

1

Chapter

Revenue from Operations _____

What is it?

Revenue from operations (RFO) is one of the most important part for the purpose of analysis of financial statements. The sum total of total sales (may be from manufacturing or may be from trading or may be from any other activity) throughout the year is shown as revenue from operations. The objective and the purpose of any entity is to do commercial activities and that is why the entity is being set up. Therefore, it is the RFO, which is going to make resources available for purchases of goods, payment for various expenditure on salary, power, fuel, interest etc. and also the source for repayment of loan. It can be said that it is RFO which is used to meet the day to day expenditure and also the repayment of the loan and further, cost of the investment made in the business in the form of fixed assets etc. Therefore, there has to be sufficient enough RFO which should be capable of not only servicing the entity but also sufficient accumulation of the funds after payment of the loan etc.

Revenue from operations is divided into two parts: core operating revenue and other operating revenue. Core operating revenue includes sales from the products for which a unit is established or the principal business objective. For example, in the case of an auto industry, revenue from the sales of motor cycles, scooters and components will be part of the core operating revenue, whereas sale of scrap will be part of other operating revenue.





Similarly, if the operations for which a unit has been established includes manufacturing as well as trading, then the revenue generated from manufacturing activities as well as revenue from sale of traded goods both will be considered as part of the core operating revenue. For example, if the unit is established for the purpose of processing of cloth and trading in cloth also, then the revenue generated from both the activities i.e. processing of the cloth as well as trading of cloth, will form part of the core operating revenue.

Further, if the main purpose/object of the unit is manufacturing, but if during the year, certain activities relating to trading or any other activity has been undertaken, in such a case, the revenue generated from trading or such other activities will form part of the other operating revenue and cannot be considered as part of core operating. For example, in the case of a steel manufacturing unit, wherein the object was to manufacture steel by setting up of furnace, and if certain activities relating to **purchase** of TMT bars (finished product) and sales thereof has been carried out, in such cases, the earnings from such trading will not form part of revenue from core operations, for the purpose of analysis of revenue from operations.

Therefore, to conclude, the core operating revenue will include sales of the product manufactured or traded or sales of services relating to the product/item for which the unit has been established or relating to principal business activities. For the purpose of analysis, the revenues from operations are required to be divided into -

- (a) revenue from core operating activities; and
- (b) revenue from other operating activities,

as it is important and relevant to know how much is the revenue from operations pertaining to core operating activities and other operating activities.

Do you know?

The aggregate amount of revenue from operations needs to be disclosed on the face of the statement of profit and loss as per Schedule III to the Companies Act, 2013.

General instructions for the preparation of statement of profit and loss, as provided in **Schedule III, require that revenues from operations are to be separately disclosed in the notes, showing separately the revenue** from:

- (a) Sale of products (including taxes such as GST etc.);
- (b) Sale of services; and



(c) Other operating revenues.

However, as per the guidance note on value added tax (VAT), the VAT, sales tax, goods and services tax (GST) and service tax are collected from the customers on behalf of the relevant authorities and, therefore, its collection from the customers is not an economic benefit for the enterprise and it does not result in any increase in the equity of the entity. **Accordingly, these taxes are not required to be recorded as revenue of the entity and revenue should be presented net of taxes since such taxes do not form part of the income.** At the same time, the payment of such taxes should not be treated as an expense in the financial statements of the company, as the same are paid against the collection made.

For the purpose of analysis, all taxes collected such as GST (earlier excise, VAT, service tax etc.) are required to be excluded and only the net revenue collected should be considered for the purpose of analysis.

Why is it important?

Revenue generated from core operating activities is one of the most important parts of the analysis of statement of profit and loss. It is this revenue, which is going to generate value for the entity. The value generated has to be sufficient to meet the costs of various expenses and provide support for further expansion and development. This will be possible only if the quality of the revenue generated is sustainable. Such revenues will bring value to the entity and are the result of a successful business model. Any business model which does not generate sustainable growth is likely to fail and therefore, analysis of revenue from operations is crucial for overall analysis of financial statement.

The revenue generated from other operating activities is equally important as the business process/manufacturing process, sometimes, is of such nature, which gives rise to other operating revenues. Thus, other operating revenue is normally linked to core revenue operating activities and sometimes the both are inseparable. **In such cases, revenue from such activities, which is not directly from core operating activities, but follow as a result of core operating activities, must be shown as other operating revenue.** For example, in the case of an auto manufacturing unit, stainless steel strips, nickel etc. are purchased as raw material which are used to manufacture motor cycles, scooters etc. In the process, scrap is generated and therefore, the sale of scrap in such entity is a part of other operating revenue, and not other income, as in the case of other entity.



Whether a particular income constitutes other operating revenue or other income is to be decided based on the facts of the case and detailed understanding about the principal activities of the entity. For example, in the case of export of goods, export price is determined keeping in mind export incentives and therefore, export incentive is a part of other operating revenue.

It is the nature of core operating activities, which is relevant to decide what can be considered as other operating revenue. However, the same may include -

- (a) sale of scrap
- (b) sale of by-products
- (c) misc. sales
- (d) trading sales
- (e) subsidy
- (f) duty drawback
- (g) insurance claim
- (h) other claims
- (i) export incentives
- (j) sales tax or any other incentive

How to analyse to unlock?

