

THE STORY OF TATA INVESTMENT CORPORATION LTD. EFFECT OF RESERVE AND SURPLUS

Mridul Kumar Ghosh*
Dr. Bijay Krishna Bhattacharya**

ABSTRACT

The price of any stock is dictated by demand and supply arising out of fundamental micro-economic factors as well as concurrent socio-economic and political issues. So long the socio economic and political stability do not affect the stock market, the driving force behind the price of a stock remains the fundamental micro-economic factors. The main driving forces behind the price of a stock are earning power of a stock or EPS (earning per share), business growth prospect, dividend issues and the news of bonus issue or split of face value of a stock. The gradual rise of reserve and surplus on account of transfer of profit to reserve even under stagnant growth of earning power or EPS can also provide fuel or power to the engine of stock price. It can be shown that rise of reserve content of a stock inflates the book value of the stock and hence the price. Even if earning power remains same or changes insignificantly arising out of normal business operation, the rise of valuation from investment of the company can also infuse blood to the body of the share price. The rise of valuation of asset, in which the company has made investment be it financial asset or real asset, can increase the reserve, the net worth of the company and thus the book value. This is what happened for Tata Investment Corp Ltd.

Keywords: Investment, EPS, Reserve, Stock Price, Micro-Economic Factors.

Introduction

In recent times the movement of stock price of Tata Investment Corp Ltd is very much interesting in the sense that excessive growth of stock price cannot be explained only on the basis of normal fundamental parameters like earning per share or profitability or return on equity.

Stock price rose almost 100% this year (2021) with respect to price noted in 2020. Actually the growth of stock price of the company outperformed the stock market index.

This phenomenal rise draws the attention of the investors and efforts are being made to identify the reason of such activity.

Objective of the Study

The recent surge of price of the Tata Investment Corp Ltd has outperformed the stock market growth. The growth of earning power i.e. earnings per share fluctuated roughly between Rs24/ and 34/- over the years between 2013 and 2021

	Mar-21	Mar-20	Mar-19	Mar-18	Mar-17	Mar-16	Mar-15	Mar-14	Mar-13
Basic EPS (Rs.)	30.44	17.89	24.48	23.79	36.37	35.28	33.73	33.81	31.56

(EPS grew to above Rs36/- but fell again to Rs30/- level reaching Rs17 level in 2020.)

But the price of the share grew handsomely over the last a few years

Year	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Oct-21
Close Price Rs	406.1	572.95	547.95	558.8	889.5	890.95	807.95	999.3	1666.15

CAGR of stock price growth 19.3%

* Financial Analyst, Kolkata, India.

** Associate Professor, Indus Business Academy, Lakshmpura, Bangalore, Karnataka, India.

The apparent fallacy of rise of stock price needs a thorough analysis of the financial situation of the company.

There definitely stands a strong pillar of strength which is pushing the price upwards.

Source of Data

Data have been collected from annual report 2021 of the company and secondary reliable source moneycontrol.com and National Stock Exchange.

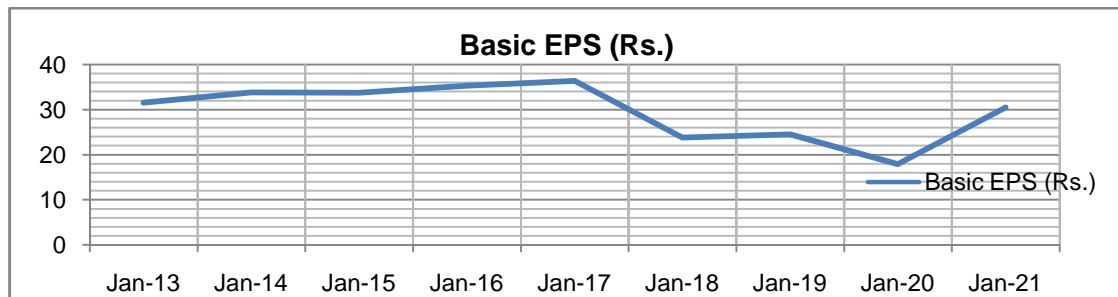
Method of Study

Study involves construction of following tables and interpretation of data

- Data table of EPS of the company from 2013 to 2021.
- Data table of Book value of shares of the company during the same period.
- Data table of yearly close price of the company from 2013 to 2021.
- Data table of equity and reserve and surplus of the company from 2013 to 2021.
- Net profit table during these period and plough back of profit.
- Return of equity (ROE) during these period.

