ROCE Policy Implementation

Introductory Training for Plant Heads

Presented to

Advik Hi Tech Private Limited

ADVIK
Passionately Innovative

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KNOW YOUR TRAINER

AMARENDRA JOSHI

- Amar joined Altus in 2019 and comes with 5+ years of experience as a senior finance leader for a USD 500 mn + business (Dubai based)
- As Head of Finance and Strategy for a division of NSE listed Aster DM Healthcare, Amar was responsible for the following:
    - Established and delivered on sustainable targets towards Revenue growth, EBITDA margins and ROCE
    - Creating a finance function, building a team and SOPs at a BU level
    - ERP and BI tool implementation
    - M&A and investor relations
- Prior to Aster, Amar worked at EY (M&A practice) for 7 years and worked on several successful deal closures across various industries
- Amar is a BCom graduate and a Chartered Accountant. He has also completed his E-MBA from IIM (A) and a Mastermind leadership program with MECA CFO Academy.
- Apart from Advisory vertical, Amar also leads the Healthcare M&A vertical for Altus

INTRODUCTION TO THE PROJECT

Project Objective

Advik Group ("Advik") is planning to restructure the Financial MIS in order to review the business performance in a holistic manner (i.e., including Balance sheet & Return matrices) at a Business Unit & Plant level.

Business plan & ROCE

- The Board of Directors of Advik wish to evolve from an EBITDA based performance monitoring system into a more holistic, ROCE based review mechanism. This is in line with Advik's strategy over the next few years.
- ROCE benchmarking
  - **For established Plants and Warehouses** : could be benchmarked basis the historical trends and duly adjusted for future capex and any operational changes
  - **For New Plants/ Acquisitions** : comparison of the performance to budgeted ROCE basis feasibility study/ commercial due diligence

INTRODUCTION TO THE CONCEPT

SIGNIFICANCE OF ROCE

CONCEPT

- *ROCE stands for* ***Return on Capital Employed.*** *It is a financial ratio used for assessing a company's profitability and capital efficiency.* ROCE gives the amount of profit a company is generating for each Re. 1 of capital employed.
- As **companies mature** in their lifecycle, they typically rely on holistic ratios like ROCE to measure business performance

COMPONENTS

- ROCE $= \dfrac{\text{EBIT}}{\text{Capital employed (C.E)}}$
- EBIT i.e Earnings before Interest and Tax
- Capital employed
  - Fixed assets (after depreciation)+Net working capital (Receivables + Other current assets + Inventory – Trade & other Payables)

IMPLICATIONS

- Capital markets rely on this ratio to compare performance
- ROCE also indicates the margin of safety relative to the borrowing costs of the Company. **Ideally ROCE should be 2x cost of borrowing**
- Industries with low EBITDA margins but high ROCE
  - Retail – eg: Grocery, pharmacies etc.

LEVERS

- *Net Fixed Assets : Any reduction or optimisation in capex for a new expansion project / plant will positively impact ROCE*
- *Net Working capital : In most capex light businesses, working capital is a key lever to improve ROCE.*
  - *Higher Inventory holding – negatively impact ROCE*
  - *Higher receivable cycles (eg: exports) reduce ROCE*
  - *Higher Payable cycles may improve ROCE, but might have adverse impact on Company reputation due to delayed payments,*

Large Corporates typically employ measures such as Revenue growth, Operating Margins & ROCE in a combination for assessing near & long term business performance…

CHALLENGES IN ADVIK CONTEXT

Departure from conventional method of calculating ROCE	**Reasons / Comments**
Gross block considered instead of Net block of assets	• The age of the plant was impacting the ROCE figures & not how the assets were utilized • Frequent changes in depreciation method might skew comparisons at the same plant over the years
EBITDA considered instead of EBIT	Since Gross block used above, it was logical to ignore the depreciation
Interplant AR / AP ignored	After a lot of deliberation with Apex committee, it was decided to exclude the Interplant Payable & Receivable from Capital employed calculations. Reason being cashflow & treasury management in Advik is a central function & as such levers for Interplant dues are beyond control of Plant Heads. Also, significant system configuration changes were needed costing lot of time & resources

ROCE – FINAL DEFINITION IN ADVIK CONTEXT

Considering above challenges, ROCE definition has been customized in Advik context as follows :

- ROCE = EBITDA / Capital employed (C.E)
- EBITDA i.e Earnings Before Interest, Tax, Depreciation & Amortization
- Capital employed
  - Fixed assets (Gross block + Capital Work in Progress)+Net working capital (Receivables + other current assets + Inventory – Trade & other Payables)

ADVIK ROCE POLICY

COMPONENTS OF ROCE - EBITDA

Apex committee signed off on the following policy document in consultation with the Altus team on 16th November 2021

Income

MANUFACTURING PLANTS

Raw Material Cost

Sales	Plant	BU	Apex	Group/ MD	
Manufacturing Sales	✓	✓	✓	✓	
Scrap & Other Sale	✓	✓	✓	✓	
Inter Plant Sale and Intercompany sale	✓	×	×	×	BU level - adjust in RMC
Pass through Sale	×	✓	✓	✓	shown in other income
Child Part Sale to Vendors	×	×	×	×	shown in other income
Wind Power Sales	×	×	×	×	shown in other income

Other Income	Plant	BU	Apex	Group/ MD	
Foreign Exchange Fluctuation Gain/Loss (AP/AR)	×	×	×	×	
Foreign Exchange Fluctuation Gain/loss (borrowings)	×	×	×	×	
Income from Investment	×	×	×	✓	Not to be allocated to BU / Plants
Non Manufacturing Sales (tool, Rm, asset sale)	×	×	×	×	
Other Income (govt incentives, Cash Discount)	✓	✓	✓	✓	
Pass through sale	✓	×	×	×	
Child part sale to vendors	✓	✓	✓	✓	
Wind Power Sales	×	×	×	✓	Not to be allocated to BU / Plants
Volume discount	✓	✓	✓	✓	

RMC - Direct Material & Sub Contracting (B)	Plant	BU	Apex	Group/ MD	
Raw Material	✓	✓	✓	✓	
Interplant Sale BOM Cost	✓	×	×	×	shown in other raw material costs
Child Part Sale to Vendor BOM Cost	×	×	×	×	shown in other raw material costs
Pass through RMC	×	✓	✓	✓	shown in other raw material costs
Running Product Die Replacement Cost	✓	✓	✓	✓	
Loss - Physical Stock Adjustment	✓	✓	✓	✓	

Other raw material costs	Plant	BU	Apex	Group/ MD	
Interplant Sale BOM Cost	×	✓	✓	✓	
Child Part Sale to Vendor BOM Cost	✓	✓	✓	✓	
Pass through RMC	✓	×	×	×	
Volume discount	✓	✓	✓	×	Provision

Volume discount will be worked out & reduced from sale & considered in other income. Same value will be considered as volume discount expenses provision under other raw material costs. In summary, volume discount effect will be nullified at plant, BU, Apex level. Whereas at Group level, actual position will be considered.

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COMPONENTS OF ROCE contd.

Notes:

1. All other expenses to be considered at actuals
2. Provisioning for gratuity, leave encashment, etc. to be done periodically to reduce Year end reconciliation with actuarial valuation.
3. Volume discount to be considered under other income (to be accrued on quarterly basis) and to be expensed out at all levels (Plant, BU and Apex) except Group level
4. Provisioning for export incentives on monthly basis.
5. Quarter end / Year end Sale in transit and respective COGM should be reversed.
6. Customer and Vendor price amendments : Provisioning to be made on a quarterly basis – this has been confirmed by relevant leadership team
7. Sales from India to other legal entity abroad to be eliminated at group level.

Pricing policy for Interplant transfers (Domestic)

- ❖ Sales within the BU
  - Finished Goods : Sales from supplying plant at end customer price
  - Semi-Finished Goods : Sale from supplying plant at raw material cost (process cost not considered)
  - Raw material : Sale from supplying plant at raw material cost
- ❖ Sales between BU: at Arm's length price. Will be decided by the BU heads at the time of budget
- ❖ Sales between Legal entities : As per Income tax Transfer pricing guidelines, certified by CA

✓ ***As per internal discussions regarding the joint recommendation, all Operational & Financial forex gains/losses will be treated as non-EBITDA expenses at Plant, BU, Apex and Group/MD level.***

SPECIAL CASES- TREATMENT OF WAREHOUSES

- **Warehouses sourcing majority of their requirement from a single plant (Parent Child relationship)**
  - P&L and Balance sheet of such warehouse should be clubbed with supplying parent plant
  - Warehouse inventory to be considered at the cost of finished goods of the parent plant based on the budgeted COGM / RMC rate of that year.
  - Actual receivable for warehouse (sale from warehouse to customer) to be considered in the parent plant
- **Warehouse sourcing from multiple plants (warehouse does not have an Administrative head) :**
  - Accountability of such warehouse shall be responsibility of the plant responsible for its administration.
  - P&L and Balance sheet of such warehouse shall be clubbed with the plant responsible for its administration.
- **Warehouse sourcing from multiple plants (warehouse has an Administrative head) :**
  - Admin head of such plant will be responsible for the P&L and Balance sheet
  - Such plant will have independent ROCE calculations for target setting / monitoring

Warehouse Relationships

Warehouse	Location	BU	Receiving supplies from	Treatment
Plant 22	Bawal	1	multiple plants	Independent warehouse
Plant 24	Haridwar	1	100% from single plant- plant keeps changing	To be clubbed with Plant 9
Plant 26	Noida	1	multiple plants	To be clubbed with Plant 22 since Plant doesn’t have admin head
Plant 31	Chennai	1	Parent Plant -P-14	To be clubbed with Plant 14
Plant 32	Mysore	1	Parent Plant -P-14	To be clubbed with Plant 14
Plant 37	Bawal	2	Parent Plant Wasuli 36	To be clubbed with Plant 36

SPECIAL CASES- SSD

Shared Service Division (SSD)

Wasuli Location:

Wasuli location is being used by the following :

Plant 15(BU1), Plant 34(BU2), Plant 35 (SSD), Plant 36 (BU2),Plant 39(BU1), Corporate engineering department

1. Plant and Machinery at Wasuli location : Split on the basis of actual usage of each plant.
2. Land & Building : Gross Block to be split across the above locations (irrespective of age of construction), in the proportion of 50:40:10 for BU1, BU2 and SSD respectively.
3. Utilities : To be allocated in the same proportion as Land and Building

SPECIAL CASES- SSD contd.

Shared Service Division (SSD)

Other SSD (Plant 5 & Plant 35)

1. Entire P&L result (excl. R&D and New Product Development (NPD) costs) to be allocated to each plant (in excel MIS only) in the ratio of :-
    a) 50% towards proportion of Plant Gross Block to the consolidated Group Gross Block and
    b) 50% based on absolute value of Plant contribution margin to Group contribution margin
2. (Contribution = Sales (-) COGM)
3. Allocation to be made on Quarterly basis.
4. Windmill related P&L result, Financial Income (interest, dividend etc.) and MD office expenses should not be allocated to the plants & BU. To be incorporated only in MD & CFO MIS.
5. R&D and New Product Development or "NPD" costs not to be considered/ allocated for ROCE calculation at Plant and BU level for the first 1-2 years. The R&D cost will be allocated to Plants as per the no. of products developed by each Plant/ BU from Year 2 or 3 onwards. Decision to be taken in the future on the basis of no. of products developed for each plant. Alternatively, R&D budget can be given to each plant at the beginning of the year.
6. Fixed assets of Baner location (excl. assets of MD office) will be considered in capital employed at Apex and Group level and not at the Plant and BU level. MD office vehicles and any other assets of MD will only be considered at Group level

COMPONENTS OF ROCE-CAPITAL EMPLOYED

Capital employed will be calculated at each plant based on

Gross block of fixed assets + Net Working Capital (excluding Interplant balances)

Fixed Assets:

Inclusions :

- Tangible fixed assets (Gross Block)
- Intangible fixed assets (Before impairment)
- Capital work in progress (Tangible/ Intangible)

Exclusions :

- Intercorporate deposits
- Investment in shares etc.
- Investment in group companies

Net working capital :

Current Assets

Following components considered as part of Current Assets for net working capital figure:

Inclusions :

- Inventories
- Debtors/ Trade Receivables
- Loans and advances
- Other current assets

Exclusions :

- Cash and cash equivalents
- Interplant receivable balances/ zero balance clearing account.

