Daizy Healthcare (A)

Daizy Healthcare Limited (Daizy) was one of the leading pharmaceutical firms of the country. The promoters of the company had five decades of experience in the Indian healthcare industry. The company was growing at a rapid pace. It had gone for a public issue of its shares in 1999-2000 and had recently acquired strategic stake in Italian Remedies Limited. With this acquisition, it was poised to become the 4th largest pharmaceutical company in India. It was launching new brands every year – by developing in-house formulations and by entering into joint ventures and collaborations. The Balance Sheet for the year ending March 31, 2000 is given in Exhibit 1.

During the year 2000-01, while the Indian Pharma industry grew at a rate of 8.91%. Daizy's own growth in sales was up from Rs.4,777,515 to Rs. 5,087,927* (Daizy usually sold goods on credit. The average realisation period of credit sales was 60 days). Daizy had a strategic plan of growth through subsidiaries and joint ventures. They had received Rs.590 as dividends from subsidiaries during the year. While they were expanding capacities, they had also parked a substantial amount of the public issue proceeds in investments. Daizy had received a dividend income of Rs.66,702 from investments. This amount was substantially higher than the dividends of Rs.437 Daizy had received in 1999-2000. Apart from the above amounts, the company had the following receipts:

Details	Amount (Rs)
Miscellaneous and other income	25,910
Cash discount	9,140
Rent (net of Tax deducted at source Rs.95)	553
Interest on Investments (net of tax deducted at source of Rs. 27,025)	84,449
Proceeds from Sale of Fixed Assets (Gross Value Rs.314,703, Accumulated Depreciation Rs.17,595)	287,260
Proceeds from Sale of Investments (face value Rs. 63,179)	80,771

As per the Income tax rules, the companies who were paying rent/interest withheld tax at source. Daizy had received certificates for the clients having paid these amounts.

Daizy was not only selling its formulations within the country but also had a substantial export business. The export sales were recorded at rupee value as per the prevailing exchange rate on the date of invoice. However, they often found that the actual realizations from such sale differed from the sale value due to exchange rate fluctuations. At the end of the year, if the amount was not received, it was shown as receivable at the rupee value of invoice irrespective of the exchange rate prevailing on the date of closure of books. During the year 2000-01, Daizy had received an amount Rs.4,602 as exchange gain on realization due to fall in the rupee value against the corresponding currency.

While most of the credit sales did result in realization, there were inherent risks in selling on credit. At the end of the year, the total amount receivable under the head sundry debtors was Rs. 550,022. Of this Daizy considered Rs. 9,990 to be bad debts. In addition, Rs.23,927 of the sundry debtors was considered to be doubtful as on 31st March 2001. Daizy usually made provision for the amount considered as doubtful.

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* All figures in the case are in thousands

During the year 2000-01, Daizy had made the following purchases (All purchases were paid within 60 days). On 31st March 2001, the balance of trade creditors was Rs.718,807.

Details	Amount (Rs)
Raw Materials	1,646,377
Packing Materials, stores and spares	323,636
Finished Goods	625,675

The company usually paid Central Excise duty in advance. Thus, it had an opening balance of advance Central Excise duty of Rs.65,829 at the beginning of the year. During the year, Daizy had paid in cash, a Central Excise duty of Rs. 278,020. However the actual incidence of Central Excise duty pertaining to 2000-01 was Rs.309,324. In addition there was a demand from the Central Excise department for a further tax payable to the extent of Rs.30,601. There was a similar demand of Rs.31,111 raised by the Central Excise authorities in the year 1999-2000. The company had disputed this amount with the authorities. The appeal of the company was pending before the tribunal. It was the opinion of the legal advisors of the company that this demand by the department was not tenable as per the reading of the rules and notifications.

The company incurred some additional expenses, which were all paid in cash. The details are:

Details	Amount (Rs)
Power, fuel and processing expenses	212,705
Repairs – plant and machinery	9,621
Wages and bonus	156,890
Insurance expenses	10,311
Other repairs	22,845
Rent, rates and taxes	9,540
Salaries, staff welfare and other administrative expenses	645,799
Selling and distribution expenses	452,227
Donations	13,897

The opening balance of unpaid interest was Rs.31,025. Accrued interest expenses for the year on secured and unsecured loans were to the tune of Rs.124,061. At the end of the year an amount of Rs. 1792 was due and remained unpaid, and Rs.10,592 was due to be paid in June 2001.

The other payments were made for the following items:

During the year the company had imported additional fixed assets worth Rs. 513,334 (including Rs.121 on account of devaluation of the rupee from the date of the contract to the actual date of payment). Additional Land was purchased for Rs.5,783 during the year. All these were paid for in cash. Opening balance of Land included leasehold land of Rs.8,320, which was taken on a lease in April 1995 for a period of 80 years.

