our students. Student related announcements and other developments in the education and training are included in the newsletter. The newsletter also reinforces education with the contextual and topical articles.

Regulations

It is being contemplated to increase the number of article assistant(s) that a practising Chartered Accountant is entitled to train. It is also proposed to allow members, who are in full time employment under a practising Chartered Accountant or a firm of Chartered Accountant, to train article assistants. In this regard a draft of proposed amendments in the Regulations covering these and other provisions has been hosted on the website for comments.

Campus Recruitment

In the month of February and March, 2007 campus recruitments were held across the fourteen cities. The response from the industry was very encouraging as large number of them participated and selected our young members. Several multinational/large corporations vied to recruit young Chartered Accountants. In the programme 1840 members were absorbed with an average salary of Rs. 4.79 lacs per annum. Highest salary that was offered was US $ 85000 per annum (equivalent to Rs. 34.5 lacs) for an international posting to four candidates. There were 798 candidates that were offered at least 5 lacs. The data of campus interview reflected the growing importance of service sectors as recruiters of our members. About 89% of the members got jobs in industries such as banking, BPO, firm of Chartered Accountants, consultancy and aviation. Banking topped as far as number of offers that were made.

Forthcoming Conference and Convention

Knowledge and skills required for the profession are evolving rapidly. Contemporary knowledge can not be attained through mere reading of available books. Being part of a course where education is mainly imparted through distant education, our students often need a platform where they can assemble, interact and enrich their knowledge. For the benefit of the students the Board of Studies conducts a series of programmes at branch and regional level. At national level also we conduct seminars, conventions, contests and similar others programmes. Two national level programmes are proposed in the month of June and July as given below:

♦ 20th All India CA Students’ Conference to be held on June 23 & 24, 2007 at Ahmedabad.

(Continued on Page 4......)
Board of Studies (BOS), an educational wing of The Institute of Chartered Accountants of India, having on roll 4,32,000 students in different stages of the chartered accountancy course, has adopted a unique pedagogy for imparting theoretical education and monitoring practical training:

♦ A unique blend of theoretical education with hands-on practical training. It effectively prepares the students to deal with the challenges of the business and excel in their career.

♦ Theoretical education consists of Common Proficiency Test, Professional Competence Course and Final Course.

♦ Students are provided a study package consisting of study materials. The study package is complemented with other material such as compact disks, model question papers, revision test papers.

♦ The study material for Professional Competence Course would be available in CDs in digital form from 1st of July to provide ease of carrying by the students on outstation assignments.

♦ In some of the complicated topics video lectures of subject experts are also provided to the students.

♦ Conducting crash courses for the benefit of the students.

♦ BOS conducts virtual classes that are simultaneously available across twenty-five cities using video conferencing technology.


♦ To provide contemporary knowledge the education is complemented with a number of seminars, conferences and contests at branch, regional and national level.

♦ To facilitate pursuance of graduation and post-graduation by the chartered accountancy students there is an MOU with Indira Gandhi National Open University (IGNOU). Under the MOU exemptions are available in certain common subjects to the students for undergoing B. Com and M. Com. courses from IGNOU.

♦ BOS is gearing up itself to be a research center for doctoral programmes so as to offer Ph.D. programme to its students.

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Invitation to Write Articles

Members, academicians, students and others may send their original articles for inclusion in this newsletter. Typically the length of articles should be between 2000 to 4000 words. Articles written by the students are encouraged. Every year best articles that are written by students are awarded cash prize and a certificate at the annual function of the Institute.

All correspondence in this regard should be done at Board of Studies, ICAI, C-1, Sector – 1, Noida 201301. Please write your complete name, complete address and the membership/registration number in your correspondence. Also send a copy of recent passport size photograph.

Total Circulation: 1,05,400 copies.
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(Continued from page 1)

♦ 4th National Convention for CA Students to be held on July 6 & 7, 2007 at C.C. Mehta Auditorium, MS University Campus, Baroda.

I exhort students to contribute papers for the programmes. Details are available in this issue.

PCC Study Materials in Hindi

For the benefit of the students of Professional Competence Course, who opt to pursue Chartered Accountancy in Hindi medium, the Board of Studies has released a full set of Hindi version of the Study Materials. The Hindi version has been developed in lucid manner to make learning simple and interesting. Interested students may buy the study material from the nearest office of the Institute.

Digitization of PCC study materials

Our students often travel for outstation assignments for the purpose of practical training. Carrying bulky study materials to different places becomes difficult. As access to computers and laptops has increased tremendously in recent times it has been felt that a digital version of study material will provide ease of carrying. Thus the study materials will be available in compact disks (both English and Hindi version of PCC study materials). These would be given free of cost to the students registered on or after 1st of July, 2007.

CD based Information Technology Training Modules

100 hours Information Technology Training will be reinforced with the interactive modules in CDs. Out of 100 hours of training, the Board of Studies has developed 68 hours of study materials in CDs digital format using multimedia to make the learning simple and enjoyable. The CDs will also contain interactive examples which a student can practice while undergoing these modules. The CDs will be distributed free of cost with the ITT modules from 1st of July.

Be a leader

Being successful requires strong leadership skills. If you are interested and have the desire and willpower, you can acquire these skills. These skills are developed through a never ending process of learning, training, and experience. An important element of leadership is to be good in behavioural skills. How you deal with others will determine your success in getting support from them. To quote Dale Carnegie – “If you want to gather honey, don’t kick over the beehive”. He in his classic book - ‘How to win friends and influence people’ gave nine principles for being a leader and how to change people without giving offense or arousing resentment. These principles if followed should help everybody. These are:

♦ Begin with praise and honest appreciation.
♦ Call attention to people’s mistakes indirectly.
♦ Talk about your own mistakes before criticizing the other person.
♦ Ask questions instead of giving direct orders.
♦ Let the other person save face.
♦ Praise the slightest improvement and praise every improvement. Be “hearty in your approbation and lavish in your praise.”
♦ Give the other person a fine reputation to live up to.
♦ Use encouragement. Make the fault seem easy to correct.
♦ Make the other person happy about doing the thing you suggest.

Point to ponder

Many a times we are stressed out or are worrying about issues concerning our lives. The anxiety reduces efficiency of mind and also affects our health. The next time when you are worrying on some issue try the recipe given by Willis H. Carrier. Ask yourself question that what is the worst that can possibly happen if you can’t solve your problem. Then prepare yourself mentally to accept the worst lest the worst comes true. After that gradually and in a calm manner try to improve upon the worst possible. In this manner you will have satisfaction that you did not allow the worst to happen.

With best wishes,

Yours truly,

CA. Jaydeep Narendra Shah
Corporate treasury of Rosemont Enterprise is considering a proposal for credit policy review initiated by the marketing department. The Head of the Marketing Department Mr. John D. Stowe wrote to Mr. William Feist, Head Treasury:

“We need to review our credit policy of 2 months flat in view of the new credit policy announced by Kimball International our next best competitor which holds a market share of 20% as against 35% of ours. Kimball is offering 1% cash discount on payment between 0 – 10 days with credit term of 60 days. Ours is 75 days. Dealers are enquiring about cash discount. In our telephonic conversation, you had assured that a policy can be worked out. I am anxiously waiting for an attractive one which should offer at least 1.5% cash discount with a better credit term than Kimball. Otherwise I am afraid we will lose some market share.”

William passed this note to Mr. Ned C. Hill, Assistant Treasury Manager for remarks about current level of bad debts and bad debt impact for reduced credit line to 65-70 days. Ned remarked that it is currently 2%. There is no data to support if it is reduced to 70 or 65 days and its impact on bad debt. Ned remarked:

“I guess a 65 days credit line would reduce 0.25% bad debt level as I had casually discussed this issue with our banker who manages credit data of Nathal International which has 65 days credit line. However, there is no information available for 70 days credit line. It is safe to assume that it will not change bad debt impact.”

William passed this note to Mr. Ned C. Hill, Assistant Treasury Manager for remarks about current level of bad debts and bad debt impact for reduced credit line to 65-70 days. Ned remarked that it is currently 2%. There is no data to support if it is reduced to 70 or 65 days and its impact on bad debt. Ned remarked:

Working Average Cost of Capital of Rosemont Enterprise is 14.5%. While evaluating this proposal, Mr. Ned presented to the Team the following collection pattern of 2006:

Annual credit sales Rs. 500,000,000, Net profit 20%, Contribution 40%.

<table>
<thead>
<tr>
<th>Payment</th>
<th>Mid point</th>
<th>%</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-5 days</td>
<td>2.5</td>
<td>10%</td>
<td>10.20%</td>
</tr>
<tr>
<td>6-10 days</td>
<td>8.0</td>
<td>15%</td>
<td>15.31%</td>
</tr>
<tr>
<td>11-20 days</td>
<td>15.5</td>
<td>10%</td>
<td>10.20%</td>
</tr>
<tr>
<td>21-30 days</td>
<td>25.5</td>
<td>10%</td>
<td>10.20%</td>
</tr>
<tr>
<td>31-40 days</td>
<td>35.5</td>
<td>10%</td>
<td>10.20%</td>
</tr>
<tr>
<td>41-50 days</td>
<td>45.5</td>
<td>10%</td>
<td>10.20%</td>
</tr>
<tr>
<td>51-65 days</td>
<td>58.0</td>
<td>10%</td>
<td>10.20%</td>
</tr>
<tr>
<td>66-70 days</td>
<td>68.0</td>
<td>10%</td>
<td>10.20%</td>
</tr>
<tr>
<td>71-75 days</td>
<td>73.0</td>
<td>5%</td>
<td>5.10%</td>
</tr>
<tr>
<td>75-100 days</td>
<td>87.5</td>
<td>8%</td>
<td>8.16%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>98%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

He has further worked out that weighted average credit period of the company is 37.65 days with a default rate 2%.

Ned put forth the following proposal:

Kimball type proposal will have a straight impact of cash discount to the extent of Rs. 2.5 million. I guess there will be 20% shift across the longer payment classes to 0-10 days category. For payment 11-30 days, there should 1% cash discount, which should cause another 10% shift across longer payment categories. To maintain the existing payment categories, a two tier system will be beneficial otherwise there will be tendency to pay by 65 days which is the maximum credit term. As Kimball imposes strict penalty of 1% for payment beyond 60 days, we should also have a penalty system.

To this John objected. John explains that any penalty will take away 8% of our sales. William retorted that payment behaviour of our customer is not going to change. Why should we impose penalty? Ned viewed that we may charge extra payment in...
31 - 65 days payment category. John says “you create a third tier of 31 - 40 days with 0.5% cash discount structure, we shall bring 2% extra sales in that category”.

William summed up: “let us work out three tier cash discount system, the third tier being as proposed by John, with 65 days payment term. 1% penalty will be levied for payment beyond 75 days. After all, this will cause another 50% shift in the longer payment categories to 71-75 days category. Also reduction in 0.25% bad debt will increase collection – that may be in the 71-75 category again”.

John agreed. William advised Ned to have financial analysis. You may help Ned and advise what should be financial impact.

[Hints: Current level of opportunity cost

$$= (Sales - Net Profit) \times \left(\frac{37.65}{365}\right) \times \left(\frac{14.5}{100}\right)$$

= Rs. 59,83,226

While computing opportunity cost, weighted average collection period is considered since bad debt is assumed to be from any of the payment categories.

You may work out new payment categories taking clue from the discussion and work out new level of opportunity cost.

You may work out additional contribution on 8% extra sales applying 40% contribution ratio.

Other factors to be considered are reduction in the level of bad debt and cash discount.]

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**Examophobia**

*Kunal Harish Chheda*

Just like every dangerous thing in life, it starts quietly. The exams are still 3 months away for the theatre regulars. But for the library geeks it’s just 12 Sundays. Their already aching necks dip a bit more into the books. Then suddenly something snaps— the ground seems to give away beneath the feet. Just two days for the exams. God no!