Current liabilities:

Following components considered as part of Current Liabilities for net working capital figure:

Inclusions :

- Trade payables
- Outstanding expenses
- Other payables

Exclusions :

- Interplant payable balances/ zero balance Clearing account
- Short term borrowings
- Current Maturities of long term borrowings

OTHER ASPECTS

1. Sales from a plant in one legal entity to a plant in another legal entity gets classified as AR/AP and not as interplant transaction. Same will be eliminated at group level during consolidation.
2. Calculation and monitoring of ROCE to be done on quarterly basis, based on MIS, and reinstated for Q4 as per Audited figures.
3. ROCE calculations to be performed at Plant, BU, Apex and Group / MD levels including foreign entity PT Advik Indonesia (PTAI) and Advik Vietnam (AVCL).
4. For target setting of ROCE, AR to be adjusted for normative credit terms (PO terms + Transit days+ other agreed time period) and customer sales mix of each plant
5. Other components (Inventory, Trade payable) of working capital to be taken on actual basis and represented in the Capital employed calculation accordingly.
6. Other Net working capital (i.e., excl. AR, AP, Inventory) to be factored in as per the ratio at a group level. (e.g.: It was 7 days in FY20).
7. Since we have used customised approach for ROCE calculations that excludes the interplant balances from capital employed, separate working capital related KPIs need to be given for monitoring working capital targets/ performance at Plant, BU and Apex level.

ROCE AND WORKING CAPITAL TRENDS

PLANT & BU WISE

IMPORTANT NOTES

Particulars	Description
Transfer pricing policy for Interplant Sale / Purchase	As per policy document, Interplant transfers of FG to be made at end customer price and Semi finished and Raw material transfers to be done at Raw material prices. Process costs not to be considered
exception to ROCE policy >>	Process cost is considered in interplant sale/purchase value in FY 19-20 FY 20-21 Budget 21-22
	Process cost not being considered during FY 21-22 (Actuals)
Difference between MIS and ROCE P&L	Difference between MIS and ROCE document P&L (Forex gain/loss, non budgeted expenses etc.) adjusted to Cash and Bank balances in balance sheet. The impact on creditors/ debtors not considered and therefore Working cap days will be affected to that extent. This impact shall be ignored since the quantum of the same is immaterial
Non-manufacturing sales	As per signed off policy document, the same are to be ignored while computing ROCE. Historically, the amounts under this line item are immaterial & hence ignored for purpose of future ROCE calculations

Key Comments re FY21-22 estimated ROCE workings
For H1 FY22, non-EBITDA expenses adjusted in interplant or cash balances
For FY 21-22 EBITDA estimate, Budgeted Plant wise EBITDA for H2 are added to actual EBITDA of H1. The Capital employed figures are considered as per Balance sheet of 30.09.2021
No information received on Vietnam for FY21-22 & hence ignored
Hanon - Sales & COGM annualised based on H1 figures for working capital calculations
Sales from plants in India to overseas group entities have not been eliminated. However, there is no impact on Apex level EBITDA & ROCE
Sale in transit as on 30.09.21 ignored in H1 FY 22 figures

NWC days = Net working capital / Sales x 365

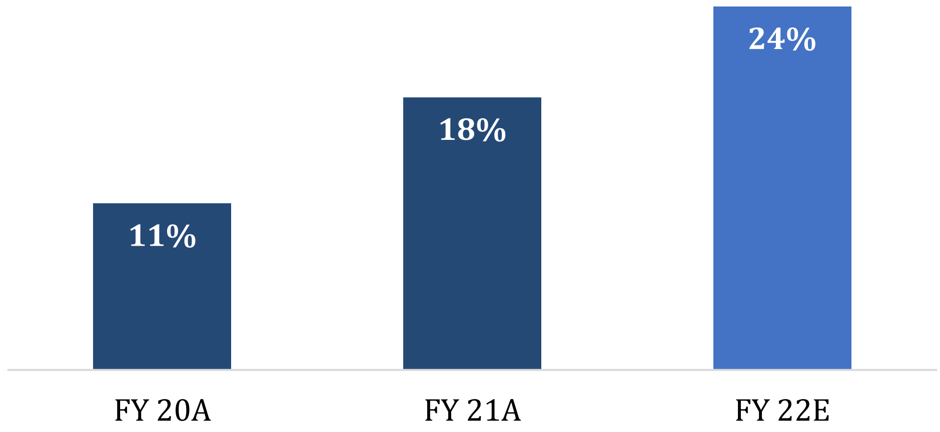
Debtor days (DSO) = Debtors (net of advances) / Sales x 365

Inventory holding period days = Inventory / RMC x 365

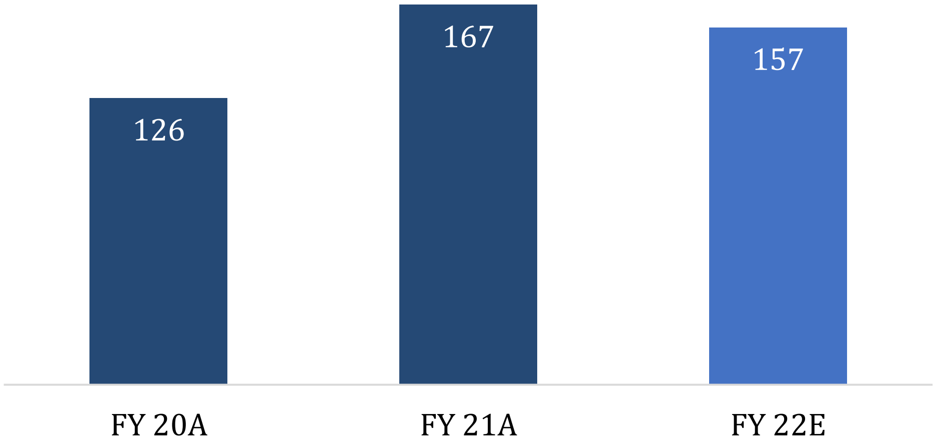
Trade Payable days (DPO) = Trade Payable (net of advances) / RMC x 365

CHAKAN - P15

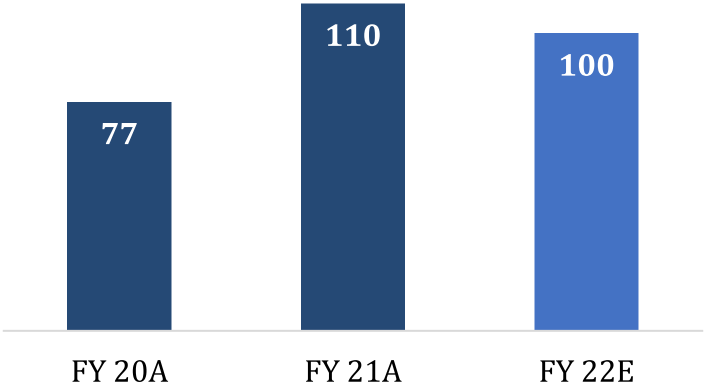
3 year ROCE trend



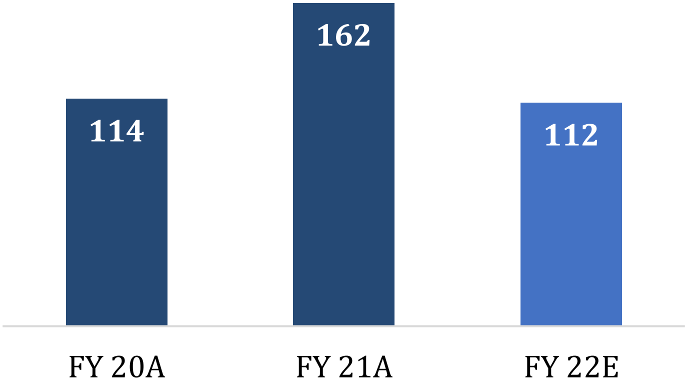
Net Working Capital Days



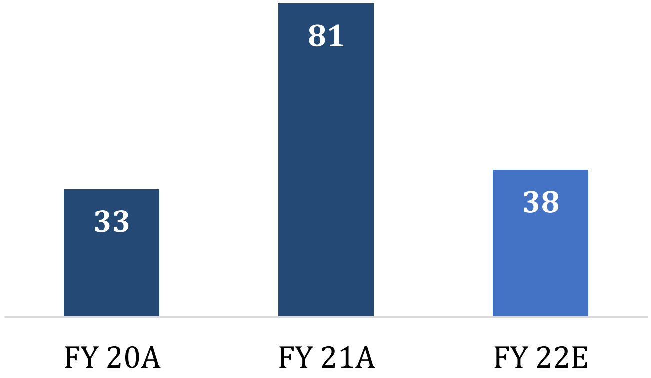
Debtors (Days)



Inventory (Days)



Creditors (Days)

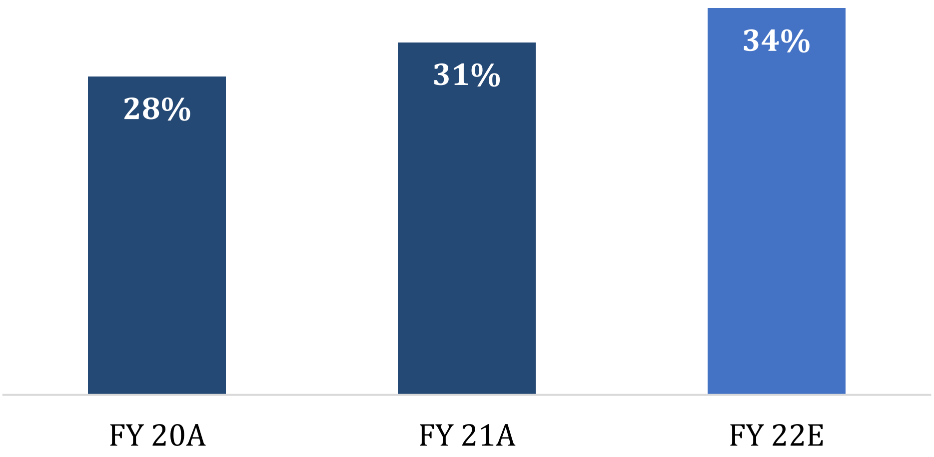


ROCE Analysis FY 22E vs FY 21A

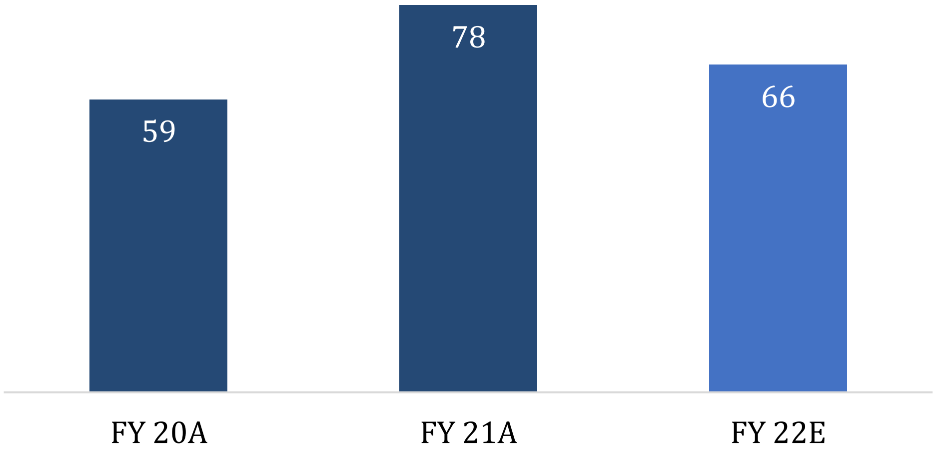
- Sales growth of 23%
- EBITDA margins likely to improve to 22% vs 19% in PY
- Reduction in NWC days by 10 days or 6%
- **Result - 660 basis points (bps) increase in ROCE**