In order to find out what is hidden in portrayal of revenue from operations, these given steps are to be followed to decode the same:

Steps:

1. Which are the products/items, in which entity is primarily engaged? This can be determined on the basis of investment in plant and machinery and other assets as well as discussion in the director's report.
2. What is the break-up of product-wise sales?
3. Are there sufficient sales from the core operating activity or the products or the products for which an entity is established?
4. Does such sale of products or revenue from operations include any other sale, which is not related to principal or core operating activities?
5. Does revenue from operation include any revenue from ancillary revenue generating activity?



6. Find out how much revenue is from core operating activities and other than core operating activities.
7. Do revenues from operation include any taxes such as GST, Excise, VAT etc. collected on behalf of government?
8. If answer is yes, to step No.7 above, exclude the same (such amount of taxes are separately disclosed or not available to be taken from entity).
9. Compare the net core operating revenue and other operating revenue, as compared to earlier 2 to 3 years, to find out the trend.
10. What is the quantity of sales (as real analysis is on the basis of quantity and not in terms of value, due to fluctuations in sales rate due to change in raw material cost, purchase cost etc.)
11. Are the sales in terms of quantity increasing, maintained or decreasing?
12. Is the growth in sales is temporary or sustainable in long term?
13. Analyse the trend with respect to any major expansion by the entity.
14. Compare the trend with respect to general industry trend.
15. If other operating revenue is substantial, compare the same with overall PBT and PAT.
16. If there are different products, analysis of each product needs to be done, to find out which activity is giving better quality of earning.

Case Analysis-1

This case analysis pertains to a leading pharmaceutical manufacturing company – Strides Arcolab Ltd., which is a listed company having market capitalization of ₹ 2.65 thousand crores. As revenue from operations is very important in a pharma company and since, there are different types of revenues involved in a pharma company and further the method of recognising revenue is also equally important therefore, to explain various issues involved therein, this case analysis (though is pertains to year 2010) has been selected. The statement of Profit and loss is given in Box 1:

BOX 1

PROFIT & LOSS ACCOUNT

(₹ in million)

Particulars	2010	2009
Income		
Total Sales and Services	5,046.38	7,694.42

(Box Contd.)

*(Box 1 - Contd.)*

Particulars	2010	2009
Other Income	248.06	131.50
Total	5,294.44	7,825.92
Expenditure		
Material Consumed	3,015.41	4,473.36
Increase/(Decrease) in Stock	(78.54)	(119.86)
Personal Cost	525.51	836.60
Operating and Other Expenses	884.63	1,367.01
Finance Charges	420.77	598.03
Total	4,767.78	7,155.14
Profit Before Depreciation, Exceptional Items & Tax	526.68	670.78
Depreciation	150.82	226.85
Profit Before Tax & Exceptional Items	375.84	443.93

Analysis

- ◆ On the plain reading of above, it is clear that, the revenue from operation in 2010 has declined from 2009 by ₹ 2,648 million. The same is down by 34%.
- ◆ PBT has also declined from ₹ 444 million in 2009 to ₹376 million in 2010. The fall in PBT is about 15%.
- ◆ In 2010, on a total sales and service of ₹5,046 million, the PBT is ₹375 million, which is about 7%.

For the purpose of analysis of sales (i.e. revenue from operations), as explained hereinabove “How to analyse to unlock”, the break-up of the revenue from operations requires to be looked into. The relevant details as provided in the various schedule are abstracted as per Box 2.

BOX 2

(₹ in Million)		
Particulars	2010	2009
Schedule I - Sales & Services		
(a) Sale of products [including Sale of Traded Goods ₹1,063.70 Million (P.Y. ₹1,077.94 Million)]	4,313.92	6,826.73
Less : Excise Duty on Domestic Sales	14.36	25.31
Net Sales	4,299.56	6,801.42

(Box Contd.)



(Box 2 - Contd.)

Particulars	2010	2009
(b) Development Income	609.68	834.01
(c) Contract Manufacturing Services	32.43	48.05
(d) Export Licenses & Incentives (net)	6.79	10.94
(e) Share of Profit on Sale of Products	97.92	-
Total	5,046.38	7,694.42
Schedule J - Other Income		
Other Income (Refer Note B 27, Schedule P)	248.06	131.50
Total	248.06	131.50
Schedule K - Materials Consumed		
Opening Stock	628.56	
Add: Merger Adjustment (net)	-	
Add: Purchases [including Purchase of Traded Goods ₹646.06 Million (P.Y. ₹814.27 Million)]	3,274.92	
Less: Stock Transferred on Account of Transfer of Business	-	
Less: Closing Stock	<u>888.07</u>	
Total	3,015.41	4,473.36
Schedule L - Increase/(Decrease) in Stock		
(i) Opening Stock	87.79	88.80
Work in Process	238.68	128.81
Finished goods	326.47	217.61
(ii) Merger Adjustment		-
Work in Process	-	1.61
Finished goods	-	84.61
	-	86.22
(iii) Stock transferred on Account of Transfer of Business		
Work in Process	-	50.03
Finished Goods	-	47.20
	-	97.23
(iv) Closing Stock		
Work in Process	160.99	87.79
Finished Goods	244.02	238.68
	405.01	326.47