Don’t know how the time flew by, someone mutters as s/he retrieves his/her text books from beneath a pile of junk and blinks incredulously at the strangest of topics staring back with unabashed effrontery.

A massive hunt for text-books begins. The xerox machines run overtime. Notes are begged, borrowed or stolen.

Books change hands as never before. The words ‘day’ and ‘night’ lose their meaning. Alarm clocks shrill at every obnoxious hour.

The minutes seem to tick faster. Unwashed clothes and water-logged spirits become ubiquitous.

**D-day minus 1**

Apprehension sets in. A committee of expert analysts sits down with question papers and unanimously decides chapters that can be safely left to option. But the fear of changed patterns haunts the mind of the strongest. Time runneth.

The famous pledge ‘to start studying from the beginning of the next term’ is once again renewed only to be forgotten immediately after the exams. The library geeks cuddle in their cozy beds, confident and determinant. For many the battle is lost before it begins. People do not believe in miracles. They rely on them.

**D-hour minus 1**

Lucky shirts and pens are pulled out. The sun is high in the skies but the spirits are low.

The infamous walk towards the exam hall! Feet drag as exhausted eyes try to drink in every last ounce of formulae, resulting in total amnesia. Sobs are not uncommon. Clenched fists and flaring nostrils are not exceptions, but rules.

One can smell the stench of fear. 36 million gods are remembered. Even the atheists turn religious.

**D-hour!**

The bell rings. Butterflies flutter inside the stomach. Sweaty palms exchange luck. The final scan through the text book (that seems to have aged in 2 days).

They are shut with an air of finality with adrenaline pumping the entry into the tunnel of death. The question papers smack into the trembling hands. Words pour down on the paper. The think tank runs dry. The paper is finally over.

Next paper—21 hours away. Feet again patter homewards. The cycle is unending...relentless...(sigh!)

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*The author is a student of ICAI. (Registration number: WRO 0242254).*
The importance of cross-border Mergers and Acquisitions (M&As) seems to have increased now-a-days as a means to expand and compete internationally. Especially since 1999 companies from India and abroad have started on a large scale using Mergers & Acquisitions for extending their activities globally. M&A are means to enter foreign markets, secure resources and increase global outreach.

**M&A deals increased by 28% in 2002-2006 in India**

The value of mergers and acquisitions deals has grown at a compounded annual growth rate of around 28 per cent between 2002 and 2006. Most of this growth has come over the last two years, with the value of such deals increasing from $7.5 billion in 2004 to $21.4 billion in 2006. The total number of M&A deals increased from 357 in 2005 to 480 in 2006.

<table>
<thead>
<tr>
<th>Table 1</th>
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<tbody>
<tr>
<td>M &amp; As – Number of deals</td>
</tr>
<tr>
<td>2005</td>
</tr>
<tr>
<td>1. Domestic</td>
</tr>
<tr>
<td>2. Inbound</td>
</tr>
<tr>
<td>3. Outbound</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

(Source: The Hindustan Times, New Delhi – April 9, 2007)

It is estimated that from 1995 to August 2006, the largest proportion of outbound acquisitions happened in North America, which accounted for 32 per cent of the total outbound deals. This was followed by Europe, which accounted for 29 per cent of the total deals. Europe is emerging as the prime destination for Indian companies making acquisitions abroad. Bilateral trade between India and Europe is likely to touch $100 billion by 2010 on the back of outbound merger and acquisition (M&A) activity by India Inc.

The comparative share of domestic, inbound and outbound deals was more or less stable, with a majority being domestic deals (44 per cent), followed by outbound deals (40 per cent) and inbound deals (16 per cent) during 2006.

The share of overseas M&A deals, including inbound and outbound, is also increasing. Overseas M&A deals accounted for 42 per cent of the total M&A deal value in 2002. This increased to 73 per cent in 2006.

For outbound deals, pharmaceutical companies were the most aggressive in seizing opportunities, and struck M&A deals with a total value of a little over $2.2 billion. The other sector that took the lead was information technology. In the energy sector, Oil and Natural Gas Corporation Ltd’s acquisition of equity stakes in a couple of oil blocks in Columbia and Brazil, as also Suzlon Energy’s acquisition of Hansen, set the trend.

“What has given a fillip to this M&A activity is the evolution of government policy on overseas investments. For instance, the upward revision of the ceiling on quantum of overseas investments and the introduction of the Foreign Exchange Management Act, 2000 have changed the scenario.” The recent upward revision of overseas investment limits by RBI will further give fillip to M & A deals.

**Reasons for M&A deals**

Cross-Border M & A are pursued by companies for various reasons. Companies might choose to enter the market in a country by M & A and use it as a mode of entry. If they already exist there, they might be interested in attracting more customers or increase their regional coverage and do so by acquiring a local competitor. Some companies may be interested to secure access to resources they need or integrate vertically. Companies may also be interested in resources as an input for their production process, which is an upstream (backward) integration, or they may be willing to get hold of important distribution channels, which is a downstream (forward) integration. They may also acquire a foreign company because it has better insights into the local market and existing relationships both with potential customers or the host country government. They may also want to extend the product line or acquire a local brand in order to satisfy local needs or product specifications in a better way.

M & A deals offers a quicker route to growth by harnessing existing project facilities more optimally. M & A offers quick alternative options for setting up Greenfield ventures.

There are other reasons also for this predatory move. Having established their domestic presence, companies in India and abroad are now looking for an international presence. Secondly, having improved their productivity, quality and reliability, companies feel more confident about spreading their wings abroad. Various other factors are also being attributed to this penchant for the acquisition and takeover game in all sectors.

The author is Joint Director of Studies, ICAI.
An upswing in manufacturing is one of them. There is no shortage of companies that have slashed costs, improved productivity, mastered technology and invested in marketing. Along with lower cost, there has been a marked improvement in the quality of output. A presence abroad means easier access to new markets and the resources.

The changing perception about India

A changing perception about India has also helped – India is no more a backward third world country in the minds of many international bankers, financial institutions and other businessmen. This positive attitude has translated directly into a growing confidence in the Indian Community to move towards the direction of M & A deals in a big way. Helping boost the image are favourable opinions of leading international financial Institutions (FIs) and other foreign investors.

Earlier global operations for an Indian Company meant plain exports. But now the definition has been expanded to denote assembly and manufacturing in foreign shores also.

A spin off of companies internationally taking the acquisition route for further growth is the trend of the day. Many corporates are setting up greenfield ventures in India and abroad. Indian Companies in 2006 have invested $1 billion towards marketing, production, acquisition and even research and development abroad.

With economic liberalisation paving the way for prosperity, Indian companies are better equipped to take advantage of new opportunities. Many of them are sitting on piles of cash thrown up by profitable local ventures. Add to this is the erosion in the values of international companies due to an ongoing global recession, more Indian companies can therefore be expected to snap up their foreign competitors in the days to come.

M&A deals in mining sector

The year 2006 is considered to be the year of Mergers & Acquisitions game in India. A quiet metamorphosis is taking place in Asia as Indian Companies buy up their rivals and capacities abroad. Indian firms took over more than 75 international companies last year. The trend is expected to continue in 2007 also as the companies are on shopping spree in India as well as abroad.

In recent days also a number of acquisition deals have been struck. One of the major announcement has been relating to Vedanta’s acquisition of Sesa Goa - India’s second largest private sector iron ore exporter.

Interestingly, this is the third Iron ore deal in recent past. Earlier, Essar group announced its intention to acquire ore rich Minnesotta Steel in the US. While British mining giant Anglo-American proposed its $ 1.5 billion acquisition in MMX mines – Rio, Brazil. The mining sector has witnessed M & A deals close to $ 70 billion so far this year.

One of the basic question which arises in this context is what people ought to know while doing M & A deals in India? The answer to this question is very essential and significant for the success of such deals. People ought to keep in mind SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 – popularly known as the Takeover Code.

The Concept of Acquisition and Takeover

The words “acquisition” and “takeovers” signifies the mechanism by which companies change hands through transfer of shareholding pattern and ownership. Whereas acquisition signifies the purchase of or getting across to significant stakes in a company, the word ‘takeover’ has more of a negative connotation that conveys the impression that the acquisition is meant for replacing the existing management or controlling the affairs of the company.

A takeover can be both a ‘friendly’ and ‘unfriendly’. A welcome takeover is usually favourable and friendly takeover. Friendly, takeover generally go smoothly because both companies consider it a positive situation. In contrast, an unwelcome or ‘hostile’ takeover can get downright ‘nasty’.

The SEBI’s Takeover Code

The SEBI’s (Substantial Acquisition of Shares and Takeovers) Regulations came into being in 1997. The Code aims at to ensure fair play and transparency in acquisitions and takeovers. The fair play is ensured by the provisions of public offer whenever there is a substantial acquisition or takeover so that the other shareholders are also benefited and get an equal exit route as well. The transparency is ensured through mandatory disclosures and guidelines on the conduct of the public offers.

The Indian Takeover Code, applies to direct or indirect acquisition of any publicly traded company in India. The Securities and Exchange Board of India (SEBI), the Indian securities regulator, is very strict in its interpretations of the Takeover Code – more so than many other jurisdictions around the world. In fact, the code can affect – Companies that are not even primarily involved in an Indian M & A deal. For example, if a Japanese Company is buying another Japanese Company which has an indirect interest in a company that is publicly traded in India, the Takeover Code could in certain cases require the buyer to make an open offer to acquire an additional 20 percent of the shares from retail shareholders of the Indian company.

Beside this, Indian insider trading regulations could present tricky issues in conducting due diligence of a publicly traded company in India since there is no exception for disclosure of information in an M & A transaction.

The code has defined:

- An “acquirer” as the person who acquires or agrees to acquire shares or voting rights or control over the target company.
- ‘Control’ means right to appoint majority of directors or to control management or policy decisions.
- ‘Persons acting in concert’ means persons having the common purpose of substantial acquisition of shares or...

C A S E  S T U D Y
voting rights or gaining control over a target company. The code has listed out certain categories of persons who may be identified as persons acting in concert. For example, companies under the same management as the acquirer and their directors, their merchant bankers, stock brokers, attorneys/solicitors etc.

- The word ‘promoter’ used in the take over code has wide connotation and includes persons named in any offer document as promoters or persons in control of the management of such companies either directly or indirectly, this also includes their relatives and related firms and companies.

### Disclosures to be made as per Takeover Code

- Disclosure to be made to concerned company and the stock exchanges at every stage by the acquirer as soon as holding reaches at 5%, 10% and 14%. Stock exchanges to publicise this information.
- No holdings exceeding 15% to be made without public announcement to acquire shares through a public open offer.
- No holdings more than 5% can be acquired in a financial year without complying with the open offer requirements, if the existing holdings are between 15% and 75%.
- No acquirer can acquire any more holdings in the target company without complying with the requirement of open offer, if the existing holdings have already reached 75%.
- No acquirer shall gain control of a target company without announcing a public offer, unless such control has been vested by a special resolution.
- An acquirer has to comply with the aforesaid requirements both in direct acquisitions of holdings or control in listed companies or through indirect acquisitions through holding companies whether listed or unlisted or whether in India or abroad.

The relevant provisions of Takeover Code are triggered as soon as the acquirer reaches at the threshold limit of share acquisition and has to strictly comply with them. In case a public offer is made upon reaching the threshold limit of 15% and if the existing promoters/shareholders wishes to contest, they can make a counter offer. The ‘Takeover Code’ provides enough leeway for a corporate battle of control in such cases within its framework.

### Deal Process for Acquisition and Takeovers

An acquisition or takeover may happen under the following three routes:

- **Open Market Purchases**: The acquirer purchases shares of a listed company from the secondary market to increase and consolidate his holdings. Hostile acquisitions are mostly made through this route.