P'NAGAR - P3

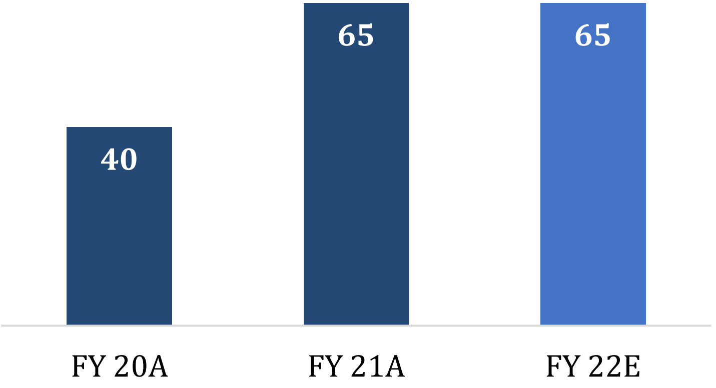
3 year ROCE trend



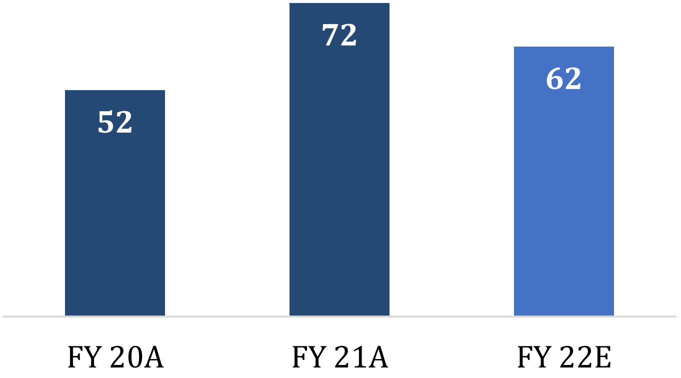
Net Working Capital Days



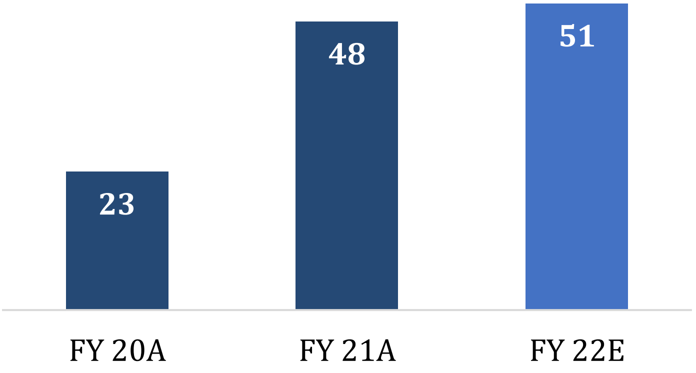
Debtors (Days)



Inventory (Days)



Creditors (Days)

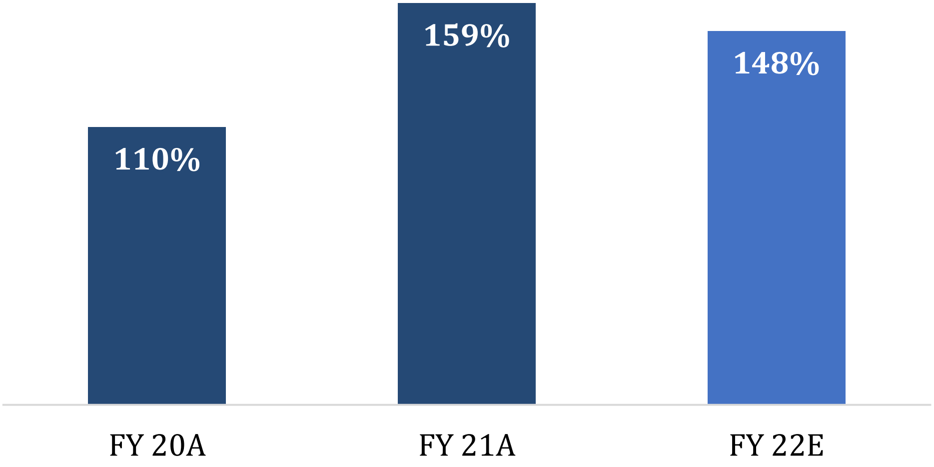


ROCE Analysis FY22E vs FY21A

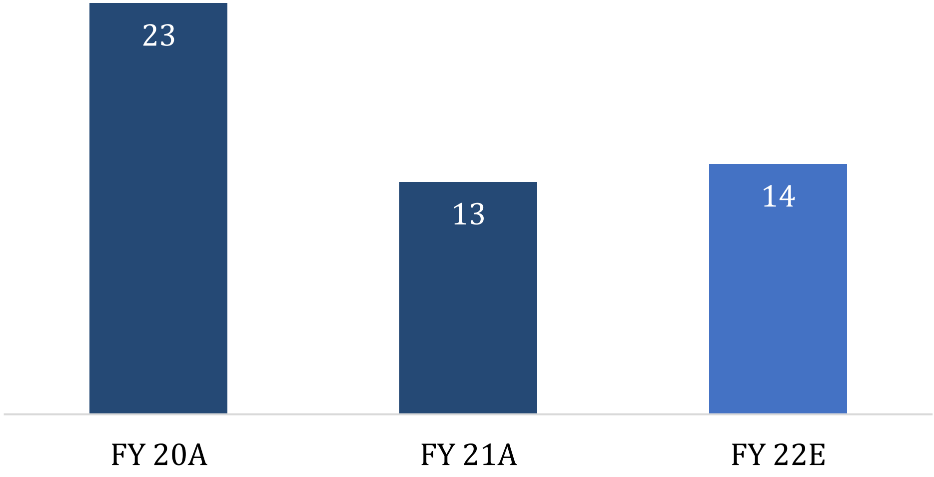
- Sales growth of 11%
- EBITDA margins to contract by 50 bps
- Reduction in NWC days by 12 days or 16%
- **Result - 310 bps increase in ROCE**

P'NAGAR – P9 + P24

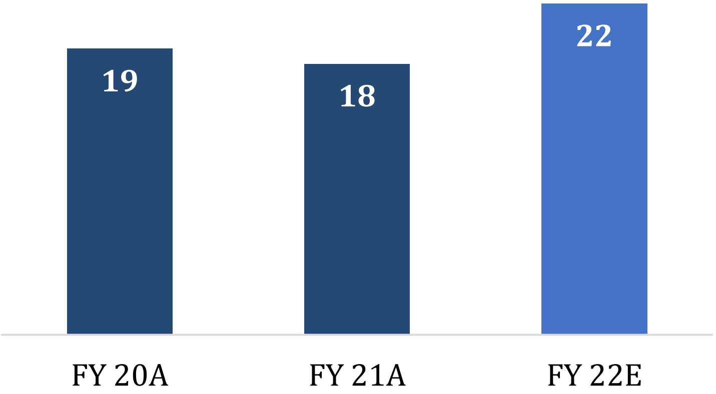
3 year ROCE trend



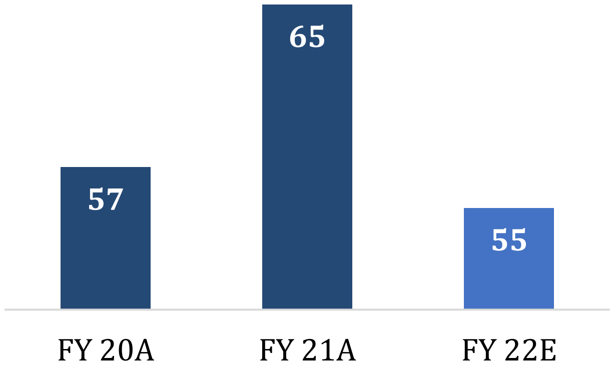
Net Working Capital Days



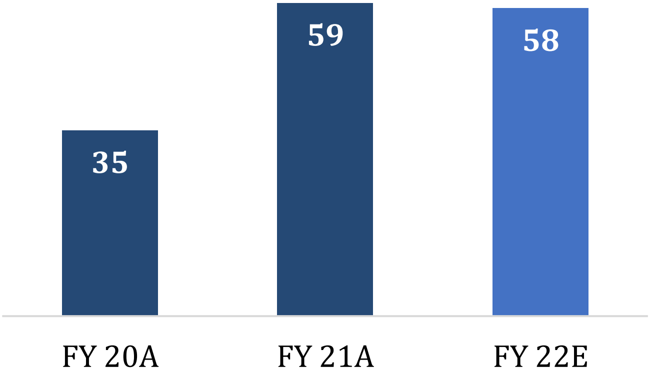
Debtors (Days)



Inventory (Days)



Creditors (Days)



ROCE Analysis FY22E vs FY21A

- Sales de-growth of 1%
- EBITDA margins drop by 110 bps
- Increase in NWC days by 0.5 days or 4%
- **Result - significant decrease by 1130 bps in ROCE**

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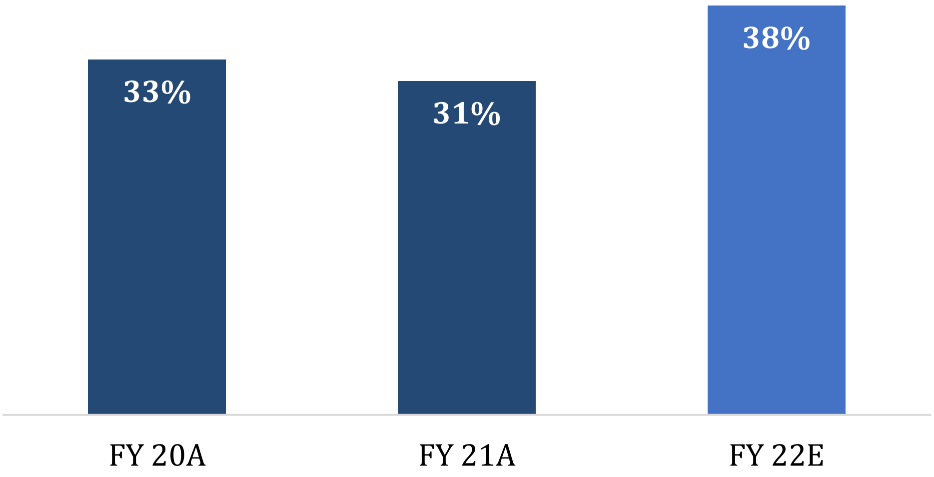
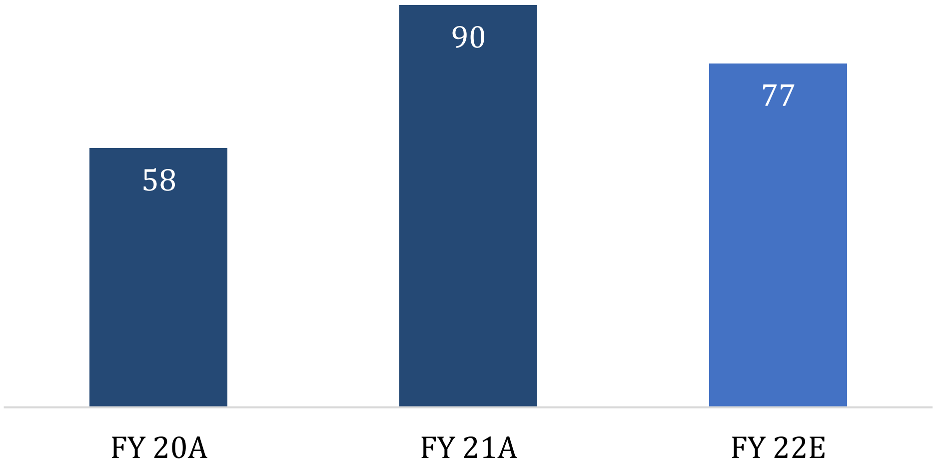
BANGALORE P14 + CHENNAI P31 + MYSORE P32