Table 1: EPS table of the company

	Mar-21	Mar-20	Mar-19	Mar-18	Mar-17	Mar-16	Mar-15	Mar-14	Mar-13
Basic EPS (Rs.)	30.44	17.89	24.48	23.79	36.37	35.28	33.73	33.81	31.56

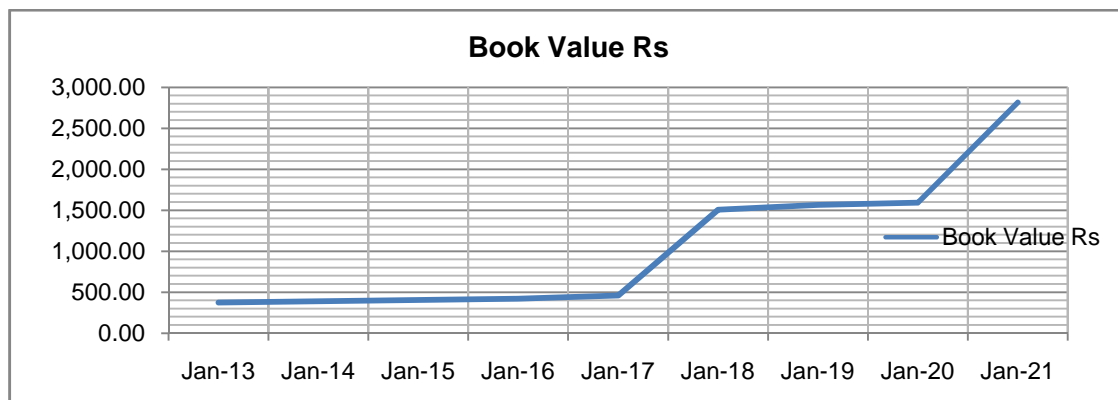


Interpretation

Average Rs EPS 29.7, (overall growth rate negative). EPS made upward trend up to 2017, thereafter down trend noted up to 2020. In 2021 EPS recovered significantly but below the level of 2017.

Table 1A: Year wise Book Value

	Mar-21	Mar-20	Mar-19	Mar-18	Mar-17	Mar-16	Mar-15	Mar-14	Mar-13
Book Value (Rs)	2,814.66	1,592.70	1,566.45	1,507.09	457.23	419.72	405.5	390.45	373.16

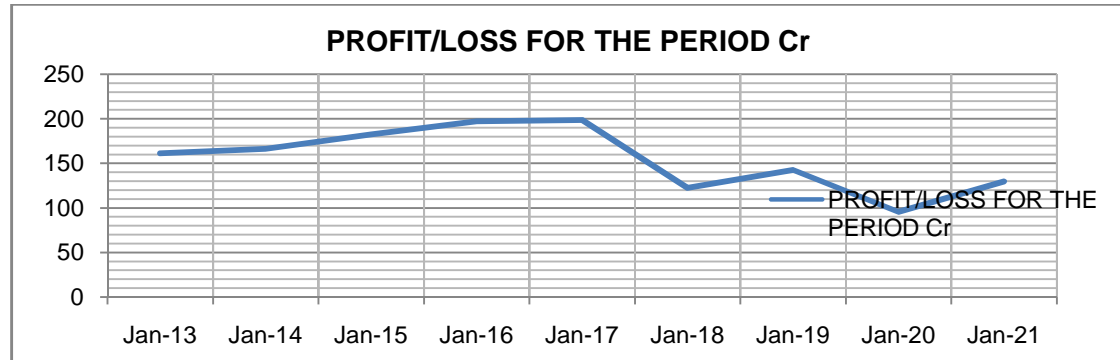


Interpretation

Book value rose steadily up to 2017, thereafter took a giant leap and finally in 2021 a massive jump to reach the figure of Rs 2814.66.