- **Negotiated Acquisition**: The acquirer strikes a deal to acquire a stake in the target company from one or more existing shareholders for substantial acquisition. The case of Vedanta’s acquisition of Sesa Goa belongs to this category whereby the acquirer has struck a deal of acquiring 51% holdings from Mitsui and Co. of Japan and made a public offer for the additional acquisition of 20% more holdings at the same price per share as paid to Mitsui & Co. This protects the interest of retail shareholders of Sesa Goa and provides them an opportunity to exit if they want, at attractive prices. This is also a good example of ‘Friendly takeover’. This friendly takeover has two distinct dimensions (i) It is friendly because the shareholders sold their shares willingly and (ii) The deal provided them a convenient route of exit at negotiated and attractive prices.

- **Preferential Allotment**: Under this route, the acquisition is meant for the benefit of company, it is customary to build the stake of the acquirer through issue of fresh equity so that the company receives the sale consideration. Induction of strategic partners into a company is generally through this route. The route is only another mode of a strategic deal except that in such cases, there is no seller and a buyer like in aforesaid cases. The acquirer enters into a deal with the company for subscribing to the preferential allotment. Such offers are no longer exempted under the takeover code. Therefore, if pursuant to such allotment, the open offer requirement is triggered off, it needs to be complied by the acquirer.

### Purchase of Assets compared with Purchase of shares

The most common form of merger or acquisition involves purchasing the shares of the merged or acquired companies. An alternative to the share acquisition is to purchase the target company’s assets. In doing so, the acquiring company can limit its acquisition to those parts of the firm that coincide with the acquirer’s needs. When a significant part of the target remains after the asset acquisition, the transaction is only a partial acquisition. When all the target’s assets are purchased, the target becomes a corporate shell with only the cash or securities that it received from the acquisition as assets. In these situations, the corporation may choose to pay shareholders a liquidating dividend and dissolve the company. Alternatively, the firm may use its liquid assets to purchase other assets or another company. In Table 2, we describe the modes of corporate integration.

The instant case of Vedanta acquiring Sesa Goa, is a negotiated Acquisition from M/s Mitsui & Co., the Japan’s second biggest trading company. The company is shifting its business emphasis to investments, moving away from its traditional role as a middleman earning moderate agent commissions. It would be the first time that Mitsui has sold a big, highly profitable business to gain a profit. The sale will generate 50 billion yen (Rs.1261 crores/$ 423 million) in profit to Mitsui which had bought stakes in Sesa Goa in 1996.

### The Profile of M/s Vedanta – The Acquirer

M/s Vedanta Resources PLC is a well known London based group of companies listed at London Stock Exchange. India focused...
Vedanta has also operations in Zambia and Australia. The company is a global player in Aluminium, Copper and Zinc.

Vedanta Resources’s full-year production of all metals had significantly increased in India but prices of copper and zinc had fallen in the fourth quarter. Its aluminium output in the year ended March, 2007 rose to 351,000 tonnes from 210,000 tonnes a year ago, while copper cathode production from its Indian operations rose 15 per cent to 313,000 tonnes. Annual refined zinc production increased 23 per cent to 348,000 tonnes, boosted by the ramp-up of the new hydro smelter in Rajasthan. The firm’s gold production had been hit by an ongoing dispute with the Armenian Government, which has halted mining.

Its business turnover during the last two decades has gone up from Rs.15 crores to Rs. 27,000 crores. The company flagged off its new pursuit on April 23, 2007 by acquiring a controlling stake of 51% in Sesa Goa Ltd., owned by Japanese Mitsui for $981 million (around Rs.4070 crores) implying a price of Rs. 2,036 per share.

The company has been a debt-free organization. Over the years, it has funded all the projects from its own resources. However, for acquiring Sesa Goa, it will raise $1.1 billion in debt and use that with internal accruals to fund the deal. The deal advisor M/s Nomura Holdings Inc will lend $1.1 billion, the loan will be raised at between 50-60 bps over LIBOR. (London Inter Bank Offered Rate)

The acquisition of Sesa Goa by Vedanta marked its entry into the Iron ore market prompted by rising steel demand throughout the world especially in China and India. India’s demand for steel is growing at almost twice the global average.

Table 2
Various Forms of Corporate Integration

<table>
<thead>
<tr>
<th>Mergers/Amalgamations</th>
<th>Acquisition/Take-overs</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) This form of integration is through the asset route.</td>
<td>Integration under this category takes place through the transfer of shareholding pattern/ownership.</td>
</tr>
<tr>
<td>(ii) In merger one company is absorbed by another. The absorbed company loses its identity.</td>
<td>Does not involve transfer of assets or liabilities.</td>
</tr>
<tr>
<td>(iii) In Amalgamation, two or more companies are merged into one of themselves or to form a new company. Amalgamation includes merger and is a wider term.</td>
<td>There is no change in the balance sheet of the company.</td>
</tr>
<tr>
<td>(iv) Transfer of Assets and liabilities takes place from transferor to transferee as per mutual terms and conditions.</td>
<td>Acquisition may not necessarily be for controlling interest or to interfere in day to day routine affairs. There may be certain strategic reasons for acquisition.</td>
</tr>
<tr>
<td>(v) The purchase consideration is generally in the form of stock swap at agreed rates between transferor and transferee company based on scientific methods of valuation in case of all stock deal, otherwise cash or a combination of both cash and shares is adopted.</td>
<td>SEBI’s (Substantial Acquisition of shares and Takeovers) Regulations, known as Takeover Code are applicable in case of acquisition/Takeover in a listed company. Strict compliance of Take-over Code is mandatory.</td>
</tr>
<tr>
<td>(vi) Regulated by the Provision of Companies Act, 1956 and other statutes in force.</td>
<td>The term Takeover denote a hostile acquisition wherein the acquirer intends to control the management.</td>
</tr>
<tr>
<td>(vii) This is generally done through the judicial process. Sanction of the court is necessary.</td>
<td>No Judicial Process is involved.</td>
</tr>
</tbody>
</table>

The total cash transaction for the 71 per cent stake (including the 20% open offer) will be $ 1.37 billion. This acquisition will make Vedanta an integrated mining and metal company. Iron ore will contribute 11 per cent to the group’s turnover. The other companies of the group are Balco, Hindustan Zinc, Madras Aluminium and India Foils.

Table 3
Vedanta Resources PIC - Segmentwise Contribution post Sesa Goa Acquisition

<table>
<thead>
<tr>
<th>(i) Aluminium</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>(ii) Zinc</td>
<td>11</td>
</tr>
<tr>
<td>(iii) Iron ore</td>
<td>21</td>
</tr>
<tr>
<td>(iv) Copper</td>
<td>10</td>
</tr>
<tr>
<td>(v) Others</td>
<td>55</td>
</tr>
<tr>
<td>(vi) Total</td>
<td>03</td>
</tr>
</tbody>
</table>

(Source: Financial Express, New Delhi – April 25, 2007, P. 22)
value to its newly acquired iron ore business by involving itself in steel making. This will however, be through a joint Venture with a steel maker. The rational behind formation of joint venture for steel making is based on the premise that metal mining and production are different businesses and the world over mining companies have entered into steel making only through joint ventures with a partner that has the knowledge for steel making.

Iron ore was the missing link in the profile of Vedanta. The acquisition will put Vedanta at the top four global metals league. With Sesa Goa in its kitty Vedanta has shed its tag of being non-ferrous metal giant. The phenomenal commodities of tomorrow are Iron ore and coal. Vedanta believes that its strength lies in upstream projects. Backward integration is the way forwards for it and hence entry in iron ore is a key strategy for its success.

Vedanta group is also entering into the power sector and eying an entry into coal. It is setting up a large scale 2400 MW independent power project in Orissa that marks its entry into the commercial power sector. As a group it will produce 5000 MW of energy in the next few years, up from the current 1300 MW.

Vedanta’s entry into iron ore business will not be limited to Sesa Goa and the company would definitely look at more iron ore deals. It will be looking at Brazil for sure. It is a good place for iron ore.

<table>
<thead>
<tr>
<th>Year</th>
<th>Acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>Madras Aluminium</td>
</tr>
<tr>
<td>1999</td>
<td>India Foils</td>
</tr>
<tr>
<td>2001</td>
<td>Bharat Aluminium</td>
</tr>
<tr>
<td>2002</td>
<td>Hindustan Zinc</td>
</tr>
<tr>
<td>2004</td>
<td>KCM Australia</td>
</tr>
<tr>
<td>2007</td>
<td>Sesa Goa</td>
</tr>
</tbody>
</table>

Vedanta plans to invest $13 – 14 billion in greenfield and brownfield expansion programmes across group companies over the next 3-5 years. The company also plans to acquire more iron ore assets. Vedanta aims at a capacity of 1 million tonnes each in copper, aluminium and zinc segments. Much of this capital expenditure will make Vedanta closer to its goals.

Sesa Goa : The acquiree – A Win – Win Deal

The target - Sesa Goa is India’s second largest Iron and manganese ore private sector producer. It was founded in 1964 and was under Italian management before being acquired by Mitsui in 1996. It produces about 10.11 million tonnes of iron ore from mines across Goa, Karnataka, and Orissa and exports about 90 per cent of its production. The production is expected to cross 20 million tonnes a year by 2010. It has a well established client base in key markets like China, Europe and Japan. Its mining operations are globally cost competitive. The company will not only focus on the overseas market but also on the domestic market in order to maximize returns to its shareholders.

Sesa Goa may enter a metal for equity arrangement with leading steel manufacturers. It is common in this sector that iron ore suppliers at the time of entering into long-term contracts also take minority stakes in the project. This offers assured supply to steel makers and an upside in the equity to Iron ore suppliers. The company may enter into a strategic alliance including equity participation, with a leading global steel maker to secure long term business and a possible upside in value addition. Leading iron ore producers like BHP Billiton take minority stakes of around 10 per cent in steel producing companies. This is an ongoing trend in this sector.

At the current production rates, Sesa’s iron ore reserves and resources of 207 million tonnes may support over 20 years of mined production. The company also operates a 2.5 mtpa pig iron and metallurgical Coke facilities.

It has acquired a pre-operative licence for Jharkhand. The company also has a small wet coke division with 280000 tonnes capacity and a Pig Iron unit with a capacity of 220000 tonnes a year.

Sesa’s acquisition will ensure Iron reserves for Vedanta. The acquisition has once again highlighted the need amongst large metal players to gain control of key raw materials like Iron-ore. Vedanta believes that it is beneficial to get Sesa Goa’s assets. Sesa Goa is highly profitable and debt free company. In the year ending March 31st, 2006, it posted a revenue of about $432.2 million and a net profit of $193.8 million.

The company’s revenue has risen by 41 per cent of Compound Annual Growth Rate (CAGR) over the last 5 years, while EBITDA has grown 95 per cent of CAGR over the same period. The EBITDA margin in financial year 2006-07 was 46 per cent, while the return on capital employed ROCE was 71 per cent. It appears to be a good buy for Vedanta.

Sesa Goa will also help shield Vedanta’s earnings from volatility in metal prices. There appears to be better outlook for metal prices and it is expected that the metal prices will further firm up in future. In view of bullish trends, it is expected that prices may hover around $5000 per tonne for copper, $3000 per tonne for Zinc and $2500 for Aluminium.

There is no plan to delist Sesa Goa immediately. It is believed that the acquisition is immediately earning and cash flow accretive and it will create significant long term value for all stakeholders.

Sesa Goa will also help Vedanta to leverage skills in mining and project management and take the company to another level of efficiency.

The Open Offer

As per SEBI’s takeover norms, Vedanta has announced for an open offer to buy 20 per cent from Sesa Goa’s retail shareholders.
at the same rate of Rs.2036 per share. This will bring the total deal value to $1.37 billion. The offer will open on June 21 and continue till July 10, 2007.

The current takeover norms stipulate that if a company buys 15% or more of voting or controlling rights of another company’s equity, it should make an open offer to buy at least 20% of minority shareholding at the prices to be determined in accordance with takeover norms.

The company has made an open offer to acquire upto 7872404 equity shares representing 20% stake in the equity shares of Sesa Goa. The purchase consideration is payable in cash upto a maximum of Rs.1603.05 crores.