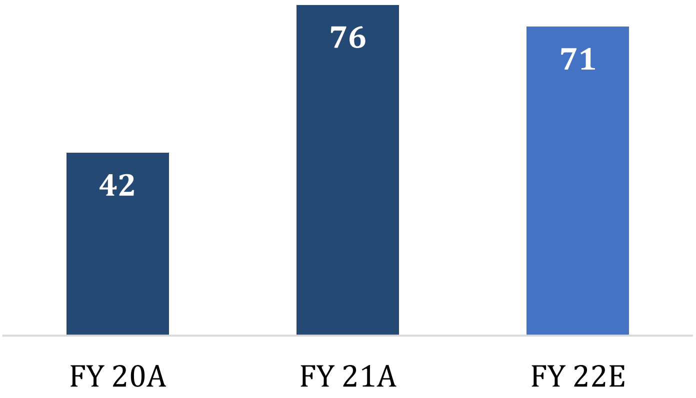
3 year ROCE trend



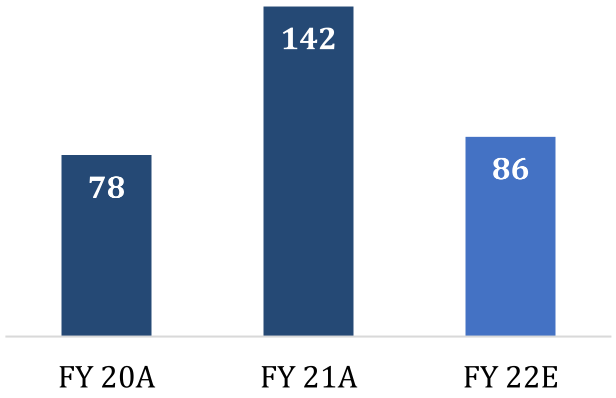
Net Working Capital Days



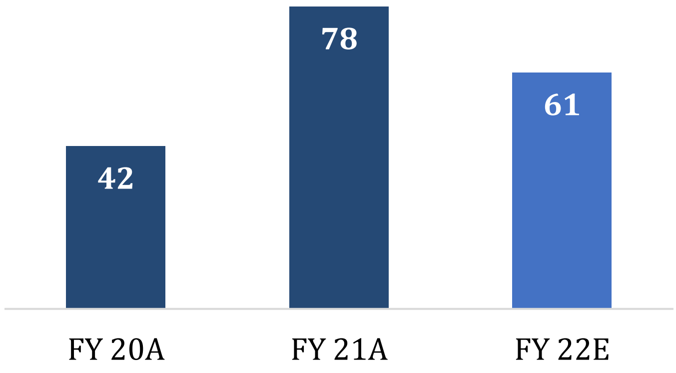
Debtors (Days)



Inventory (Days)



Creditors (Days)

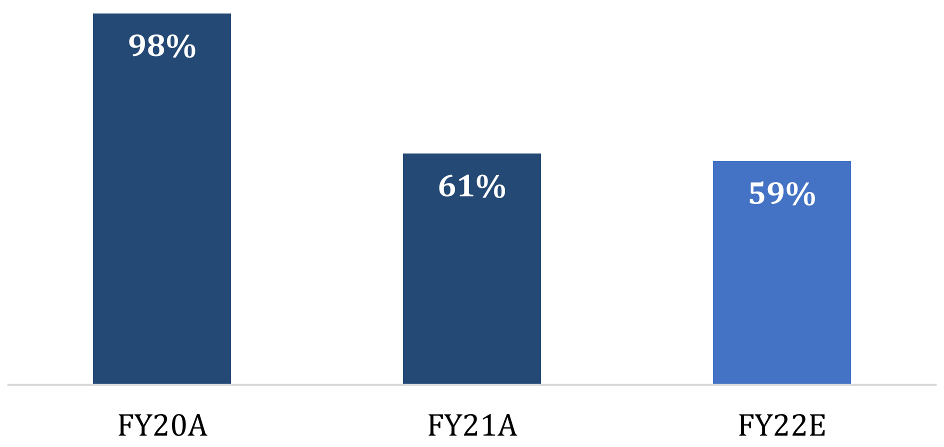


ROCE Analysis FY22E vs FY21A

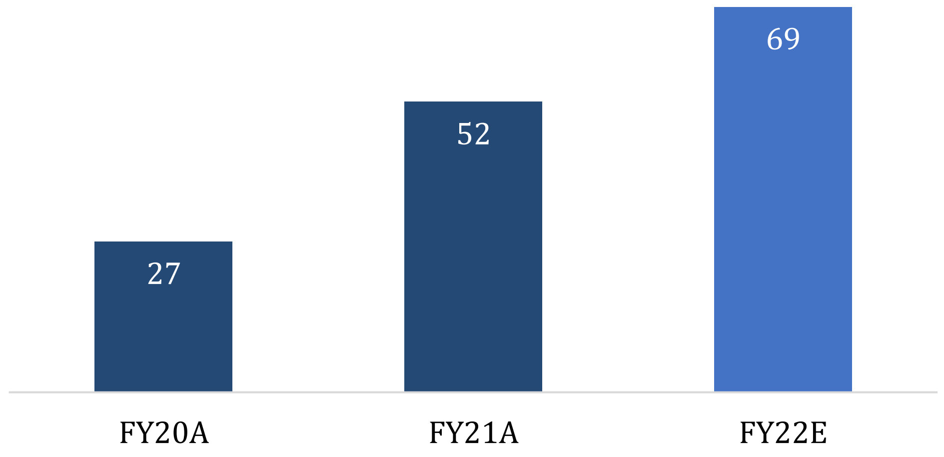
- Sales growth of 31%
- EBITDA margins flat
- Reduction in NWC days by 13 days or 15%
- **Result - significant increase by 730 bps in ROCE**

GUJARAT P18

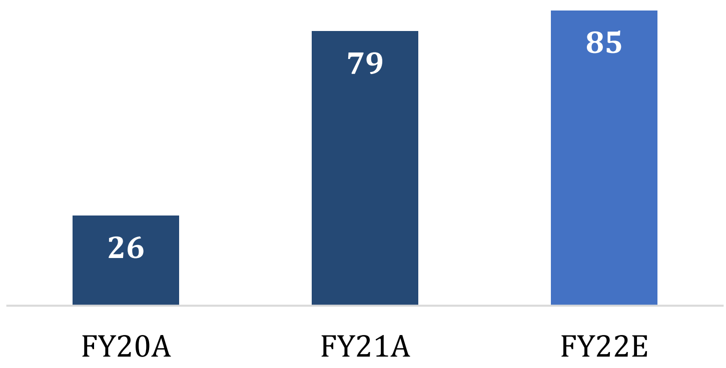
3 year ROCE trend



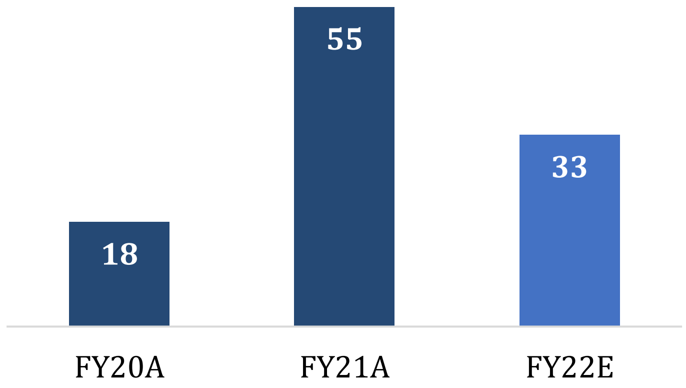
Net Working Capital Days



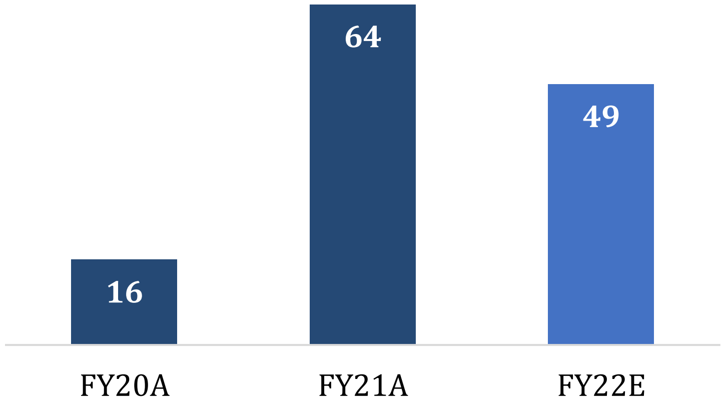
Debtors (Days)



Inventory (Days)



Creditors (Days)



ROCE Analysis FY22E vs FY21A

- Sales growth of 16%
- ~ 70 bps expansion in EBITDA margins

- Increase in NWC days by 17 days or 33%
- **Result - decrease by 140 bps in ROCE**

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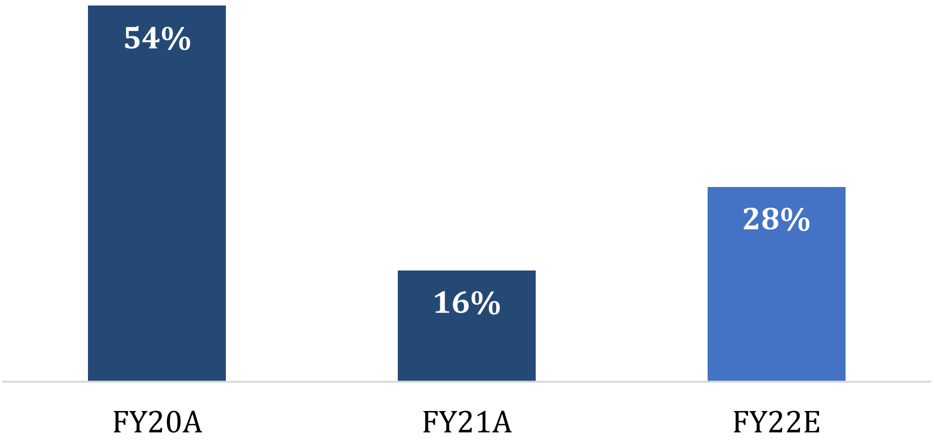
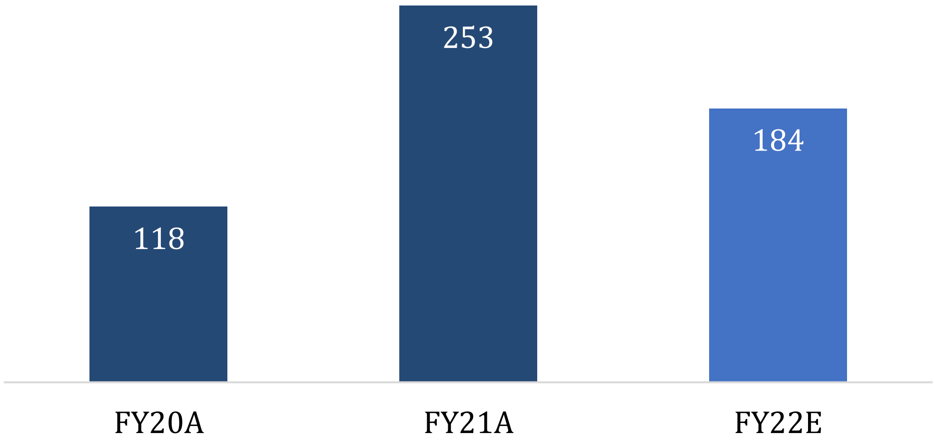
BAWAL P22 + NOIDA P26

