# UNIVERSITI PUTRA MALAYSIA

### *FINANCIAL ANALYSIS OF PERFORMANCE OF AGRIBUSINESS FIRMS LISTED ON THE KLSE*

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**FINANCIAL ANALYSIS OF PERFORMANCE OF AGRIBUSINESS FIRMS LISTED ON THE KLSE**

By

**ILMAS ABDUROFI**

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia, in Fulfilment of the Requirements for the Degree of Master of Science**

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# FINANCIAL ANALYSIS OF PERFORMANCE OF AGRIBUSINESS FIRMS LISTED ON THE KLSE

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### September 2014

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Agriculture in Malaysia is one of the potential sectors that contribute to the country's Gross Domestic Product (GDP). Since the declining trend of agriculture sector, Malaysian Government plan (2012) focuses on developing the country's agricultural sector by providing various forms of support and schemes in encouraging investments. Many agribusiness firms that are registered in the Malaysian capital market are hoping to achieve good results by acquiring tremendous capitals since an improved company performances relate positively to stock returns. There are numbers of variables that contribute to the effect of the stock returns between using technical and fundamental analysis. Financial ratio variables, as one of fundamental analysis, involves the construction of the ratios using specific element from financial statements in ways that help identify the strengths and weakness of the firm and also may predict the stock return. Many researchers investigated the relationship between financial ratios and stock return that indicate the connection between financial ratios and stock return is normally related. Nevertheless, some of the researchers found that the connection sometimes is not existed. The objectives of this study is to analyze the effect of financial ratios on the return of agribusiness stocks, investigate the performance of Malaysian agibusiness sectors, determine the industry ratios of agribusiness firms and compare the effect of financial ratios between the total stock return and capital gain. The financial ratios on this study consist of Dividend Yield (DY), Earning Yield (EY), Book-to Market (BM), Debt-to Equity Ratio (DER) and Return on Asset (ROA).

The research focused on agribusiness firms in Bursa Malaysia or Kuala Lumpur Stock Exchange (KLSE). The data used quantitative data, that is, secondary data on financial statements and stock price from agribusiness firms in the Malaysian Stock Exchange Statistics from 2006 to 2012. The process of collecting data was filtered by using six criterias that employed 40 agribusiness firms. Panel data regression techniques was conducted to estimate the relationship between the independent and dependent variables using data analysis and statistical software. The study also applied generalized least squares (GLS) and ordinary least square (OLS) method to

correct set of covariance t-statistic and tackle the heteroskedasticity and non-normality distributed residuals. The findings showed that, the overall agribusiness performance in terms of profitability, leverage and market ratios was fluctuated from 2006 to 2012, where there are significant difference performance between the period 2006-2008 and the period 2009-2012. Next, the value of agribusiness industry ratio from variable DY, EY, BM, DER, and ROA are 3.98%, 9.36%, 1.3, 0.7, and 8.95% respectively. Furthemore, the study found the evidence that the individual financial ratios as DY, EY, BM and ROA are able to predict future total stock return and capital gain, where the result has the similar findings from the previous researchers that the BM variable contributed as the highest predictive power and the combination of the financial ratios had significant predictability to forecast future total stock return and capital gain, also enchanced the predictive power to explained those dependent variables. Eventually, the total stock return and capital gain had a similarity to be predicted by financial ratios, where the slight differences solely emerged through both of the slope coefficient and adjusted $R^2$. Since the differences was not outlying and imperative contribution was identical, both of the total stock return and capital gain are the proper parts of stock return theory that may accurately be predicted. In addition, as a suggestion to future investors, before investing the money, investor needs to investigate any output of company's financial ratios as a fundamental background to appraise future stock investment, since the relationship between financial ratios and stock return are correlated. Furthermore, the relation of dividend yield to stock return was negative, denoting that the firms focused solely to the long term profit by holding the firm's capitals. Hence, the study recommended that the agribusiness firms should also considered sharing tremendous dividends in the short term to attract more potential investors. Finally, the outcomes were elaborated that the capital expenditure of agribusiness firms are quitely excessive and urge the company to lend huge capital from outsider, the study also suggested the Government to create some of the agricultural policies to provide several incentives in terms of production cost or intial cost in order to reduce the company's debt.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Sarjana Sains