The offer was made by the two wholly owned subsidiaries of Vedanta – West-globe Ltd., Mauritius and Richter Holding Ltd., Cyprus in compliance with Securities Exchange Board of India (SEBI’s) Regulations.

If the open offer is fully subscribed Vedanta’s shareholding will go upto 71 per cent. It is not however, yet clear whether Vedanta would eventually seek to enhance its stake beyond 71%.

A shareholder of Sesa Goa has however, petitioned to the Supreme Court and the apex court has ordered that any subsequent sale of shares in Sesa Goa shall depend on the outcome of petition.

**The Valuation of Target and Price War**

The importance of a systematic valuation of a business in an acquisition process cannot be ignored. The methods and data considered in the valuation of business vary widely. There are certain standard methods and hard data to consider in the formulation of valuation.

Among the various techniques of valuation the more commonly adopted are any or all of the following methods viz., Net tangible Assets Method, Stock Exchange Method, Earning Capacity Value Method, Fair Value Method and Face Value plus Interest Method. These are some of the methods which can be employed for this purpose. The methods may provide different business values. However, their accuracy can be tested through a basic sensitivity check, which can be performed by comparing the resulting values with certain benchmarks that indicate the floor value of the company. The floor value is the normal minimum value that the company should command in the market place. (Students may refer to Chapter on Business valuation in the course material of MAFA)

Financial factors sometimes motivate some M&A. For example, an acquirer’s financial analysis may reveal that the target is undervalued. That is, the value of the buyer may be significantly in excess of the market value of the target, even when a premium that is normally associated with changes in control is added to the acquisition price. Other motives, such as tax motives may play a role in an acquisition decision.

**Desirable Financial Characteristics of Targets**

An acquirer may use the following characteristics as financial screen:

- Rapidly growing cash flows and earnings.
- Low price relative to earnings:
- Market value less than book value:
- High liquidity:
- Low Leverage ratios.

As Sesa Goa’s valuation demonstrates, the wealth creation through independent steel making and mining activities is much higher than the current scenario permits.

This acquisition is being done on an enterprise value per tonne of iron ore reserves at about $ 8. the deal reflects the strong demand conditions in the Iron ore industry.

At Rs. 2036 a share, the deal is favourable for Vedanta. This puts the value of Sesa Goa at $ 1.37 billion i.e., seven times of Earnings before Interest, Tax. Depreciation and Amortisation (EBITDA). Globally, mining and metal acquisitions have been struck at higher P/Es. Anglo-American PIC, the world’s second largest mining company bought 49% in iron ore project MMX Mines – Rio in a deal valued at 8.4 times of the Brazil Company’s earnings. Steel maker corus’s acquisition by Tata Steel was valued at nine times of the U.K. based company’s earnings.

In an acquisition the valuer wants to know the absolute value of the share. This can be done by employing the stock exchange method in those cases where the companies are listed on one or more stock exchanges. The method is very easy to understand and operate. However, it suffers from certain drawbacks. These can, however, be overcome by averaging out the prices of the scrips of a company for a certain period as per norms of SEBI Takeover Code.

The price offered by M/s Vedanta @ Rs. 2036 per share reflects a 31% premium more than the stock’s six months daily average market price, whereas globally acquisitions in this segment is happening between 32% - 50% premium.

The final round of bidding for Mitsui’s 51% stake in Sesa Goa witnessed a decline of more than 25% from the previous round because Union Budget for 2007-08 had slapped an export duty.

The bidding was started in January, 2007. On January 29, the Japanese parent of Sesa Goa, had indicated a review of its stake in the Indian company. The Sesa Goa stock had averaged Rs.1,759 from this review decision and prior to the acquisition announcement. Competition for Sesa Goa drove its share prices to a record more than Rs.2,000 per share subsequently.

The race for Mitsui’s stake saw initial valuations in the range above Rs.2.500 per share. The price had to be however, scaled down after the government’s announcement of an export duty of Rs.300 per tonne of Iron ore exported from India. The government’s move was aimed at reducing ore exports after steel players complained that local ore was not being made available to them.

The acquisition announcement has ended a four months high profile bidding war that attracted bids from global steel and iron ore plants.
Although three bidders, including Arcelor Mittal, Vedanta Resources PIC, and the Aditya Birla Group had submitted bids, the last appeared to be the front runner with its bid for Rs.1,550 per share. Although Arcelor Mittal’s bid was the highest around Rs.1,700, however, they had put a number of conditions which were very difficult to fulfill by the sellers M/s Mitsui. The bid of M/s Vedanta resources PIC at Rs.1300 was seen to be far behind the market expectations.

As soon as the announcement was made on April 23, 2007 for the acquisition of 51% of Mitsui’s stake in Sesa Goa, high volatility was seen in the scrip of Sesa Goa at BSE in early trades. It opened at Rs.1,851 a gain of Rs.109 over the closing prices of previous day. It went up to Rs.1,900 before falling to Rs.1,668. It was last traded around Rs.1,727. More than 3.5 lakh shares were traded in early deals.

Reacting to the news, shares in Sesa Goa fell further on the Bombay Stock Exchange (BSE) because only about 40 per cent of freely floated shares could participate in Vedanta’s open offer. Its shares closed down 2.5% at Rs.1698.55 on the BSE on April 24, 2007. While Vedanta’s shares were trading at 1.427 pence, up by 17 pence or 1.21% on the London Stock Exchange (LSE).

Further, shares were closed at Rs.1763.35 marginally declined by Rs.4.15 (0.23%) on BSE on April 27, 2007 as compared with previous day’s closing prices.

**Conclusion**

Consolidation in the steel sector is clearly here to stay and India’s M & A juggernaut is not likely to slow down soon. Healthy performance at home, strong management capabilities and access to competitive financing will boost the cross border mergers and Acquisitions (M & As) activity in India in 2007. Though the M & A activity has been moving at a great pace the average deal size is still low compared to global averages.

The acquisition of sesa Goa provides an opportunity to Vedanta to get into the Iron ore business. It is a natural fit for Vedanta as Sesa Goa is an efficient low cost unit with growth opportunities in the world’s fastest growing economies. This transaction augures well for Vedanta and is expected to create accretion to earnings and cash flows. Sesa Goa will also prosper under Vedanta realm.

**References**

8. Asia Times on line www.atimes.com
12. C.A. Final – Management Accounting and Financial Analysis (Mafa) course material.

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**Appeal to Create Endowment Funds**

**Invitation to individuals, trusts, societies and others to create endowments to award scholarships.**

The Institute of Chartered Accountants of India grants liberally scholarships to meritorious and needy students. Scholarships are also awarded with external participation under different endowment schemes. Individuals and organizations can create endowments by contributing a minimum sum of rupees one lakh only. Returns from the Corpus will be used to grant monthly scholarship. Extend your helping hands to meritorious students to become Chartered Accountants.

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The Reserve Bank of India (RBI) announced its Annual Policy Statement for the year 2007-08 in April, 2007. In the following paragraphs, we will highlight its main points.

**Domestic and Global Developments**

- **The Indian economy recorded an impressive performance during 2005-07.** The real GDP growth in 2005-06 was 9 percent which accelerated to 9.2 percent in 2006-07. Encouraged with improved performance, the RBI has pegged the GDP growth target at 8.5 percent for the year 2007-08.

- **Industrial activity expanded strongly with the real GDP originating in industry estimated to have risen by 10.2 per cent in 2006-07 as compared with 8 per cent in the previous year.** The production of consumer and capital goods increased by 9.5 per cent and 17.8 per cent respectively during April-February 2006-07 over and above the increase of 12 per cent and 16.3 per cent a year ago. Corporate sector performance remained buoyant supported by favourable domestic and export demand conditions during 2006-07.

- **Real GDP originating from agriculture and allied activities is estimated to have registered a growth of 2.7 per cent in 2006-07, closer to the trend growth but lower than 6 per cent in the previous year.**

- **The major indicators of services sector indicates continued buoyancy in 2006-07.**

- **Inflation, on an average basis, based on the WPI, increased from 4.4 per cent in 2005-06 to 5.5 per cent in 2006-07.** Measured on a year-on-year basis, inflation increased from 4.1 per cent at end March 2006 to an intra-year peak of 6.7 per cent in end-January 2007 and remained firm in the range of 6.1-6.6 per cent in the succeeding weeks. At a disaggregated level, the prices of primary articles increased by 10.7 per cent as compared with an increase of 4.8 per cent in the previous year, largely on account of rising prices of food articles such as wheat, pulses, fruit and milk. The annual increase in prices of the ‘fuel, power, light and lubricants’ group at 1 percent was much lesser than 8.3 per cent a year ago.

- **India’s merchandise exports in US dollar terms, increased by 19.3 per cent during 2006-07 as compared with 26.3 percent last year.** Imports showed an increase of 27.8 per cent as compared with 32.7 per cent last. While the increase in oil imports was lower at 32.6 per cent during 2006-07 as compared with 49.7 per cent in the previous year, non-oil import growth at 25.7 per cent was comparable to 26.4 per cent of the same period.

- **India’s foreign exchange reserves recorded an increase of US $ 25.6 billion during April-December 2006 and rose to reach a level of US $ 199.2 billion by end-March 2007.**

- **The world economy expanded strongly in 2006 and experienced a growth rate of 5.4 per cent.** Globally, inflation has picked up in the wake of increase in commodity prices. As international crude prices have started rising again, inflation is likely to increase further.

- **Globally, financial risks have increased notably emanating from the behaviour of oil prices, adverse development in the US housing market, persistence of global imbalances and possible emergence of inflationary pressures.**

- **Monetary Policy authorities all over the world are keeping an eye on inflation and assets prices.** Some central banks have recently paused their policy cycles, some have cut back their policy rates (which were raised earlier in response to high inflation) and others some have tightened their policy rates.

- **Money supply increased by 23.7 per cent during 2006-07 as compared with 17 per cent in 2005-06.**

- **Aggregate deposits of scheduled commercial banks increased by 23 per cent during 2006-07 as against 18.1 per cent in 2005-06.** Non-food credit extended by Scheduled commercial banks increased by 28 per cent on top of 31.8 per cent in the previous year.

- **During 2006-07, financial markets shifted from conditions of easy liquidity to occasional spell of tightness necessitating injection of liquidity.** Financial markets experienced generally stable conditions during the greater part of 2006-07 although with some volatility in the second half.

**Stance of Policy**

The Policy places GDP growth for 2007-08 at 8.5 per cent, aggregate deposits at Rs 4,90,000 crore, M₄ at around 17-17.5 per cent and aims to contain inflation in the current year at close to 5 per cent against 5-5.5 per cent last year. The stance of the Policy would be conditioned by the global and domestic developments. The RBI will ensure appropriate liquidity in the economy so that all legitimate requirements are met. For this it will use all its policy instruments at its disposal flexibly and as

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The author is Deputy Director, ICAI.
when the situation warrants. Barring the emergence of any adverse and unexpected developments in the economy, the overall stance of the monetary policy in the period ahead continues:

- To reinforce the emphasis on price stability and well anchored inflation expectations while ensuring a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum.
- To re-emphasise credit quality and orderly conditions in financial markets for securing macroeconomic and financial stability.
- To respond swiftly to the evolving global and domestic situation impinging on inflation expectations and the growth momentum.