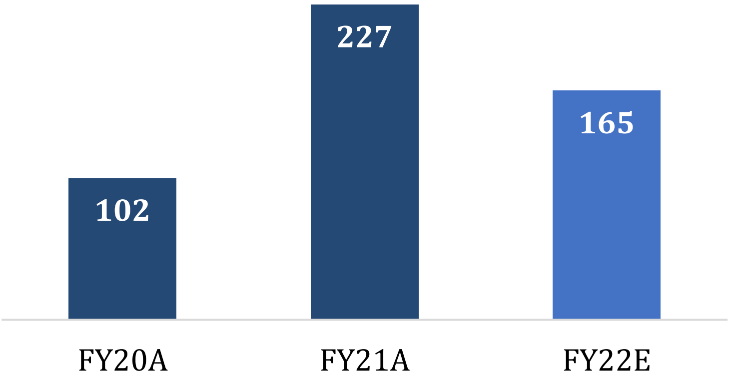
3 year ROCE trend



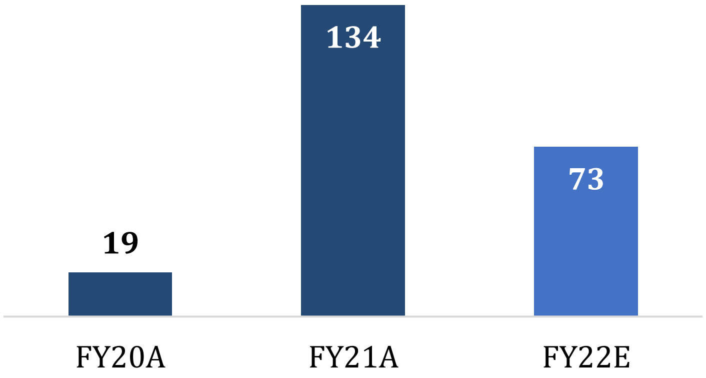
Net Working Capital Days



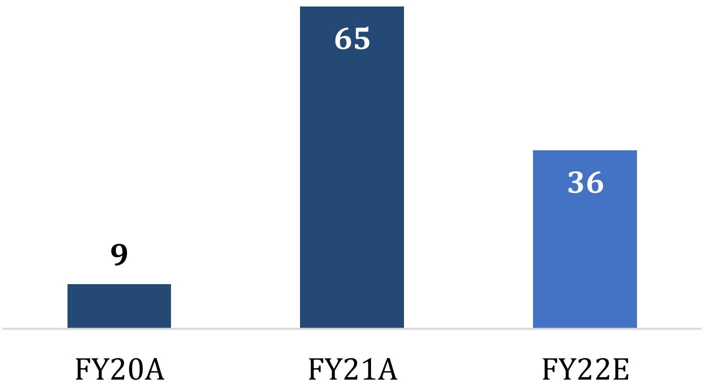
Debtors (Days)



Inventory (Days)



Creditors (Days)



ROCE Analysis FY 22E vs FY 21A

- Sales growth of 35%
- 530 bps expansion in EBITDA margins
- Reduction in NWC days by 70 days or 27%
- **Result - significant increase by 1210 bps in ROCE**

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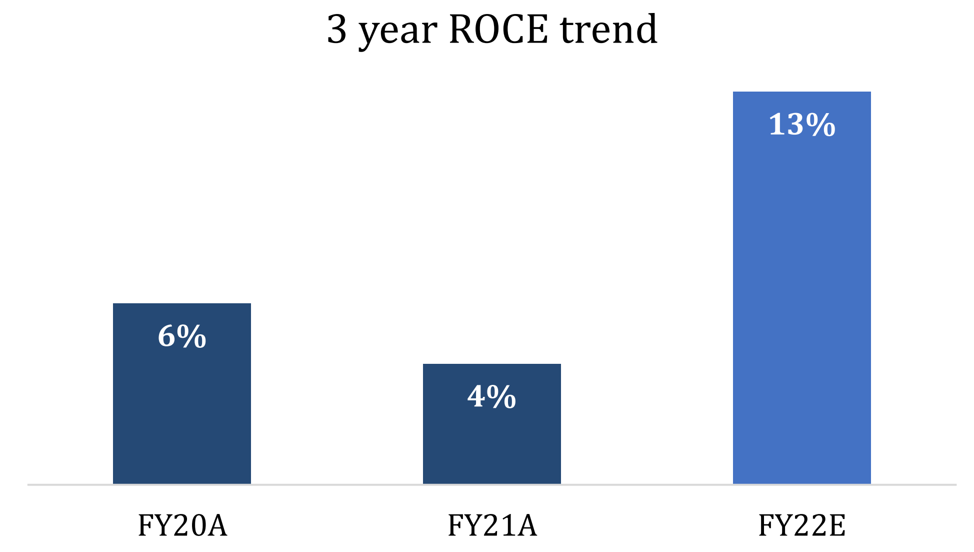
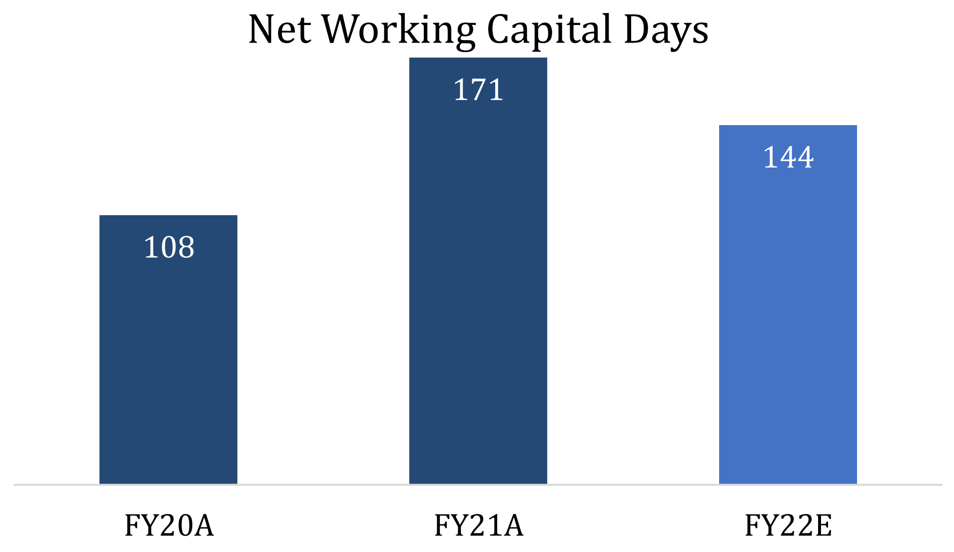
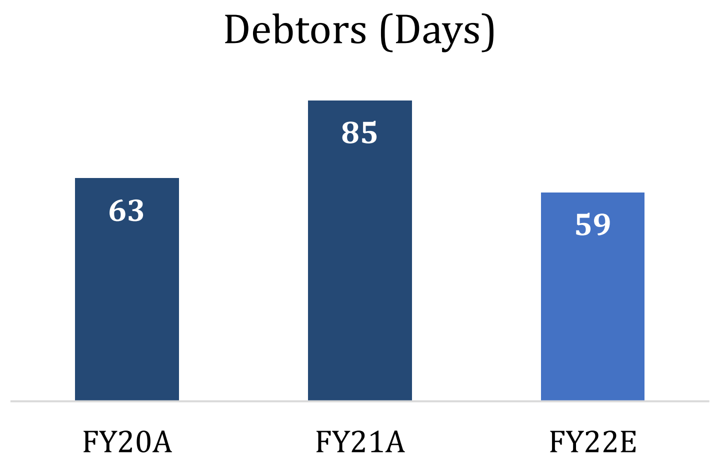
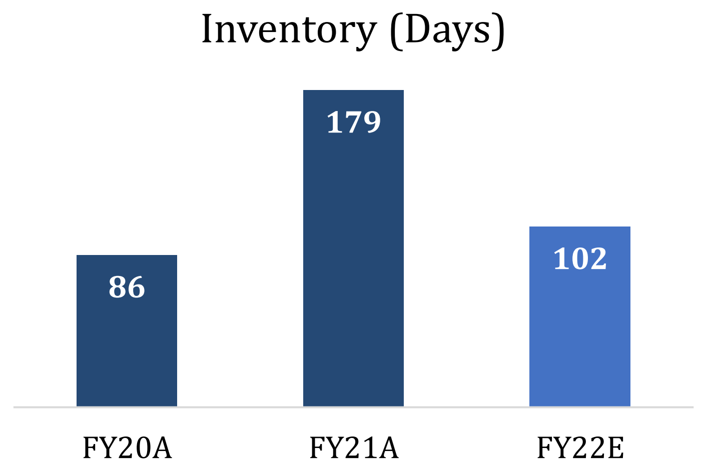
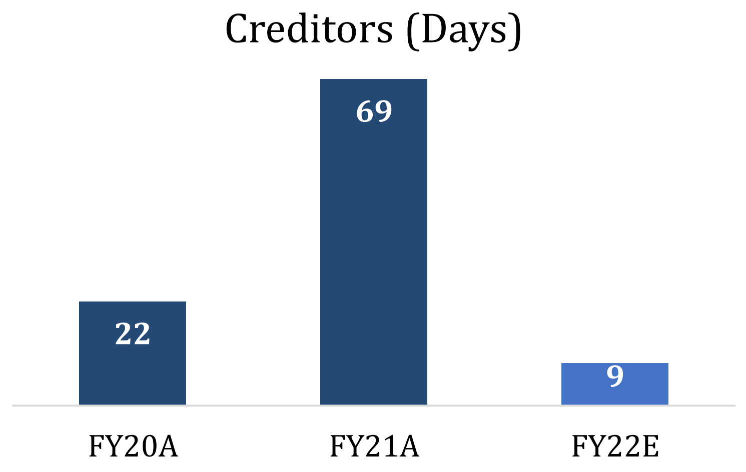
INDONESIA











ROCE Analysis FY22E vs FY21A

- Sales growth of 45%
- EBITDA margin > 2x to ~9.5%
- Reduction in NWC days by 27 days or 16%
- **Result - significant increase by 890 bps in ROCE**

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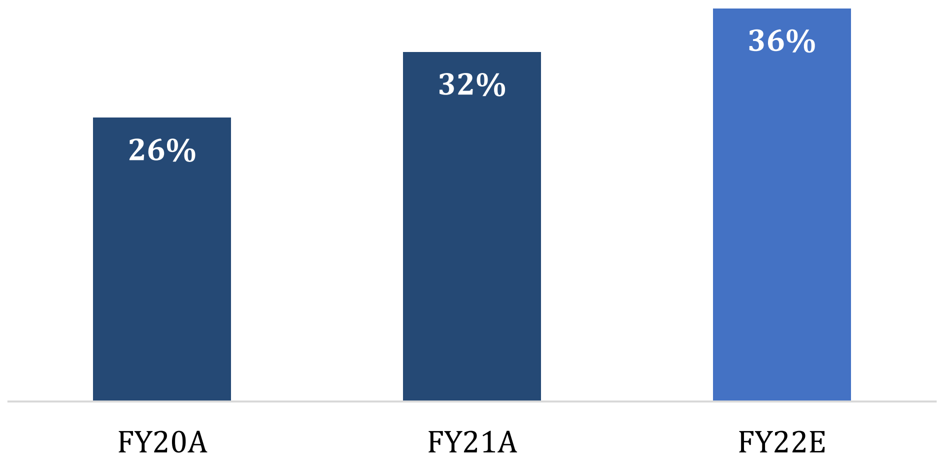
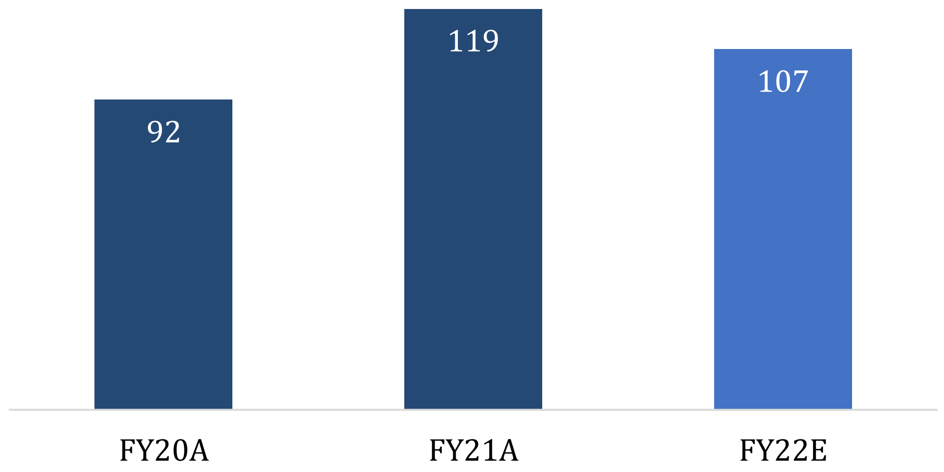
BU1 - Summary