The company's fixed assets also consisted of patents developed by in-house research. The policy of the company was to book all revenue expenses to the respective heads of account. However all capital expenses pertaining to R & D were recorded under pre-operative and project expenses. When the project was completed, these expenses were transferred to fixed assets and depreciated over their life. During the year, the company had incurred a capital expense of Rs. 805 in cash on such projects. Also, Rs.8,778 worth of completed projects were added to fixed assets from this head during the year.

As a part of its expansion plans, the company was building a new plant. All expenditure pertaining to this was recorded as Capital Work-in-process (C-WIP). The company spent a further amount of Rs.5,614 in cash during the year. The construction was not complete. There were no transfers from (C-WIP) to Fixed Assets.

The depreciation for the year on the entire block of fixed assets (including amortization of leasehold land, and assets purchased during the year) was Rs.143,278.

Since the company had sufficient resources resulting from the public issue the previous year, the company had retired a significant part of its debt to most of the financial institutions. At the end of the year, the company had a liability of Rs.328,719 under the head Secured Loans. Similarly the outstanding unsecured loans to financial institutions at the end of the year was Rs.142,203.

During the year Daizy made investments of Rs.1,728,255 in various securities, mutual funds and in associate and subsidiary companies. All these were paid in cash. Daizy had also given additional loans Rs.152,375 to associate companies, which was classified as Loans and Advances.

The employee benefits did not include any provision for the retirement benefits of the employees. This was to be calculated on an actuarial basis, and as per the estimates the amount pertaining to the year 2000-01 was Rs.6,102 (Balance of provisions as on 31-Mar-2000 was Rs.30,623).

Deferred revenue expenses comprised of public issue expenses of shares and debentures. It was decided that an amount of Rs.10,792 should be written off from the deferred revenue expenses for the year.

Inventory at the end of the year was as follows:

Item	Amount
Spares and Packing Materials	79,950
Raw Materials	205,359
Work-in-process	158,975
Finished Goods	399,019

It was not unusual for spares and packing materials to be damaged in the warehouse. In the experience of the company, this wastage would usually not exceed more than 2% of the entire material handled during the year. For the year ending 2001, the damages was Rs.5,925. This amount was yet to be accounted.

The total advance tax paid by the company during the year was Rs.65,840. This included payments made directly by the company to the tax department of Rs.Rs.38,720 and tax deducted at source by others who had paid directly to the income tax department. The taxation liability for the year was estimated at Rs.55,000. In addition, the returns of the previous years were assessed and the company had made provisions in excess of the assessed amount to the extent of Rs.2,519. This amount was to be adjusted.

The company had paid in cash, the dividends that were proposed in the past year in full. All the taxes pertaining to dividend distribution were also paid.

For the year, the company had decided to use the net profits in the following manner:
1. Rs. 10,724 was to be transferred to Debenture Redemption Reserve.
2. Rs. 306,670 was to be transferred to General Reserve.
3. Dividends on preference shares were to be declared.
4. Dividend on equity was proposed at a rate of 60% of the equity share capital.
5. Dividend pay out tax of 10% was to be paid to the Government on amounts payable as dividends to the equity and preference shareholders of the company. In addition a surcharge of 2% was to be paid on the dividend payout tax.

Exhibit 1

Daizy Healthcare Limited Balance sheet as at 31st March, 2000			
Particulars	**Amount(Rs in 000s)**		
Shareholders' Funds			
Share Capital			
59,541,368 Equity Shares of Rs.5 each fully paid up		297707	
200,000 12% Preference Shares of Rs.100 each fully paid up		20000	317707
Reserves and Surplus			
Capital Reserve and share premium account		3837906	
Debenture Redemption reserve		59900	
General Reserve		650000	
Balance in Profit and Loss Account		122573	4670379
Loan Funds			
Secured Loans		898456	
Unsecured Loans from Financial Institutions		1340933	
Zero interest Debentures		50000	2289389
Total			**7277475**
Fixed Assets			
Land (including leasehold land of Rs. 8,320)		33202	
Cumulative amortization of leasehold land		520	32682
Other Fixed Assets: Gross Block		2529265	
Less: Accumulated Depreciation		222744	2306521
Capital Work in Progress			240731
Preoperative and Project Expenses pending allocation			8606
Investments			100970
Net Current Assets			
Raw Material Inventory	198374		
Work in Progress Inventory	101089		
Finished Goods Inventory	328069		
Stores, Spares and Packing Materials Inventory	79409	706941	
Sundry Debtors	611242		
Less Provision for Doubtful Debts	19958	591284	
Cash and Bank Balances		3786611	
Loans and Advances		557390	
Advance Central Excise Duty Paid		65829	
Total Current Assets, Loans and Advances		5708055	
Current Liabilities and Provisions			
Trade Creditors	917376		
Interest Payable	31025		
Provision for Taxation	7541		
Provision for Retirement Benefits	30623		
Provision for Payment of Dividend and tax on Dividend	155701		
Total Current Liabilities		1142266	4656789
Miscellaneous Expenditure to be written off:			
Deferred Revenue Expenses			22176
Total			**7277475**