**Measures**

- There has been no change in the Bank Rate\(^1\). It has been left unchanged at 6 per cent.
- The Cash Reserve Ratio\(^2\) will increase to 6.5 per cent with effect from the fortnight beginning April 28, 2007, as announced on March 30, 2007.
- Reverse Repo\(^3\) Rate and Repo Rate have been kept unchanged at 6 per cent and 7.75 per cent respectively.
- In view of the current macro-economic and over all monetary conditions, the RBI retains the option to conduct overnight repo or longer term repo under the Liquidity Adjustment Facility (LAF) depending on market conditions.
- At present the interest rate ceiling on Foreign Currency Non Resident (banks) [FCNR (B)] deposits is fixed at London Inter Bank Offered Rate (LIBOR) minus 25 basis points for all maturities. The Policy has reduced the interest rate ceiling by 50 basis points to LIBOR minus 75 basis points with immediate impact.
- Similarly, the interest ceiling on Non Resident (External) Rupee Account [NR(Ext)RA] deposits is reduced by 50 basis points to LIBOR/SWAP rates with immediate impact. Both the above measures will have the impact of making these deposits less attractive for the Non Resident Indians (NRIs) and will result in smaller net inflows and help stabilize the rupee.
- A scheme has been formulated for the buy back of State Development Loans (SDLs)This will help the states who have earned negative income on their investments. Moreover, to encourage states, interested in open market borrowings, to announce their plans before hand, an indicative calendar is being finalized for their reference. This process will help the market plan investments in such instruments in advance.
- Currently the facility of Non-Competitive Bidding is limited to Central Government dated securities. Now this facility is being extended to primary auctions of SDLs. This will encourage the retail market (provident funds, insurance companies and trusts) interest in the SDLs and enhance SDLs’ liquidity.
- In order to simplify the methodology for pricing of the floating rate bonds (FRBs), the Policy proposes the use the cut-off yield on the 182-day Treasury Bills, instead of the yield on 364-day Treasury Bills as a benchmark rate for the FRBs to be issued in the future.
- The Clearing Corporation of India Ltd. is being advised to start a trade reporting platform for Rupee Interest rate Swaps (IRS). The RBI has indicated that repo facilities for corporate bonds will be allowed once the proposed trading platforms for bonds stabilize. Corporate bonds repos will enhance the liquidity in bonds since these bonds could be pledged as collateral to arrange liquidity in line with government securities.
- Further a Working Group is being set up to review the interest rate futures market in light of the new change in the government securities market like the introduction of short selling and when-issued scheme. Another Working Group will look into the operationising the framework for currency futures. The decision has been made seeing the increased volumes of foreign exchange contracts and cross currency and rupee options which are being increasingly used by corporates as hedging instruments.
- The overseas investment limit (total financial commitments) for Indian companies investments in joint ventures / wholly subsidiaries abroad has been enhanced from the existing

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\(^1\) **Bank Rate** is the official minimum rate at which the Central Bank (RBI) is prepared to rediscount the approved bills of exchange held by banks or to lend on approved securities to banks.

\(^2\) **Cash Reserve Ratio** refers to that portion of total deposits of a commercial bank which it has to keep with the RBI in the form of cash reserves.

\(^3\) **Repo** is a transaction in which two parties agree to sell and repurchase the same security. Under such an agreement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and a price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date in future at a predetermined price. Such a transaction is called a Repo when viewed from the prospective of the seller of securities (the party acquiring fund) and Reverse Repo when described from the point of view of the supplier of funds. Effectively the seller of the security borrows money for a period of time (Repo period) at a particular rate of interest mutually agreed with the buyer of the security who has lent the funds to the seller. The rate of interest agreed upon is called the Repo rate. The Repo rate is negotiated by the counterparties independently of the coupon rate or rates of the underlying securities and is influenced by overall money market conditions. The Repo/Reverse Repo transaction can only be done between parties approved by RBI and in securities as approved by RBI (Treasury Bills, Central/State Govt securities)

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June, 2007
200 per cent of net worth to 300 per cent of net worth, as per the last balance sheet. This will provide greater flexibility for investments abroad and aid mergers and acquisitions.

- The current reporting system does not capture data comprehensively on costs and means of funding overseas acquisitions and performance indicators. Therefore, a revised reporting framework on overseas investments is being introduced.
- The limit for portfolio investment abroad in listed overseas companies has been enhanced from 25 per cent of net worth to 35 per cent of net worth. This move will facilitate further the investment by the listed corporates in the blue chip companies abroad.
- The aggregate ceiling on overseas investment by mutual funds has been increased from US $3 billion to US $4 billion. This will further enhance overseas investments by Indians.
- The present remittance limit of US $50000 has been enhanced to US $100000 per financial year for any permitted current or capital account transaction by individuals.
- The range of hedging tools available to the market participants has been expanded.
- The RBI has allowed authorized dealer banks to prepay their external commercial borrowings of up to US $400 million without prior approval of RBI. Earlier this limit was US $300 million.
- The RBI has allowed individuals to hedge their risk in overseas investments by allowing them to participate in forward contracts. These can be freely cancelled and rebooked. This gives investors more liberty to play in the forward market and make good use of currency fluctuations.
- At present, forward contracts booked by importers and exporters of goods and services in excess of 50 per cent of the eligible limits have to be on deliverable basis and cannot be cancelled. This limit has been enhanced to 75 per cent.
- Small and Medium Enterprises (SMEs) will be permitted to book forward contracts without underlying exposures or past records of exports and imports through authorized dealers with whom the SMEs have credit facilities. This move will help the smaller exporters hedge their currency risks directly and the fact that they can cancel or rebook a contract as and when they require will give them operational efficiency.
- In respect of resident corporates, authorized dealers will be allowed, to permit, remittances on account of donations for specified purposes, remittance of foreign exchange towards reimbursement of pre incorporation expenses incurred in India, remittances on account of requests from BPO towards payment of cost of equipment to be installed at overseas sites and open foreign currency account in India.
- Indian banks will be permitted to extend credit and non-credit facilities to step down subsidiaries which are wholly owned by the overseas subsidiaries of the Indian corporates.
- The risk weight on the residential housing loans has been reduced from existing 75 percent to 50 percent as a temporary measure. This dispensation will be applicable for loans up to Rs 20 lakh and will be reviewed after one year keeping in view the default experience and other relevant factors. This may result in making home loans (up to 20 Lakh) cheaper.
- Apart from the above many other measures have been announced like operationalisation of the Indian Financial Network (INFINET) system as a Multi Protocol Label Switching, waiving of processing fees for transactions relating to RTGS, ECS, EFT, and NEFT, introduction of annual review of payment and settlement systems w.e.f the year ending March 31, 2007, increasing ceiling on the rate of interest payable to NBFCs on deposits by 150 basis points and constituting a committee to undertake a comprehensive self assessment of the Indian financial sector using the Handbook brought out by the World Bank and the IMF as the base.
Rupee Appreciation: Sectoral Impact on Exports and Imports

Nidhi Singh

In today’s scenario, the global economy is much more interlinked than it was a few years before because of lot of trade taking place between different countries. Since US is a major trade partner for many nations and biggest importer of goods and services from across the world, therefore a slowdown in demand in the US will affect the suppliers from those countries who are providing the goods and services to the US. The impact of the sluggish US economy and the interdependence of the Indian economy on the US economy also cannot be negated.

Figures from the US commerce department show that the US economy grew at its weakest pace during the first quarter of this year when compared to the last four years. US gross domestic product, which measures the value of all goods and services produced in a country and is considered the best measure of the economic health, grew at an annual rate of just 1.3% in the first three months of the year, down by 2.5% from the previous quarter. The slowdown in growth is on account of a slump in the housing market and US’s widening trade gap. The exports declined at a rate of 1.2% in the first quarter while imports rose to 2.3%. All these factors have triggered fears for the future of the world’s largest economy, thereby weakening the dollar.

Appreciation of the Indian Rupee

On 7th May, the rupee was quoted at its nine-year high against the US dollar at 40.57. The rupee has gained since the beginning of March (See Table). Apart from the effect of weakening of the US dollar, it is also due to less intervention of Reserve Bank of India (RBI) in the market. A basic question which arises today is why RBI has not intervened in curbing the rise as it used to in the past? There can be some possible reasons for the same. One of the most important one being fear of inflation. An appreciating rupee makes imports cheaper. Indian manufacturers who use imported raw materials and components benefit from the appreciating rupee. A strong rupee can also to some extent lessen the consequences of the large oil import bill, although presently it is the oil companies, which are acting as a cushion. They have been asked not to pass on the cost of the high imported crude to their customers.

Further, the rupee appreciation is mostly driven by capital inflows, which have led to a mismatch between demand and supply of foreign currency. RBI has accumulated reserves very rapidly, by buying dollars, thereby reducing its supply. RBI has bought $8 billion from November to January and around $12 billion in February from the foreign exchange market. Buying of dollars has released rupees that have added to the money supply. Heavy dollar inflow and selling pressure from exporters has pushed rupee higher.

An increase in the flow of funds through foreign institutional investors is also one of the reasons which has led to the appreciation of the rupee.

<table>
<thead>
<tr>
<th>Date</th>
<th>Rupee Value</th>
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Table: Appreciation of the Indian Rupee against US Dollar

Sectoral Impact on Exports

Exports, which constitute about 12 percent of India’s $854 billion economy, would have grown faster had the rupee not appreciated to a nine-year high and eroded the earnings of the exporters. The appreciating rupee coupled with rising interest rates has become a cause of concern for exporters. An appreciating rupee impacts our export competitiveness adversely. Exports of goods which compete only on price with very low margins are expected to come down even if marginally whereas more value added exports, which have higher import content or are less price sensitive, would be less affected.

According to a recent survey on exports conducted by Federation of Indian Chambers of Commerce and Industry (FICCI) in February 2007, the exporters lamented that the most adverse impact of the appreciating rupee is the pressure on margins. Profit margins of the Indian exporters rest on a few important constituents namely the input cost, transaction cost, and exchange rates. The cost conscious exporters are compelled to stick to the existing prices as any movement in prices in the upward direction will upset their growth performance. Both small and large exporters from all leading sectors have expressed their concern over the difficulties resulting from frequent unfavourable changes in the exchange rate. According to some of the exporters, option of hedging the currency is not feasible and forward buying comes with its set of drawbacks, for example any untimely payment can affect their realisations badly.

According to Assocham, one of the leading bodies of the Chambers of
Commerce of India. India’s foreign trade structure does not favour a strong rupee vis-à-vis the dollar. India’s top export commodities include chemicals, leather, textiles, gems and jewellery and most of the manufacturers and exporters are small or medium-sized who are operating on low margins. Therefore, it is not possible for them to absorb the currency risks. Also, hedging of currencies in India is not as popular as the costs are high for most of the operators. Therefore, with increasing cost of money due to hike in interest rates and inadequate infrastructure, appreciation of rupee would burden the exporters to a very large extent.

Companies from the information technology sector, textile, metals and oil and gas sectors would also be affected by the appreciation of the rupee.

**Information Technology (IT) Sector**

For IT companies and exporters, the rising rupee means a fall in the operating margins and increased costs as they will receive less rupees for each dollar earned. Approximately, two-thirds of India’s IT revenue is in dollar terms. The fourth quarter results of most of the big and small IT companies have revealed lower revenues and operating margins. Margins of companies like Infosys, Wipro, TCS, Mastek, Patni, etc have been affected by this change in exchange rate.

**Textile Sector**

The textile business is a low profit one with profits ranging between three to five percent and any further appreciation in the rupee value would result in decline in exports of textiles and garments. According to the Chairman of Cotton Textile Export Promotion Council (Texprocil), the sharp appreciation in the rupee has resulted in slowdown in textile and clothing exports from India. He stated that in the case of the US, while textile imports from India for the year ending January, 2007 had grown by only 5 percent, imports from China, Indonesia, Bangladesh and Cambodia for the same period rose by 27 percent, 26 percent, 20 percent and 23 percent respectively. Even as the appreciating rupee is making the country’s exports uncompetitive, textile exporters are being further burdened by high production costs caused by high interest cost, pressure on prices and growing costs of inputs.

On the other hand, the under valued Chinese currency-Yuan has resulted in the presence of Chinese textile and clothing products in the major global markets. Despite the restrictions imposed by US on imports of clothing from China, the imports from China have grown much more than imports from India.

The Chairman appealed to the government to intervene effectively in the matter so that textile exporters, already burdened by high costs, do not lose their share in the global markets on account of low realization in rupee terms.