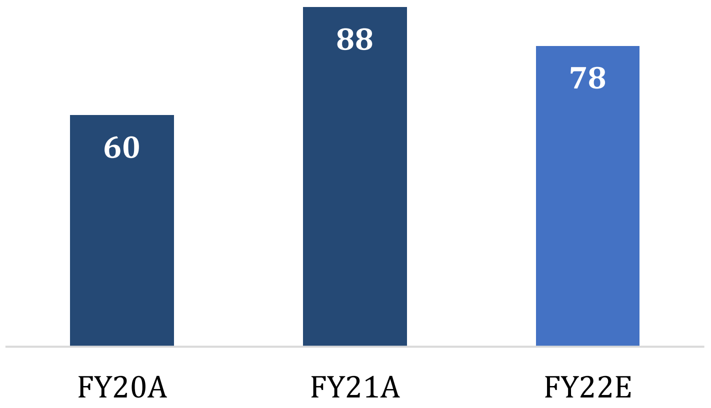
3 year ROCE trend



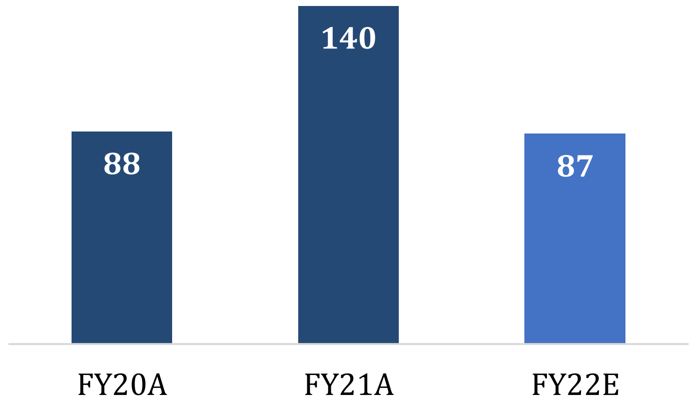
Net Working Capital Days



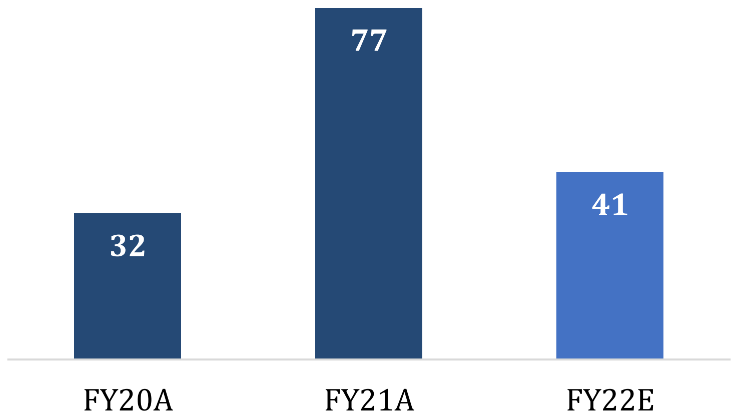
Debtors (Days)



Inventory (Days)

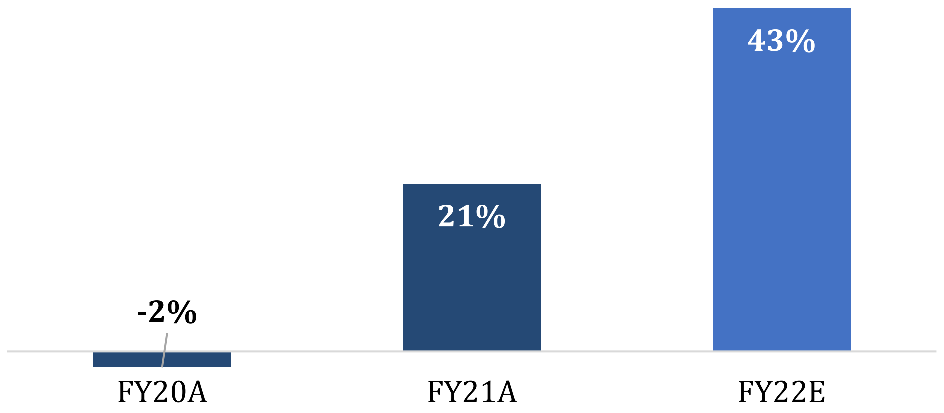


Creditors (Days)

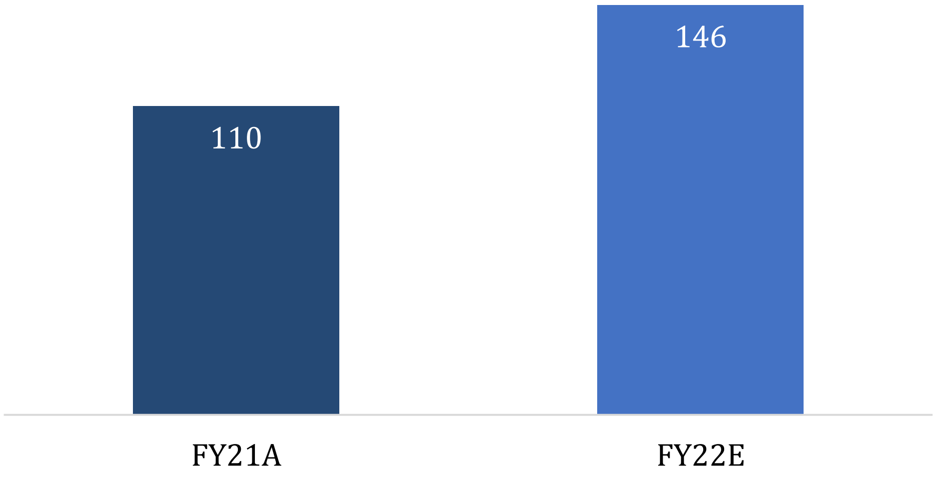


WASULI P34

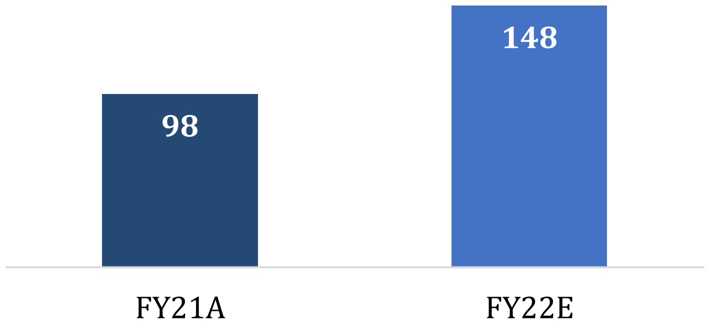
3 year ROCE trend



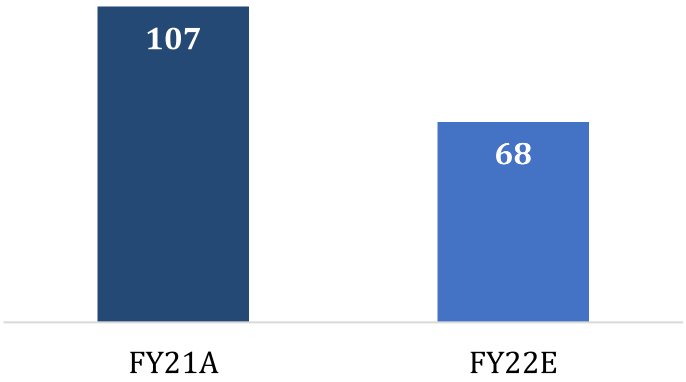
Net Working Capital Days



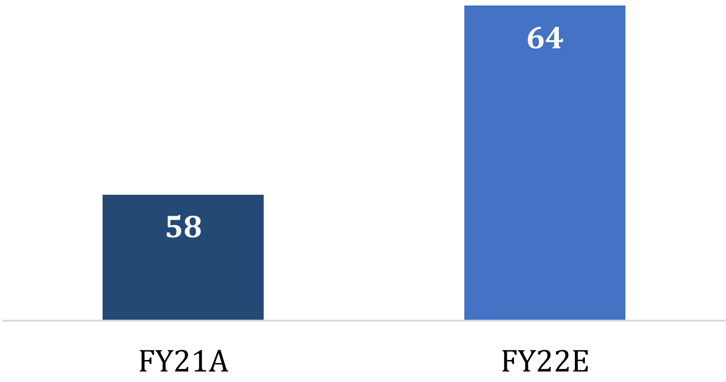
Debtors (Days)



Inventory (Days)



Creditors (Days)

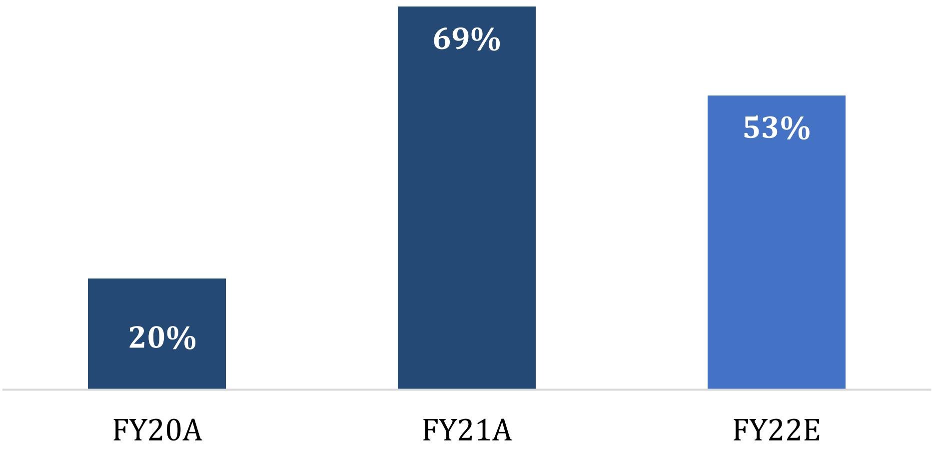


ROCE Analysis FY22E vs FY21A

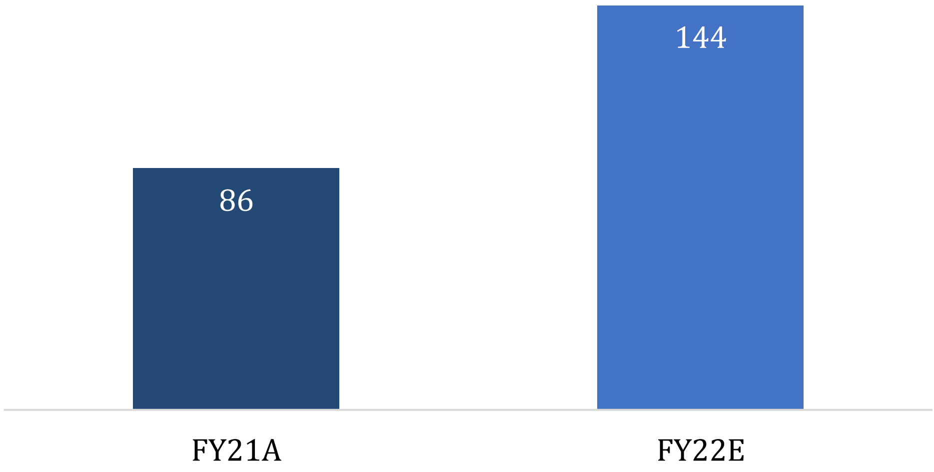
- Sales almost doubled
- Margins expanded to ~37% vs 25% in PY
- Increase in NWC days by 36 days or 33%
- **Result - ROCE more than doubled to 43%**