Table 2: Year wise Net Profit

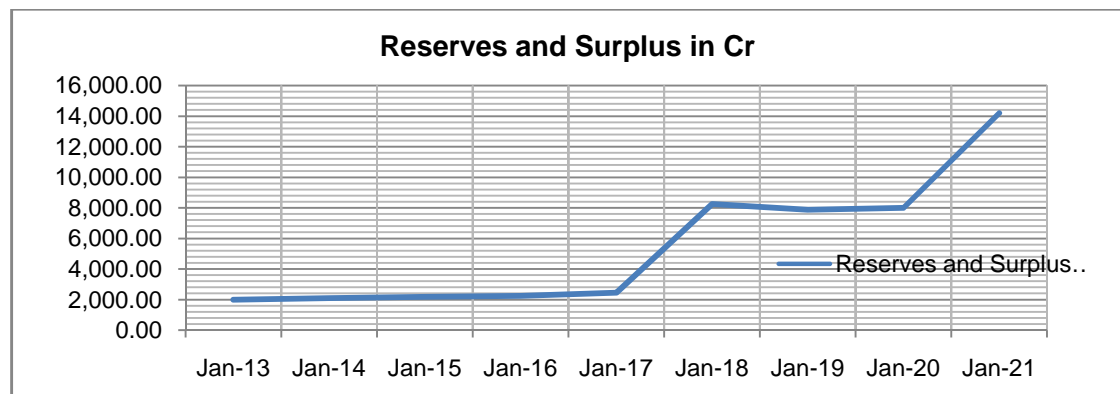
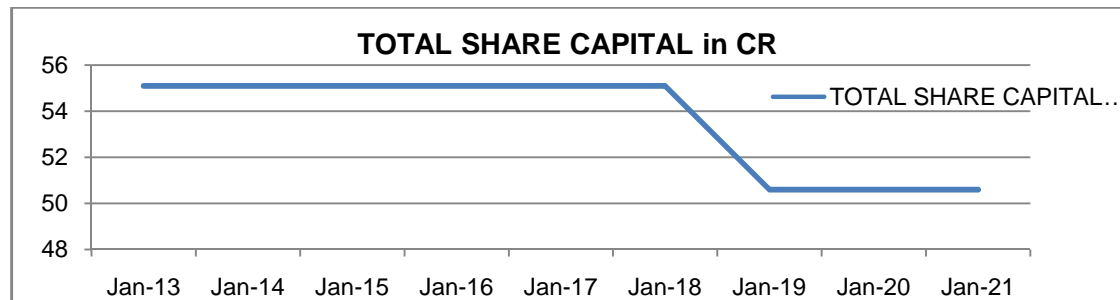
	Mar-21	Mar-20	Mar-19	Mar-18	Mar-17	Mar-16	Mar-15	Mar-14	Mar-13
Profit/Loss for the Period (Rs in Cr)	129.91	95.61	142.72	122.74	198.82	197.26	182.73	166.57	161.29

**Interpretation**

Profit growth over the years took a down turn after 2017

Table 2A: Year wise Equity and Reserve and Surplus

	Mar-21	Mar-20	Mar-19	Mar-18	Mar-17	Mar-16	Mar-15	Mar-14	Mar-13
Total Share Capital in Cr	50.6	50.6	50.6	55.1	55.1	55.1	55.1	55.1	55.1
Reserves and Surplus in Cr	14,188.37	8,006.53	7,873.59	8,246.85	2,463.42	2,256.81	2,178.46	2,095.51	2,000.08