**Pharmaceutical Sector**

Pharmaceutical companies generate a major portion of their sales from exports and only a part of the exports is to the US. Most of these companies hedge their exports and do not expect a significant impact of the appreciation of rupee in the short term. But, if there is a consistent appreciation in the value of the rupee, it could have an adverse impact on export margins in the long term.

**BPO Sector**

The ever-growing outsourcing business, which earns most of its profits in US dollars, has also been affected by the gain in rupee. They will have to look at new ways to be competitive to offset the rupee’s gains.

**Commodities Sector**

Taking a look at the commodities market, the strengthening of the rupee is worrying the exporters of plantation crops. US being the largest importer, majority of the Indian commodity exports is dollar-denominated. Since the recent appreciation of the rupee has been very fast and has taken place over a short period of time, therefore according to the exporters, it makes it difficult for them to make up for the adverse impact of the increase immediately.

The metal companies especially the iron-ore exporters would be affected by a strong rupee against the dollar. Even mining and metals would be adversely impacted as they will have to give up the gains accruing from higher global commodity prices on account of falling dollar.

**Hotel Industry**

Hotel industry too would be affected by a rise in rupee value as a major portion of their sales is from abroad.

**Shipping, Ship building and Off-shore oil fields Sector**

Earnings of shipping, ship building and offshore oil fields companies are in dollars. However, their expenses are also usually in dollars, therefore, it provides a natural hedge to a large extent. Hence, the impact on these companies would be very less as compared to other sectors.

**Gems and Jewellery Industry**

Gems and jewellery industry, where exports are more of a value added nature, for example, where gold is imported, processed/ manufactured to create jewellery, which is exported back, the impact would be very less.

As far as the foreign exchange markets are concerned, the rupee has become the favoured currency. With the rupee gaining in value, there is a demand for rupees with exporters dumping dollars.

**Sectoral Impact on Imports**

The biggest beneficiaries from the appreciation of the rupee are the importers as they would have to pay less in terms of dollars i.e. more dollar denominated goods can be bought by paying lesser amount of rupee. Therefore, there will be reduction in import costs. Among the importers, companies which are likely to benefit are from the energy dependent sectors. Also, companies that source raw materials from the global markets and are largely domestic demand driven could witness improvement in margins. Rupee appreciation is also a good sign for the government’s financial health. In the long run, a stronger rupee would be sound for the Indian economy and will bring India’s purchasing power on par with other currencies.

Further, it is very beneficial for the capital goods sector as large number of equipments and machineries are imported. Oil marketing companies like Bharat Petroleum, Hindustan Petroleum and Indian Oil, which import crude oil and Telecom companies like Airtel, Idea, which have huge requirements for import capital expenditure, stand to gain from a rise in the rupee.

**Suggestions / Steps taken by Government**

The FICCI survey, as mentioned earlier in the article, has suggested some recommendations by the exporters to the government. It has
been suggested that based on average exchange realization, the government should guarantee minimum exchange rate and if the market moves sharply against the exporters then it should be compensated with subsidies.

The exporters are also suggesting that a range may be fixed around a particular rate, say, 3 percent around Rs. 44, and the rupee movement should be restricted within this range for exporters. Further, hedging against the appreciating value of rupee is an option in the short term but if the rupee continues to appreciate then the Indian companies need to be careful. If the rupee appreciates steadily against the dollar, then the importers can do without any hedging while the exporters should go for as much forward cover as possible. Indian importers should take this opportunity to expand their global sourcing base while Indian exporters should deal more in other foreign currencies.

The exporters also suggested that RBI should come up with measures to reduce the interest rate on export credit. Also, there should be a directive to public sector banks to ensure that at least 50 per cent of the credit line allocated to exporters under the priority sector be given to small and medium exporters.

In the recent foreign trade policy, long standing major grievances of trade were addressed by providing service tax exemption/remission on services rendered in India and utilised by exporters. In the backdrop of appreciating rupee, this brought some relief to the exporting fraternity. In line with the government’s approach to address genuine grievances, services rendered abroad and charged on exports from India are also to be exempted from service tax.

To enable small and medium enterprises to hedge the foreign exchange exposure, RBI has allowed them to book forward contracts without underlying exposures or past records of exports and imports. There is an industry wide appeal for producing cost cushion, enough to compete with China. Almost every major industry namely the auto component, automobile, electricals, electronics, textile and engineering industry have raised concern and demanded for more benefits in the form of incentives to offset the pressures of rising costs.

**Conclusion**

Looking at the brighter side of the present scenario, it can be stated that India is emerging as an economic powerhouse. There is a lot of internal demand in the country that will keep the economy running. While some exports may be affected, there is enough local demand to keep the economy running. India being a growing economy, its imports are poised to increase in the future, with increased investment in technology, infrastructure and development related projects. Also, a lot of India’s exports have huge import content to it and gains on these imports will cover the loss on the export of the final product to a great extent if the rupee further appreciates. However, in the equity market, the impact of the US slowdown may vary according to the exposure of a particular company to the US market.

Therefore, the impact of a rising rupee on exporters can be offset by a falling inflation and most significantly by a shift in the basket of export goods and services. It is time India diversified into export of goods and services less vulnerable to price, by leveraging the country’s pool of scientific and engineering talent. Over the years, Japanese exporters have overcome a rising yen and retained competitive edge in the global market through innovation in products and services. This potential has been recognized in India in some technology-led segments such as pharmaceuticals and telecom equipments. The government, on its part, needs to look at strategies that would boost such exports in India.

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“Life after the Yuan Revaluation” by Rex Mathew, domain-b.com, August 2, 2005.


“India Need Not Fear a Rising Rupee” by R. Vaidyanathan, Business Line, April 19, 2007.

“India’s Muscular Rupee Hurts Exporters” by Penny MacRae, The China Post, April 23, 2007.


Preface

It is easy to evaluate the performance of a single product company because all assets and operations are identified with a single responsibility centre. A diversified company would like to assess the profitability of its different lines of business and the entire organisation. Dupont, a US company, developed and pioneered the systematic use of return on assets to evaluate the performance of different organisational units and target areas for improvement. This led to development of Dupont Chart which exhibited the return on assets financial control system.

The focal point

The central measure in the Dupont analysis is the Return on Assets (RoA), a variant of return on investments (RoI). RoA is computed by dividing operating profit (EBIT) by the average invested capital (i.e. capital deployed in acquiring operating assets – fixed assets and working capital). This ratio is also commonly known as return on invested capital (RoIC). It is the aggregate measure of performance.

\[
\text{RoA} = \frac{\text{Operating Profit (EBIT)}}{\text{Average Operating Assets}}
\]

This is a measure of pre-tax earnings power of the company.

The constituents of the ratio

The equity capital (shareholder’s fund) and loan capital (long-term debt) make up capital employed. This is deployed in acquiring operating assets (core assets) and temporarily invested in other assets (non core assets). They represent two sides of the balance sheet. RoA measures return on core assets (operating assets) and excludes from its denominator the amount of non-core assets. It also excludes from its denominator capital work-in-progress, i.e. assets under construction. Obviously, the numerator will comprise of only operating income (EBIT), non-operating income/loss being excluded. The denominator and numerator of the ratio should be mutually compatible to ensure that the ratio is internally consistent and give a true perspective of the company’s performance.

The tax angle

The numerator EBIT in RoA represents a measure of pre-tax earnings. However, the income that a company delivers to its shareholders is subject to corporation tax. In that case net operating income after tax (NOPAT) shall provide a better measure of calculating RoA as it is derived by deducting the tax charge from operating income (EBIT). Thus, NOPAT = EBIT (1 - t), where “t” is the corporate tax rate. Fiscal laws (both indirect and direct taxes) greatly influence the earning power of the company. A company may be entitled to tax-breaks that will reduce overall incidence of direct tax on its operating income. Since interest on debt is a tax-deductible expense, tax paid by the company on total income (EBIT - I) is net of tax saved on net interest paid. NOPAT, therefore, must be adjusted for tax shield on net interest payment, In that case, NOPAT = Operating income (EBIT) - (Tax + Net Interest paid x t)

The NOPAT is calculated assuming that net interest paid is deducted at marginal statutory tax rate and that the tax breaks that reduce the effective tax rate relate to operating income. Thus,

\[
\text{RoA} = \frac{\text{NOPAT}}{\text{Average Operating Assets}}
\]

This after tax return on operating assets (RoA) is the post-tax version of the earning power.

Illustration

The following data pertain to a company. Average operating assets are Rs. 500. The marginal corporate tax rate (t) is assumed 35%.

\[
\begin{align*}
\text{Operating Income (EBIT)} & \quad \text{Rs. 100} \\
\text{Interest received} & \quad \text{Rs. 10} \\
\text{Interest paid} & \quad \text{Rs. (30)} \\
\text{PBT} & \quad \text{Rs. 80} \\
\text{Tax} & \quad \text{Rs. 25} \\
\text{PAT} & \quad \text{Rs. 55}
\end{align*}
\]

\[
\text{RoA (pre-tax)} = \frac{100}{500} = 20\%
\]

To calculate RoA (post tax) we need to find NOPAT - Net Operating Profit after Tax. The actual tax paid is Rs.25 which is after a tax deduction of Rs.7 on its net interest payments [35% of (30 – 10)]. So tax on operating profit must have been Rs.32 [25 + 7]. This reflects that the company has received tax- breaks that has reduced the effective tax rate (from 35% to 32%) on its net income. It is assumed that the tax-breaks relate to operating profit (i.e. profits from its core activity):

\[
\begin{align*}
\text{Tax on operating income} & \quad \text{Rs. 32} \\
\text{Less: tax shield on interest payment} & \quad \text{Rs. 7} \\
& \quad \text{(35% of [30 – 10] )} \\
\text{Tax on net income} & \quad \text{Rs. 25} \\
\text{Therefore, NOPAT} & = 100 - [25+(20 \times .35)] = 68 \\
\end{align*}
\]

and

\[
\text{RoA (post-tax)} = \frac{68}{500} = 13.6\%
\]

The disaggregation of ratio

RoA is a barometer of the enterprise performance. This is a key
ratio and all other ratios can be linked with RoA. Thus for a more detailed analysis, the Dupont system breaks the RoA ratio into two components:

- a return ratio, that measures efficiency, and
- a turnover ratio, that measures productivity (capacity-utilisation).

Thus when the two measures (of profitability and productivity) are combined, it produces RoA, a single measure of aggregate performance. In its decomposed form the ratio shall be:

\[
\text{RoA} = \frac{\text{NOPAT}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Average Operating Assets}}
\]

i.e. \( \text{RoA} = \frac{\text{Return on sales} \times \text{Operating Asset Turnover}}{} \)

The ratio of operating profit (NOPAT) to sales is a measure of efficiency: the ability to control costs at a given level of sales activity. The ratio of sales to operating assets (often called asset turnover ratio) is a measure of productivity: the ability to generate sales for a given level of investments in operating assets.

If the enterprise has a high proportion of fixed operating cost in its cost structure, an increase in sales will fetch more than proportional increase in operating profit (EBIT). Thus higher the operating assets turnover and greater is the sales, the greater will be the operating profit (EBIT).

**Further disaggregation**

The Dupont approach to financial control further disaggregates the return and turnover ratios into sub-components by focusing on more detailed calculations of costs and different groups of assets. It thus considers important inter-relationships between many sub-components which make up the efficiency and productivity ratios. Refer Exhibit I.

The net operating profit margin ratio (a constituent of RoA) provides a broader picture of profitability on sales. This must be invariably supplemented by a common-size income statement which is a form of vertical analysis. It shows each element of cost as a percentage of sales. This provides management a complete and comprehensive view of the contribution of each cost element to overall profitability on sales. Refer Exhibit II.