WASULI P36 + BAWAL P37

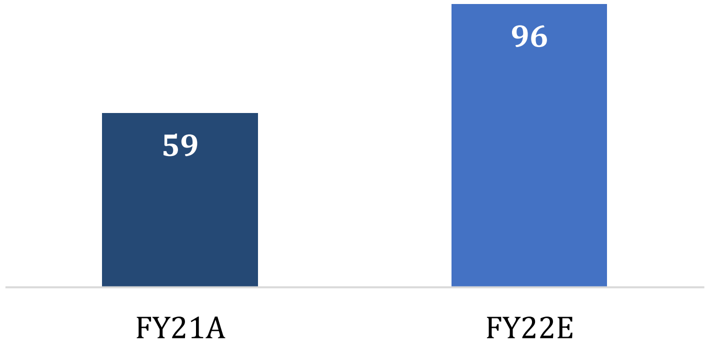
3 year ROCE trend



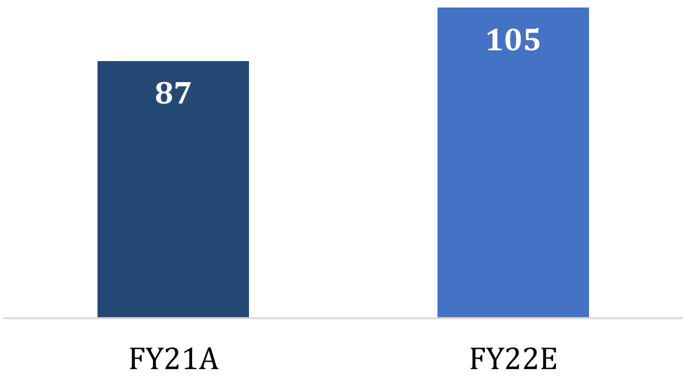
Net Working Capital Days



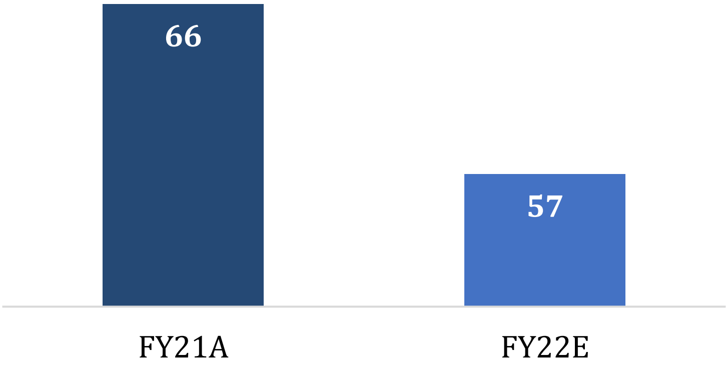
Debtors (Days)



Inventory (Days)



Creditors (Days)



ROCE Analysis FY22E vs FY21A

- Sales de-growth of 24%
- EBITDA margin expanded marginally by 70 bps
- Increase in NWC days by 60 days or 69%
- **Reduction in ROCE by 1630 bps to 53%**

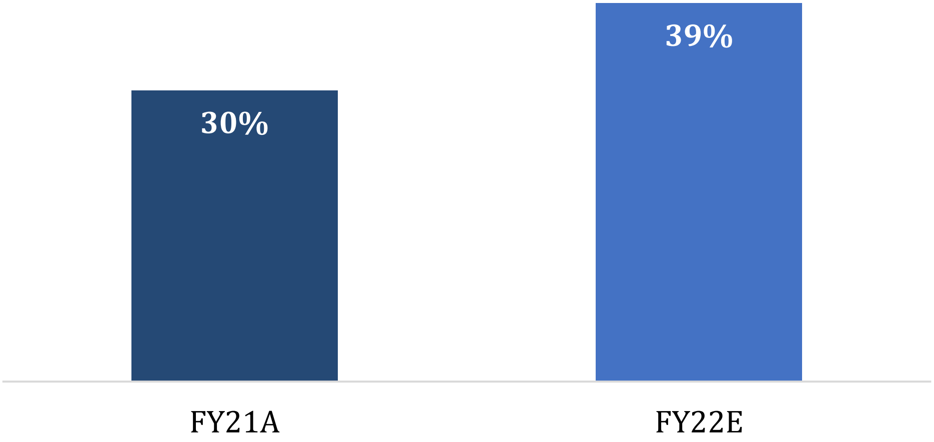
HANON

FY – 2022E

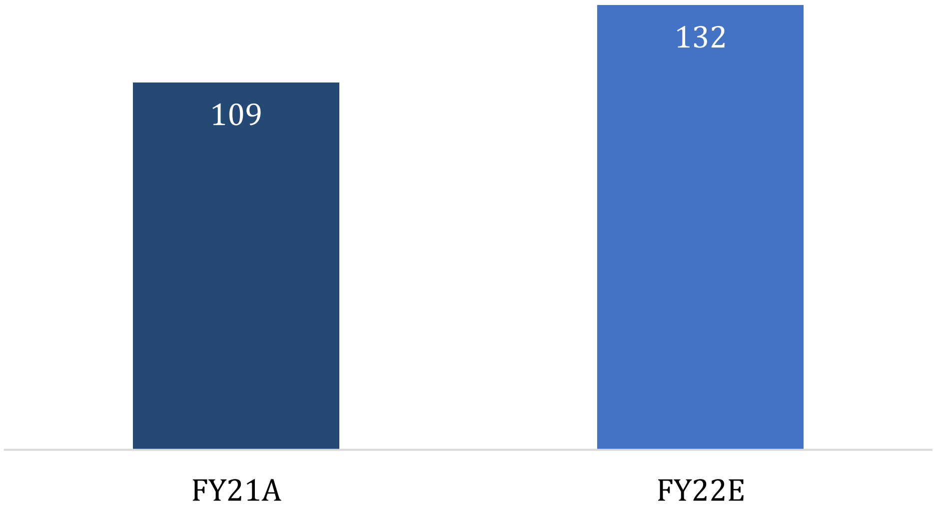
Details	Data
ROCE	17%
Net Working Capital Days	*73*
Debtors(Days)	96
Inventory(Days)	105
Creditors(Days)	57

BU2 Summary

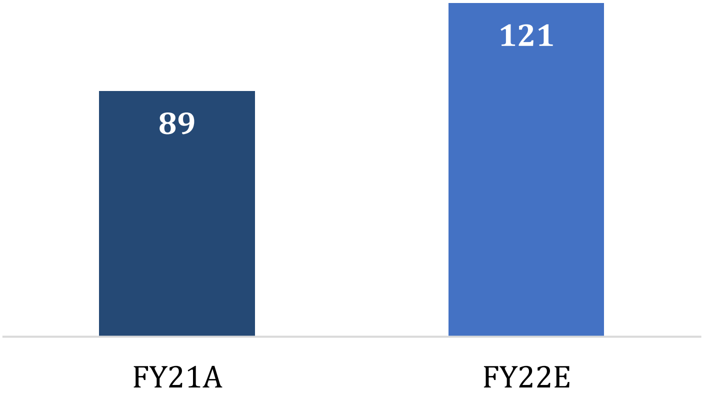
3 year ROCE trend



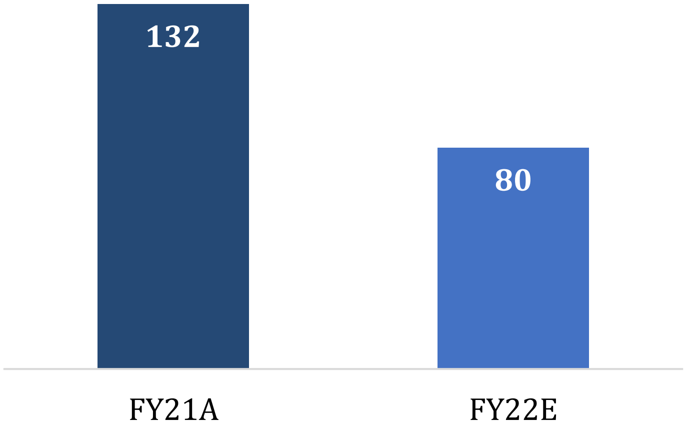
Net Working Capital Days



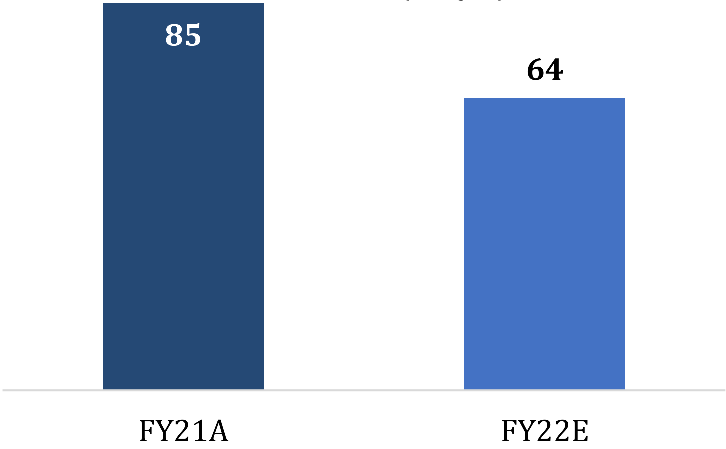
Debtors (Days)



Inventory (Days)

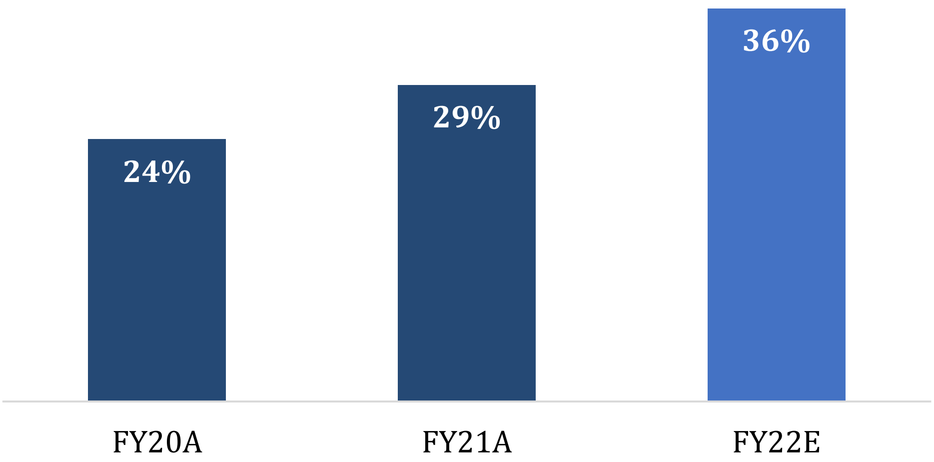


Creditors (Days)