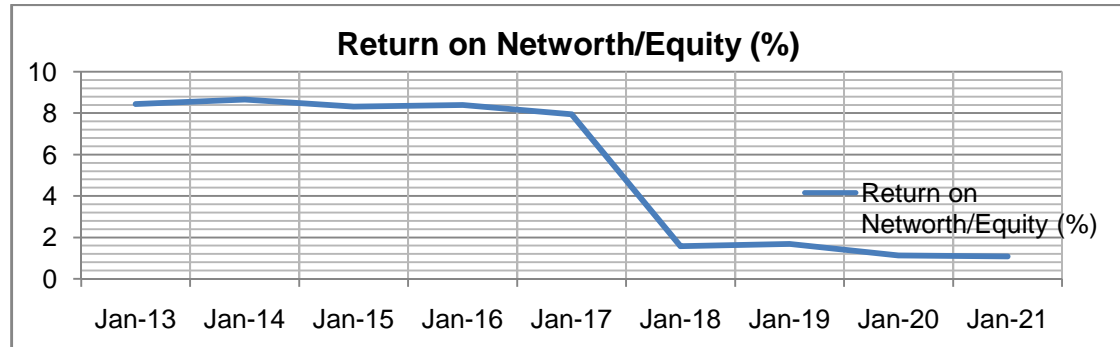
**Interpretation**

Equity base almost remained steady. However a part of share bought back in to the extent of Rs 450 Cr in 2018-19 resulted in downsize of equity base by about 10%.

The reserve and surplus grew annually considerably because of value creation, the CAGR rate is 12.91%. It can be mentioned that volume of reserve and surplus would have been more had not the company bought back the share in 2018-19.

Table 3: Year wise Return on Equity

	Mar-21	Mar-20	Mar-19	Mar-18	Mar-17	Mar-16	Mar-15	Mar-14	Mar-13
Return on Networth/Equity (%)	1.08	1.12	1.68	1.57	7.95	8.4	8.32	8.66	8.45

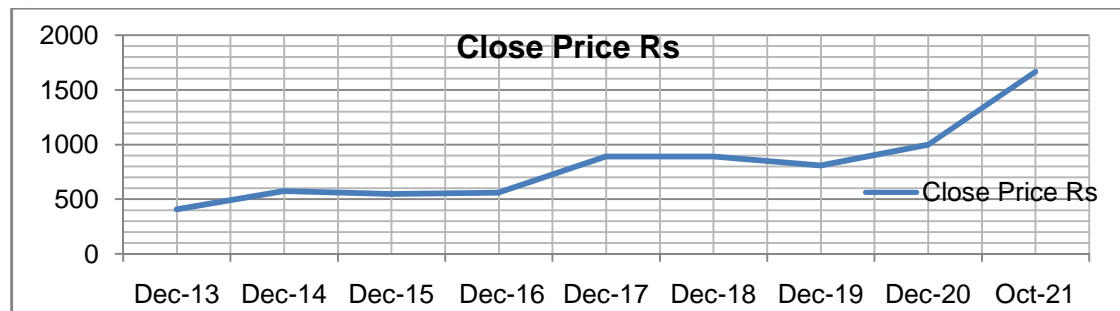
**Interpretation**

Steady decline of year wise return on equity.

Yearly close price of the company Table 3A

Year	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Oct-21
Close Price Rs	406.1	572.95	547.95	558.8	889.5	890.95	807.95	999.3	1509.65

Highest price in October'21 was Rs1734/-

**Interpretation**

Despite erratic behavior of EPS since 2018 the price trend is upward. The overall price trend since 2013 is upward; however the movement of price in 2021 is very much significant as highest price breached the barrier of Rs1700/-.

Discussion

The stock price of the company gradually increased in all these years and this increase cannot be explained only on the basis of profitability or the earning per share of the company. To explain the fact we have to divert our attention to the net worth of the company which is growing steadfastly.

The net worth of a company determines the book value of a share and this book value actually is the driving force of the stock price. A stock trading below the book value is said to be undervalued and the price of a stock which is above the book value is termed as overpriced. Book value is obtained by dividing the Net Worth by the number of shares outstanding. Net worth represents equity and reserve and surplus after deducting all liabilities.

It is to be remembered that reserves and surplus also considered as shareholders' equity; thus phenomenal growth of this retained earnings magnifies the reserves and surplus and eventually the book value of a share.

The retained earnings fully are generally not available as cash rather a large part of it are invested for growth of the company. Therefore the quality of the investment is a major issue. If invested amount fails to generate sufficient return for the company, in spite of its considerable reserve, the book value and subsequently the stock price may not grow significantly. On the other hand if invested amount grows considerably the net worth of the company also grows significantly.

Here in Tata Investment Corporation the profit generated from normal operation of the company did not commensurate with either the growth of the reserve or the stock price of the company.