The common-size income statement shall lay bare all those cost elements which have contributed in lowering of the net operating profit margin. This will enable the management to lay hands on those cost elements which have been critical in bringing down the profitability ratio or which can be worked up to enhance the productivity and thus, the profitability of the enterprise. It, thus, affords the opportunities and potential to control and reduce costs. Its usefulness will enhance if it is supplemented by a trend analysis, horizontal form of analysis, so as to identify trend in a company’s cost components over the years.

Operating assets are made up of fixed assets and working capital. Thus asset turnover ratio (the second constituent of RoA) is a multiple of two turnover ratios:

- Fixed Assets Turnover Ratio, and
- Working Capital Turnover Ratio

A high fixed assets turnover ratio indicates that production capacity is being effectively used. A low ratio indicates idle capacity and scope of expanding production and sales without additional capital investment.

Working capital turnover ratio can be further decomposed into:

- Inventory Turnover ratio
- Debtors Turnover Ratio
- Creditors Turnover Ratio

The common-size balance sheet statement will reveal the proportion of fixed assets and circulating assets as a percentage of total assets. A horizontal statement will reveal the trend

---

Note: In-fact, Dupont developed as many as 350 charts to summarise operations in detail. These were permanently displayed in a large hall and updated monthly.
over the years in the growth of fixed assets and elements of working capital.

A growth in fixed assets is normally accompanied by some fixed operating cost. Therefore, growth in sales volume mean higher capacity utilization and the company’s ability to cover its fixed operating costs. The use of operating leverage suggest that any increase in sales has a positive magnifying effect on EBIT. It can be the other way round.

A rise in working capital without corresponding rise in sales may indicate that inventories are piling up or the company is extending enhanced credit to fetch sales. The indication is something is wrong somewhere and it need to be identified and corrective measures taken.

### Evaluating Unit / division performance

The main aim of the Dupont analytical framework was to have a system of financial control so as to enable the management to assess and evaluate the performance of its many responsibility centres in an independent manner. Each responsibility centre is considered like a small business. The internal financial reporting system must ensure that all costs, revenues, assets and liabilities are accumulated and identified with a specific responsibility centre for proper assessment of that centre’s performance.

### Conclusion

RoA provides an overall summary of performance. A low RoA may signal that something is wrong but not what is wrong. The management will have to dig deeper to discover what is causing decline in profitability. Besides financial information, the management will have to dwell on non-financial information to identify the underlying problem. Non-financial information may relate to fall in market share: dis-satisfaction among customers relating to cost, quality, non-adherence to delivery schedule, poor after-sales service, etc. All these factors have potential effect on sales and the company’s loss of market share means loss of profit. Therefore, management must be careful to use financial results as aggregate measure of performance and rely on non-financial results to identify the causes or drivers of the financial results.

RoA sub-components gives an insight into what is happening to profit. It enables the management to monitor and analyse costs for improving efficiency and raising productivity. Non-financial information may help management in removing roadblock in the way of achieving higher sales.

RoA enables the management to identify that unit/division of the company which does not generate the required rate of return on investment or which are irretrievable inefficient so that these may be closed down. It will help management to concentrate on other profitable divisions/operations and enhance overall profitability. Thus RoA helps the company in identifying which of their division should receive additional capital to expand capacity.

RoA (post-tax return) must be compared with the company’s weighted cost of capital (WACC). A company is generating surplus (i.e. economic profit) and maximising the wealth of shareholders if it’s RoA (a variant of RoI) is more than WACC.

### Comments

Figures in exhibit II are hypothetical. It is assumed that increase in operating assets have been commissioned on first day of the accounting period. The analysis will reveal that unit selling price has remained constant. The company has been able to save on manufacturing cost. Consequently gross profit has increased by 2.5%. Better capacity utilisation and higher sales have resulted in substantial increase in operating profit. The magnifying effect of operating leverage can be seen - EBIT increasing by 51.52 % on increase in sales by 25%. The company has been able to fetch higher sales by increasing expenditure on advertisement and publicity (marketing costs). A deeper penetration in the market augur well for the company.

#### Exhibit II

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<td>Sales to production</td>
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<th>Particulars/Year</th>
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<tr>
<td>Sales</td>
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<td>Profit after tax (n-o)</td>
<td>36</td>
<td>4.50</td>
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| A. Return to sales (NOPAT/Sales) | 5.63% | 6.80 |
| B. Asset Turnover (sales/Op. assets) | 1.78 times | 2 times |
| C. RoA (A x B) | 10.02 | 13.60 |
The experience of processing of CPT examination OMR forms has revealed that a large number of candidates:

(i) Do not write CPT course Registration Number and date of registration (date of registration to CPT course is different to date of issue of registration letter)

(ii) Do not write Roll Number and Year of Qualifying examination (i.e. 12th class)

(iii) Do not write name in the same style and pattern as to what is registered at the time of registration to the course with the Board of Studies (say – students add or delete middle part of name or write surname first or last, leave extra space in name or do not leave one box/circle blank between parts of name, abbreviate surname or parts of name etc.)

(iv) Do not get the examination form attested by a Chartered Accountant or Gazetted Officer or Principal of a School/College.

(v) The numerical code of the examination centre opted is not correctly filled in leading to the allocation of a centre far away from the place of residence.

It is also noted that some students do not take requisite care to darken the circles in OMR examination form correctly thereby leading to delay in issue of admit cards to them and avoidable paper work for the office and inconvenience/anxiety to students as well. This situation can be remedied and still better services could be provided if the students take little more care to read and understand the instructions given in the information brochure issued along with the examination form and follow them meticulously.

Students who have submitted CPT Registration form to the Institute and have not got the Registration letter until submission of CPT examination form are advised, in their own interest, to obtain the Registration letter/registration number and date of registration. Meanwhile, such students can submit the examination form but must inform their registration number and date before issue of admit card.

**ELIGIBILITY CRITERIA CUT OFF DATES FOR THE YEAR 2007-08**

In accordance with Regulation 25 D of the Chartered Accountants Regulations, 1988, a student to be eligible to be admitted to the Common Proficiency Test need to fulfill the following eligibility requirements:

(i) Must have been registered with Board of Studies for CPT course at least two months prior to the first day of the month in which the CPT examination is scheduled to be held.

(ii) Must have already appeared or passed the 12th class or equivalent examination of Central or State Higher/Senior Secondary Education Board.

**DARKENING OF ANSWER CIRCLE IN ANSWER SHEETS**

Students should ensure that they darken the answer circles in the Answer Sheets (and not in Question Paper Booklet) correctly using HB Pencil as per illustration given below so that OMR Scanner machine could pick up the answers as given by students. If a circle already darkened is to be changed, erase it completely and leave no mark and then darken another circle. Darkening of multiple circles (i.e. more than one circle as answers) is taken as wrong answer and negative mark formula is applied.

**Marking the Answer**

Example: For Question number 52, if you consider the correct answer to be C, mark as shown below (Correct method):

```
52  A  B  ○  □
```

Not as shown below (Wrong method):

```
52  A  B  ✗  □
```

**FILLING UP OF EXAMINATION APPLICATION FORM**

It is clarified that a candidate, after registration to CPT course, has necessarily to fill in CPT Examination application form, within the notified dates, to be entitled to receive the admit card. Mere filling up of registration form does not automatically make a student entitle for receipt of admit card unless he also fills in the CPT examination form and submits to the Institute within the last date. Students may also note that no individual intimation about the filling up of examination form is sent. They should keep a watch on the advertisement relating to dates of filling up of examination forms in the Newspapers and announcement hosted on www.icai.org and Regional/branch offices. The issue of admit card is subject to fulfillment of eligibility requirements as per Regulation 25 D.

Help us to serve you better.

(G. SOMASEKHAR)
SR. JOINT SECRETARY (EXAMS)
**Announcement**

Bos/Ancment/ Regional Heads/15/25/07

May 21, 2007

**Distribution CPT Study materials through Branches**

To facilitate distribution of study materials to newly registered CPT students in expedited manner, it has been decided that students may procure prospectus for CPT, submit filled-in application form and collect study materials from the following Branches of the Institute:

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>City</th>
<th>Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Ahmednagar</td>
<td>Ahmednagar Branch of WIRC of the ICAI, 2nd Floor, Mutha Chambers (Old Vasant Talkies) Market Yard Road, Ahmednagar-414001</td>
</tr>
<tr>
<td>2.</td>
<td>Bangalore</td>
<td>Bangalore Branch of SIRC of the ICAI, ICAI Bhawan, No.16/0, Millers Tank Bed Area, Bangalore-560 052</td>
</tr>
<tr>
<td>3.</td>
<td>Ghaziabad</td>
<td>Ghaziabad Branch of CIRC of the ICAI, Yamunotri Complex, 2nd Floor, A-12, Ambedkar Road, Ghaziabad-201001</td>
</tr>
<tr>
<td>5.</td>
<td>Nagpur</td>
<td>Nagpur Branch of WIRC of the ICAI, ICAI Bhawan, 20/1, Dhanotoli, Nagpur-440 012</td>
</tr>
<tr>
<td>7.</td>
<td>Saharanpur</td>
<td>Saharanpur Branch of CIRC of the ICAI, 4/313, Boomanji Road, Above Central Bank of India, Near Pul Jogiyas, Saharanpur-247001</td>
</tr>
<tr>
<td>8.</td>
<td>Tiruchirapalli</td>
<td>Tiruchirapalli Branch of SIRC of the ICAI, G-1, Green House Apartments, 28, Mc Donald’s Road, Cantonment, Tiruchirapalli-620 001</td>
</tr>
<tr>
<td>9.</td>
<td>Yamunanagar</td>
<td>Yamunanagar Branch of NIRC of the ICAI, SCO-1, 1st Floor, Madhu Colony, Near Madhu Banquet Hall, Yamunanagar-135 001</td>
</tr>
</tbody>
</table>

**Contact Us**

We receive letters and emails from the students on various issues. For speedy disposal of queries students should write only to the concerned office. The details of various offices are given below:

For general queries that are administrative in nature such as registration, including its delay, Eligibility Certificates, Test Papers, ITT Completion Certificate and so on student should contact the respective region:

1. **Additional Director of Studies**  
   Western India Regional Council, The Institute of Chartered Accountants of India, ICAI BHAWAN, 27, Cuffe Parade, Colaba, **Mumbai** – 400 005  
   Phone: 022-39893989  
   Fax: 022-39802953  
   e-mail: wro@icai.org

2. **Joint Secretary**  
   Southern India Regional Council, The Institute of Chartered Accountants of India, ICAI BHAWAN, 122, M.G. Road, Post Box 3314, Nungambakkam, **Chennai** – 600 034  
   Phone: 044-39893989  
   Fax: 044-30210355  
   e-mail: sro@icai.org

3. **Deputy Secretary**  
   Eastern India Regional Council, The Institute of Chartered Accountants of India, ICAI BHAWAN, 7, Anandi Lal Poddar Sarani, Russel Street, **Kolkata** – 700 071  
   Phone: 033-39893989  
   Fax: 033-30211145  
   e-mail: ero@icai.org

4. **Deputy Secretary**  
   Central India Regional Council, The Institute of Chartered Accountants of India, ICAI BHAWAN, Post Box 314, 16/77B Civil Lines, Behind Reserve Bank of India, Kanpur (U.P.) – 208 001  
   Phone: 0512-39893989  
   Fax: 0512-3011173, 3011174  
   e-mail: cro@icai.org

5. **Deputy Secretary**  
   Northern Regional Office, The Institute of Chartered Accountants of India, ICAI BHAWAN, 52-53-54, Institutional Area, Vishwas Nagar, Shahdara, Near Karkardooma Court, **Delhi** – 110 032  
   Phone: 011-39893990, 30210613  
   Fax: 011-30210680  
   e-mail: nro@icai.org

For Queries related to academics and grievances:

**Director of Studies**  
The Institute of Chartered Accountants of India, ICAI BHAWAN, C-1, Sector – 1, **Noida** – 201 301  
Phone: 0120-39893989  
Fax: 0120-3054842  
**e-mail:** dos@icai.org