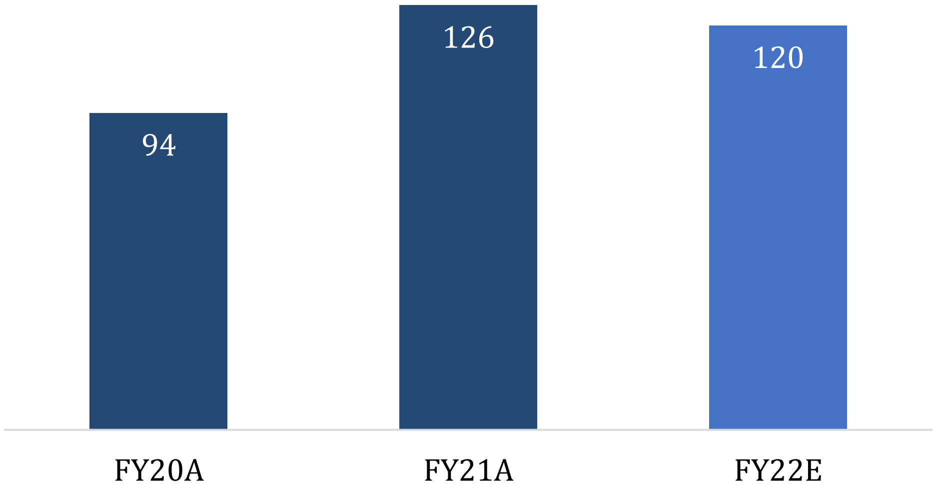


APEX

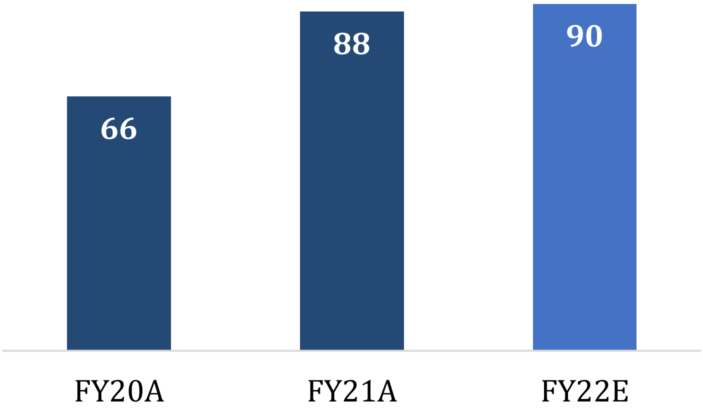
3 year ROCE trend



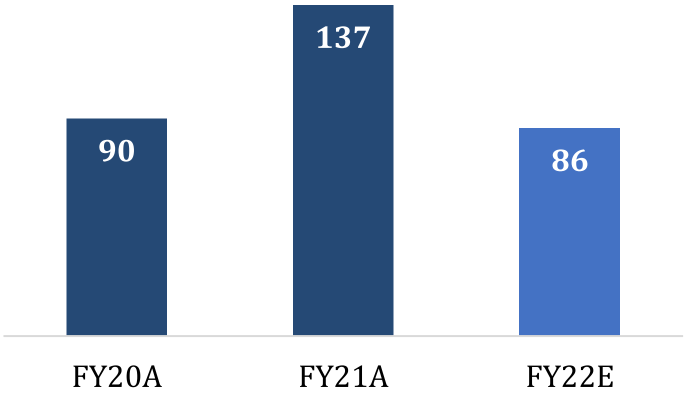
Net Working Capital Days



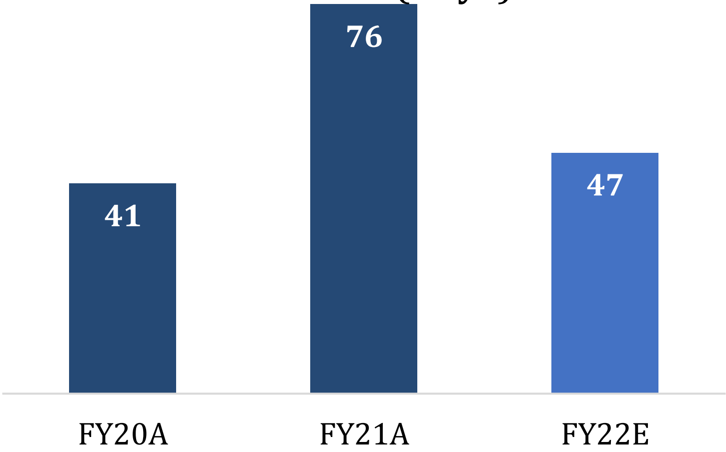
Debtors (Days)



Inventory (Days)



Creditors (Days)



Thank you

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Disclaimer

SSD allocation

	19-20	20-21	21-22
Plant 5 EBITDA	(2,189)	(1,493)	(543)
Amount to be allocated	**(2,189)**	**(1,493)**	**(543)**
50% Based on GP	(1,095)	(747)	(272)
50% Based on Gross block	(1,095)	(747)	(272)
Total GP (excl. Pass through sale)	15,838	25,094	14,857
Total Gross block	24,721	26,086	27,116
Total amount allocated	(2,189)	(1,493)	(543)
BU1 allocation	**(2,015)**	**(1,147)**	**(366)**

ANNEXURE 2

Wasuli Asset Split

Land & building				
	19-20	20-21		
Gross block at Wasuli location	3,083	4,315	Gross block taken as per	
BU1 allocation	1,541.39	2,158	50%	Splitting as per Policy doc
BU2 Allocation	1,233.11	1,726	40%	
SSD	308	432	10%	

20-21	BU1		BU2		SSD				
Plant level adjustments	Plant 1	Plant 15	Plant 34	Plant 36	Plant 35	Total	BU1	BU2	SSD
Gross block		9,177	4,779	613	21	14,589	18,542	5,392	359
CWIP		299	25	-	-				
Existing Land & Building gross block	28	2,793	1,014	-	480	4,315			
Adjustment		(635)	712	-	(49)		(635)	712	(49)

ANNEXURE 3

Abbreviations	
EBITDA	Earnings before Interest, Tax , Depreciation and Amortisation
EBIT	Earnings before Interest and Tax
ROCE	Return on Capital Employed
AR	Accounts receivable
AP	Accounts payable
RMC	Raw Material Consumption
COGM	Cost Of Goods Manufactured
WDV	Written Down Value (After depreciation / net of impairment)
GVA	Gross Value Added (Sales – COGM)
SSD	Shared Service Division
WH	Warehouse
KPI	Key Performance Indicator
TBD	To be decided
Forex	Foreign Exchange

Back up slides

Net Fixed Assets + Net working capital Approach (Including interplant balances)

ADVIK

Inclusions

- Tangible Fixed and Intangible Assets (WDV) + Capital Work in Progress
- Current Assets :
  - Inventories
  - Sundry Debtors
  - Interplant transfers (receivable)
  - Loans and Advances (Adv Tax, Deposits, other current assets)
- Current Liabilities:
  - Sundry Creditors
  - Interplant transfers (payable)
  - Duties and taxes payable, Outstanding expenses

Exclusions

- Cash and Bank balances excluded from calculation of working capital
- Short term borrowing which are usually classified as current liabilities
- Current maturities of long term borrowings

Pros

- Plant level ROCE more accurate and in line with company wide ROCE
- Limited adjustments needed for ROCE calculations outside the books
- AR/AP for interplant Sale and purchase transactions will get factored into the ROCE
- Retained Earnings of respective Plant indirectly captured in Capital Employed calculations through Interplant balances
- Holistic approach where Plant is accountable for their own fund management without any indirect support from other plants and corporate (*please refer next slide)

Cons

- Levers for Interplant AR / AP, are beyond control of Plant Heads
- Customized reports and related system configuration changes would be needed to understand the break-up of the balances as per various heads (say for Inter Plant sales, Salary payments etc.)
- Could lead to dilution of the exercise - If not properly understood by Plant heads. Plant / BU Heads focus could shift from Operations management
- Monthly settlement mechanism needed to have an accurate representation of the Working capital position. This would need changes in accounting & more manpower
- Decision regarding accounting for opening accumulated interplant balances
- SSD allocation will inflate the Interplant payable balance, unless settled in cash
- Interplant balances to be bifurcated between operating and financing activities and only the former will have to be considered in this calculation (e.g. Capex funded by SSD will form part of Fixed assets & will get reduced from the working capital as interplant payable, providing incorrect ROCE)

Net Fixed Assets + Net working capital Approach (Excluding interplant balances)

ADVIK

Inclusions

- Tangible Fixed and Intangible Assets (WDV) + Capital Work In Progress
- **Current Assets** :
  - Inventories
  - Sundry Debtors
  - Loans and Advances (Adv Tax, Deposits, other current assets)
- **Current Liabilities**
  - Sundry Creditors
  - Duties and taxes payable, Outstanding expenses

Exclusions

- Cash and Bank balances excluded from calculation of working capital
- Interplant balances (payable/ receivable) excluded from Current liabilities
- Short- term borrowing which are usually classified as current liabilities
- Current maturities of long term borrowings

Pros

- Since Inter plant balances at Company level get nullified, it would be justified to exclude them (same can be considered as proxy for Cash & bank balance)
- Capex funded by SSD will get considered correctly
- Other Net working capital (i.e. excl. AR, AP, Inventory) can be factored in as per the ratio at a group level. (e.g.: It was 3 days in FY20)

Cons

- We will be monitoring an adjusted ROCE figure customised to achieve management objectives.
- ROCE nos. across different Plants will not be comparable (e.g.: Pantnagar Plant 3 has ROCE of 44% and Pantnagar Plant 9 has ROCE of 250%). However, ROCE nos. across different years at the Apex/ Group level will be comparable
- Exclusion of Interplant AR of supplying plants will inflate the respective Plant ROCE. (There seems to be no practical solution to address this)

Illustrations : Levers impacting ROCE – indicative

CAPEX

Assumptions
New CAPEX : INR 30 Crores
Existing Capital Employed = INR 100 Crores
EBITDA : INR 15 Crores
Current ROCE : 15 %

Particulars	Capex increases by 20 %	CAPEX decreases by 20 %
EBIT (INR Crs)	15	15
Revised Capex	36	24
Revised CE	106	94
Revised ROCE	14%	16%

INVENTORY

Assumptions
Inventory : INR 10 Crores
Capital Employed = INR 100 Crores
EBIT : INR 15 Crores
Current ROCE : 15 %

Particulars	Inventory increases by 20 %	Inventory decreases by 20 %
EBIT (INR Crs)	15	15
Revised Inventory (INR Crs)	12	8
Revised CE	102	98
Revised ROCE	14.7%	15.3%

As per above illustration, savings/Low spend of CAPEX and avoiding holding of excess inventory results into a growth in ROCE

FOREX TRANSACTIONS

Forex transactions

Following points were considered w.r.t forex transactions & their accounting :

- In order to consider Forex gain/loss on operating activities at Plant level, we will have to create separate EEFC accounts under each Plant
- Forward covers will have to be taken separately in each Plant
- These EEFC accounts will be used for operating activities of the respective Plants
- A separate EEFC account to be opened under SSD for financing transactions such as ECB repayment and interest payments
- However, we will need to consider the following aspects as well :
    - EEFC balance transfer can be done from one account to the other but will require additional finance charges and administrative manpower for monitoring purposes
    - In any case, there will be a deviation between budgets and actuals if the Forex rate changes. There practically doesn't seem to be a solution to address this
    - For unrealised gains/losses - All the debtor and creditor accounts open entries and respective booking rates will have to be checked and JVs be passed. Cash/ Forex in transit (i.e. customer has made payment, but not received on cut off date) will have to be monitored carefully as well.
- Considering the above, the joint recommendation is that Forex gain/loss from operating activities be ignored while computing ROCE in Phase 1. As the process evolves, we can consider incorporating it as laid out above.
- ***As per internal discussions regarding the joint recommendation, all Operational & Financial forex gains/losses will be treated as non-EBITDA expenses at Plant, BU, Apex and Group/MD level.***