The quantitative growth of reserve and surplus, specially in 2018 and in 2021, cannot be explained simply by the growth of earning from normal operation rather the quality of investment the company made in various investment opportunities, are responsible for the massive growth of reserve.

The price of the stock is still well below the book value of the share and, therefore, there is enough opportunity for the stock to rise handsomely.

The question may be raised that the market value of the investment is subject to fluctuation. The fact is true; however the company steadily is steering the investment avenues to solid platform to achieve stability even in covid-19 situation.

The reason for decline of ROE:

It has been noted that even under stagnant or depressed earnings per share some stocks managed to remain at comfortable price level. In such situation a driving force is definitely there and it has been noted that reserve and surplus plays a big role.

$Net\ Worth_1 = Equity_1 + Reserve_1$, for a particular company in year 1, and $Net\ Worth_2 = Equity_2 + Reserve_2$ for year 2. The change can be written as $Net\ worth = equity + Reserve$, if there is no change in equity content or very minor change equity should be treated as Zero (0), and in such situation $Net\ worth = Reserve$

If reserve increases, net worth increases; book value will also increase. The price of stock may also rise.

However reserve affects ROE because of following reasons.

$EPS \times no.\ of\ shares = PAT$, ($PAT = profit\ after\ tax$), and $ROE = PAT / Net\ worth$

$EPS \times no.\ of\ shares = ROE \times Net\ worth$.

$EPS \times no.\ of\ shares = ROE \times (reserve + equity)$

If no of shares remain fixed, equity will also remain fixed

no. of shares = k_1 , equity = k_2 , k_1, k_2 are constants, so long there is no appreciable change in equity

So, $ROE = (EPS \times k_1) / (Reserve + k_2)$

Therefore it is clear from this equation that ROE directly affected by change in EPS and inversely related to change in Reserve.

If growth of reserve is greater than growth of earning power the denominator will be greater than numerator and hence the fall of ROE is indicated. Here in this case growth of reserve is greater than growth of EPS. (If changes in equity content happen necessary adjustment of ROE is to be made for rational comparison).

The fall of ROE does not indicate the weakening of financial status of the company if the reserve that has been developed over the years is used effectively to bolster the net worth.

Tata consumer Ltd with ROE shown below, is fluctuating around 5%. In spite of fall of ROE

Year	2021	2020	2019	2018	2017
Return on Networth/equity (%)	5.9	3.33	5.58	7.04	6.21
Basic EPS (Rs.)	9.3	4.99	6.47	7.85	6.17
Book value (in Rs) [exclrevalreserve]/share	169.33	161.52	132.11	127.41	113.85
Reserves and Surplus Rs in Cr	14,420.49	13,700.84	7,246.72	6,968.49	6,202.39
Profit/loss for the Period Rs in Cr	993.79	535.19	473.83	567.26	463.65

The yearly price level as shown here in below is an example of strength of reserve. The growth of reserve cannot be explained only on the basis of simple profit earned under normal business operation.

Year	29/10/2021	2020	2019	2018	2017	2016
Price	809.15	589.65	321.05	219.4	315.55	122.05

Price to book value is quite high presumably because of bonus expectation.

The growth of reserve and surplus and hence the growth of book value creates expectation in the mind of investors of the company that benefit will be pass on to them in the form of bonus. This results in rise of price. Bonus is a peculiar weapon by which a company can appease its investors without paying any dividend. The investors can sell the stock and can earn sizeable return from the market. At the same time the company retains the reserves it has acquired. Thus two birds are killed with a single arrow.

Conclusion

The example of Tata Investment Corp Ltd is imitable in corporate business culture as every enterprise needs proper investment of surplus to stimulate the growth of the business alongside normal operation.

References

1. <https://www.bseindia.com/markets/equity/EQReports/StockPrcHistori.aspx?flag=0>
2. <https://www.moneycontrol.com/financials/tatainvestmentcorporation/balance-sheetVI/TIC>
3. https://tatainvestment.com/wp-content/uploads/2021/06/TICL_Annual_Report_20-21.pdf
4. <https://www.moneycontrol.com/financials/tataconsumerproducts/balance-sheetVI/TT>
5. Pandey I. M , Financial Management, 7th edition, Vikas Publishing House Pvt Ltd, New Delhi – 700014, 1997.