Students may also note other email addresses:

- Academic Difficulty in Subjects: guidance@icai.org
- General Grievances: bosnoida@icai.org
- General Management and Communication Skills: gmcscourse@icai.org
- Compulsory Computer Training/Information Technology Training: cctnoida@icai.org
- Non receipt of Newsletter: casnewsletter@icai.org
- Non receipt of Journal: eb@icai.org
- Publications: noidastores@icai.org
Announcement

Availability of Scholarships through Endowment Funds
(w.e.f. April, 2007)

<table>
<thead>
<tr>
<th>Name of Scholarship</th>
<th>Number</th>
<th>Amount (Rs.)</th>
<th>Duration (Months)</th>
<th>Eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) Sultan Chand Memorial</td>
<td>1</td>
<td>500</td>
<td>18</td>
<td>Students of PCC/ Final undergoing articleship</td>
</tr>
<tr>
<td>ii) G.D. Salarpuria Foundation</td>
<td>2</td>
<td>500</td>
<td>18</td>
<td>– do –</td>
</tr>
<tr>
<td>iii) R.K. Khanna Memorial</td>
<td>2</td>
<td>300</td>
<td>18</td>
<td>– do –</td>
</tr>
<tr>
<td>iv) J.S. Lodha Memorial</td>
<td>7</td>
<td>300</td>
<td>18</td>
<td>– do –</td>
</tr>
<tr>
<td>v) Satish Khanna Memorial</td>
<td>1</td>
<td>300</td>
<td>18</td>
<td>– do –</td>
</tr>
<tr>
<td>vi) Chandu Lal Kapuri Devi Charitable Trust</td>
<td>1</td>
<td>300</td>
<td>18</td>
<td>– do –</td>
</tr>
<tr>
<td>vii) Likhamichand Chauthmull Kandoi Charitable Trust</td>
<td>2</td>
<td>300</td>
<td>18</td>
<td>Students of PCC undergoing articleship (payment to be made directly by the Trust)</td>
</tr>
</tbody>
</table>

Notes:
1. (i) The annual income of parents/guardians should not exceed Rs.1,00,000.
   (ii) Applicants for grant of above scholarships should be registered students of PCC/Final. Students of PCC/Final Course will be paid scholarship for maximum period of 18/30 months or balance period of articleship.
2. The scholarships will be effective from April, 2007. The duly completed application should be submitted in the prescribed form so as to reach the Director of Studies, The Institute of Chartered Accountants of India, Post Box No. 36, C-1, Sector-1, NOIDA - 201 301, latest by 21st June, 2007. Application form can be downloaded from the web site of the Institute namely www.icai.org.

Bos/Announcement/Elocution & Quiz Contests/227/23/07 May 15, 2007

Branch and Regional Head-quarter level Elocution and Quiz Contests

The Board of Studies has commenced Branch and Regional Head-quarter level Elocution and Quiz Contests for the academic session 2007-08. The Branch level contest will be completed by July 31, 2007 and the winners will be eligible to participate in the Regional level contest which will be announced later on. Students are advised to re-visit this announcement on our website from time to time for updated schedule of programmes to be organised by the Branches and Regional-Head Quarters.

Programme

<table>
<thead>
<tr>
<th>City/Town</th>
<th>Hosted by</th>
<th>Elocution Contest</th>
<th>Quiz Contest</th>
<th>Contact person</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ranchi</td>
<td>Ranchi Branch of CIRC of ICAI</td>
<td>May 19, 2007 at 10.30 AM</td>
<td>May 20, 2007 10.30 AM</td>
<td>CA. J.P.Sharma Chairman- Students Sub-Committee Ph: 0651-2206471</td>
</tr>
</tbody>
</table>

Digitization of PCC Study Materials

Our students often travel for outstation assignments for the purpose of practical training. Carrying bulky study materials to different places becomes difficult. As access to computers and laptops has increased tremendously in recent times it has been felt that a digital version of study material will provide ease of carrying. Thus the study materials will be available in compact disks (both English and Hindi version of PCC study materials). These would be given free of cost to the students registered on or after 1st of July, 2007. The salient features are:

1. You do not have to decide which study material to carry for outstation assignment. The whole set of study material is in CD which can be accomodated in you pocket.
2. Links are provided two way: page wise and go index-wise. In second option, one can go directly to any chapter/section/sub-section.
3. Print can be made as large as you like to avoid stress on your eyes.
4. Any part of the book can be printed in case printer is available.
5. You can use the search feature to locate occurance of any word/phrase in the study material.
THE BOARD OF STUDIES
THE INSTITUTE OF CHARtered ACCOUNTANTS OF INDIA

4TH NATIONAL CONVENTION FOR CA STUDENTS

THEME: CREATING GLOBAL VISION
ACHIEVING GLOBAL STANDARDS

FRIDAY, JULY 6, & SATURDAY, JULY 7, 2007
VENUE: C C MEHTA AUDITORIUM, MSU CAMPUS, VADODARA – 390005

Hosted by:
BARODA BRANCH OF WIRC OF THE ICAI & BARODA BRANCH OF WICASA

Day One

Registration: 09.00 – 10.00 hrs.
Inaugural Session: 10.00 – 11.00 hrs.
Tea Break: 11.00 – 11.20 hrs.
Technical Session I: 11.20 – 13.30 hrs.
Trends in Financial Reporting Standards
Topics:
1. Global Convergence of Financial Reporting
2. AS 15 (Revised) Employee Benefits
3. Corporate Disclosure Practices: Case Studies on Disclosures of Significant Accounting Policies and Notes on Accounts
Technical Session II: 14.30 – 15.30 hrs
Winning Strategies
Special Session I: 14.30 – 15.30 hrs
Fiscal Laws and Corporate Governance
Topics:
1. Fringe Benefit Tax (FBT): Issues and Challenges
2. Recent Changes in Service Tax
4. Corporate Governance: Global Scenario and Indian Perspective
Cultural Programme: 19.00 – 21.30 hrs.

Day Two

Audit and Assurance
Topics:
1. Risk Based Audit
2. CARO
3. Qualification in Audit Report: Case Analysis
4. Audit in Computerized Environment: Case Analysis
Special Session II: 11.30 – 12.30 hrs
Audit Documentation
Special Session III: 12.30 – 13.30 hrs
Meet the CFO: Role of Chartered Accountants in Contemporary Corporate Environment
Technical Session IV: 14.30 – 16.00 hrs.
Strategic Financial Management
Topics:
1. Business Valuation
2. Issues in Financial Risk Management
3. Portfolio Management Strategies
Valedictory Session: 16.00 – 17.15 hrs.
New Scheme of Education and Training
1. Valedictory Address
2. Best Paper Award for paper submitted in each technical session
3. Feedback from participants

Students are invited to contribute papers for various technical sessions. It has been decided to select two papers in each topic. Paper writers are exempted from payment of registration fee. They will be reimbursed the railway fare by shortest possible route for AC 3 Tier/First Class. Interested students may submit a soft copy of the paper for approval so as reach positively by June 6, 2007 to the Director of Studies, P.B. No.36, C-1, Sector-1, Noida 201301 by e-mail at psdos@icai.org. Please provide your complete address with phone number and e-mail id.

All correspondence relating to registration may be addressed to:
Convener, 4th National Convention for CA Students, Baroda Branch of WIRC of the ICAI, 2B, Ramkrishna Chambers, Productivity Road, Baroda-390007, Phone: 0265 2351151, E-mail: baroda@icai.org; artsbs@icenet.co.in website: www.icai.org

Contact Persons:
CA. Ashok Thakkar, Mobile 09825048551
CA. Rahul Parikh, Mobile 09825329995
ANNOUNCEMENT

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

20TH ALL INDIA CA STUDENTS’ CONFERENCE

THEME: WORKING WITH WORLD (www)

SATURDAY, JUNE 23, & SUNDAY, JUNE 24, 2007

VENUE: THAKOREBHAI DESAI HALL, LAW GARDEN, AHMEDABAD – 380015

Hosted by:

AHMEDABAD BRANCH OF WIRC OF THE ICAI
&
AHMEDABAD BRANCH OF WICASA

Day One

Registration & Breakfast: 08.00 – 9.00 hrs.
Inaugural Session: 9.00 – 10.30 hrs.
Tea Break: 10.30 – 11.00 hrs.
Technical Session I: 11.00 – 13.00 hrs.
Development in Accounting
Topics:
1. AS 29: Provisions, Contingent Liabilities and Contingent Assets
2. Accounting for Employees’ Stock option
3. AS 22: Accounting for Taxes on Income
Lunch Break: 13.00 – 14.00 hrs.
Special Session I: 14.00 – 15.00 hrs
Career opportunities for Chartered Accountants
Technical Session II: 15.00 – 17.30 hrs.
Issues in Financial Management
Topics:
1. Valuation of Business Acquisition: Case Analysis
2. Brand Valuation
3. Dividend Policies of Indian Companies
Cultural Programme: 19.00 – 21.30 hrs.

Day Two

Breakfast: 8.30 – 9.30 hrs
Auditing and Assurance
Topics:
1. Due Diligence
2. AAS 35: The Examination of Prospective Financial Information
3. Professional Ethics
Special Session II: 11.30 – 12.30 hrs.
Audit Planning
Special Session III: 12.30 – 13.30 hrs.
Meet the CEO: Role of Chartered Accountants in Strategic Decision Making
Technical Session IV: 14.30 – 16.00 hrs.
Taxation and Corporate Laws
Topics:
1. Issues in Minimum Alternate Tax (MAT)
2. SEBI (Disclosure and Investors Protection) Guidelines: 2000
3. Limited Liability Partnership: Issues and Purposes
Valedictory Session: 16.00 – 17.15 hrs.
New Scheme of Education and Training

Students are invited to contribute papers for various technical sessions. It has been decided to select two papers in each topic. Paper writers are exempted from payment of registration fee. They will be reimbursed the railway fare by shortest possible route for AC 3 Tier/First Class. Interested students should submit a soft copy of the paper for approval so as reach positively by June 6, 2007 to the Director of Studies, P.B. No.36, C-1, Sector-1, Noida 201301 by e-mail at psdos@icai.org. Please provide your complete address with phone number and e-mail id.
Registration fee: Rs.500 per student (Outstation students are advised to contact the conveners for accommodation on extra payment basis)
Cheques / DD to be drawn in favour of – The Institute of Chartered Accountants of India, Ahmedabad Branch of WIRC of the ICAI, payable at Ahmedabad.

All correspondence relating to registration may be addressed to:
Convener, 20TH National Convention, Ahmedabad Branch of WIRC of the ICAI, ICAI Bhawan, 123, Sardar Patel Colony, Near Usmanpura Railway Crossing, Naranpura, Ahmedabad 380014, Phone: 079 27680946, 27680537, E-mail: ahmedabad@icai.org website: www.icai.org

Contact Persons:
1. CA. Durgesh, V. Buch, RCM and Chairman, WICASA, Ahmedabad, Mobile 09898012959
2. CA. Parag R. Raval, Chairman, Ahmedabad Branch, Mobile 09824339200
3. CA. Fulak B. Pavagadhi, Co-Chairman, WICASA, Ahmedabad, Mobile 09825179479
4. CA. Anand Sharma, Convenor, WICASA, Ahmedabad, Mobile 09825940506
5. CA. Harsh R. Rath, Convenor, WICASA, Ahmedabad, Mobile 09825107195
6. CA. Kuntal Shah, Member, WICASA, Ahmedabad, Mobile 09898137388
GLIMPSES

President
CA. Sunil Talati
discussing a point
with the delegates
of SAFA students’
exchange programme

Vice President
CA. Ved Jain
being felicitated at
a virtual class
organised for the
students

President and
CA. Jaydeep
Narendra Shah,
Chairman, Board
of Studies
interacting with
the students at a
virtual class

CA. Vijay Garg
addressing the
students at
Interaction of
Students with Board
of Studies organised
by Jaipur Branch of
CIRC