## ANALISIS KEWANGAN PRESTASI SYARIKAT PERNIAGAAN TANI YANG TERSENARAI DI KLSE

Oleh

## ILMAS ABDUROFI

## September 2014

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Pertanian di Malaysia merupakan satu sektor yang berpotensi dalam menyumbang Keluaran Dalam Negeri Kasar (KDNK) di negara ini. Semenjak sektor pertanian tidak menjadi trend kepada simbol kemodenan atau kemajuan, pelan kerajaan Malaysia (2012) memberi tumpuan bagi membangunkan sektor pertanian negara dengan menyediakan pelbagai bentuk skim sokongan untuk menggalakkan pelaburan. Banyak firma perniagaan tani yang berdaftar dengan pusat pasaran Malaysia ingin mendapatkan modal yang besar memandangkan syarikat mereka ini telah menyumbangkan impak positif kepada pulangan saham di dalam sektor pertanian. Terdapat beberapa pembolehubah yang boleh menyumbangkan kepada kesan daripada pulangan saham ini antaranya melalui kaedah teknikal dan asas analisis. Pembolehubah nisbah kewangan ini merupakan salah satu asas kepada analisis yang melibatkan pengunaan nisbah melalui penyata kewangan yang bertujuan mengenalpasti kekuatan dan kelemahan sesebuah firma tersebut dan ia juga boleh meramalkan pulangan saham. Ramai penyelidik membuat kajian untuk mencari samada hubungan nisbah kewangan dan pulangan saham itu berkaitan dan bergantung antara satu sama lain. Namun begitu, terdapat beberapa penyelidik gagal mencari perkaitan antara nisbah kewangan dan pulangan saham. Objektif kajian ini adalah untuk menganalisis kesan nisbah kewangan kepada pulangan saham niaga tani, menyiasat prestasi sektor perniagaan agibusines Malaysia, menentukan nisbah industri firma perniagaan tani dan bagi membandingkan kesan nisbah kewangan antara jumlah pulangan saham dan keuntungan modal . Nisbah kewangan di dalam kajian ini terdiri daripada Divedend Hasil (DY), Pendapatan Hasil (EY), Buku-ke Pasaran (BM), hutang kepada Nisbah Ekuiti (DER) dan Pulangan atas Aset (ROA).

Penyelidikan ini tertumpu kepada firma perniagaan tani di Bursa Malaysia ataupun di Bursa Saham Kuala Lumpur (BSKL). Data yang digunakan adalah berbentuk kuantitatif dan sekunder iaitu  penyata kewangan dan harga saham dari firma perniagaan tani dalam Perangkaan Bursa Saham Malaysia 2006-2012. Proses mengumpul data ini telah ditapis dengan menggunakan enam kriteria dimana 40 firma perniagaan tani terlibat. Teknik regresi data panel telah dijalankan bagi menganggarkan hubungan antara pembolehubah bebas dan bergantung dengan

menggunakan analisis data dan perisian statistik (Stata 11.0). Kajian ini juga menggunakan kaedah umum dua terkecil (GLS) dan kaedah biasa persegi (OLS) bagi tujuan membetulkan set kovarians t-statistik dan menangani heteroskedasticity dan bukan normal-reja.

Hasil kajian mendapati bahawa prestasi perniagaan tani secara keseluruhan dari segi keuntungan , hutang dan pasaran nisbah didapati berbeza dari tahun 2006 hingga ke tahun 2012 . Terdapat prestasi perbezaan yang signifikan antara tempoh 2006 hingga 2008 dan tempoh 2009 hingga 2012. Seterusnya , nilai nisbah industri perniagaan tani dari DY berubah-ubah, EY , BM, DER , dan ROA masing-masing 3.98 %, 9.36 % , 1.3, 0.7, dan 8.95 %. Selanjutnya , kajian itu mendapati bahawa nisbah kewangan individu sebagai DY , EY , BM dan ROA dapat meramalkan jumlah pulangan saham untuk masa depan bersama dengan keuntungan modalnya, dimana kajian para penyelidik sebelum ini yang berubah-ubah faktor BM menyumbang ramalan tertinggi dan gabungan nisbah kewangan juga diramal penting untuk menentukan jumlah pulangan saham masa depan dan keuntungan modal. Juga ia boleh menjelaskan pemboleh ubah bersandar. Akhirnya , jumlah pulangan saham dan modal keuntungan itu mempunyai persamaan dengan diramalkan oleh nisbah kewangan , di mana perbezaan sedikit semata-mata muncul melalui kedua-dua pekali cerun dan diselaraskan $R^2$. Sejak tiada perbezaan ketara dan sumbangan yang sama, kedua-dua jumlah pulangan saham dan keuntungan modal adalah bahagian yang betul teori pulangan saham yang mungkin tepat diramalkan. Di samping itu, sebagai cadangan untuk pelabur masa depan, pelabur perlu menyiasat sebarang pengeluaran nisbah kewangan syarikat sebagai latar belakang asas untuk menilai pelaburan saham masa depan. Tambahan pula, firma perniagaan tani juga perlu berkongsi dividen yang besar dalam jangka masa pendek untuk menarik lebih banyak pelabur yang berpotensi. Akhirnya, kajian ini juga mencadangkan Kerajaan untuk mewujudkan beberapa dasar kebijakan pertanian untuk menyediakan beberapa insentif dari segi kos pengeluaran atau kos mula-mula untuk mengurangkan hutang syarikat

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I certify that a Thesis Examination Committee has met on 12 September 2014 to conduct the final examination of Ilmas Abdurofi on his thesis entitled "Financial Analysis of Performance of Agribusiness Firms Listed on the KLSE " in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the Master of Science.

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Date: 20 November 2014

**Declaration by graduate student**

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This is to confirm that:
- the research conducted and the writing of this thesis was under our supervision,
- supervision responsibilities as slated in Rule 41 in Rules 2003 (Revision 2012-2013) were adhered to.

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| | |
|---|---|
| TSR | Total Stock Return |
| CG | Capital Gain |
| DY | Dividend Yield |
| EY | Earning Yield |
| BM | Book to Market |
| DER | Debt Equity Ratio |
| ROA | Return on Asset |
| GLS | Generalize Least Square |
| OLS | Ordinary Least Square |
| FE | Fixed Effect Model |
| RE | Random Effect Model |
| LCC | Levin-Lin-Chu Test |
| IPS | Im-Pesaran-Shin Te |
| HT | Haris-Tzavalis Test |
| BU | Breitung Unit Test |
| DW | Durbin Watson Test |
| NA | No Autocorrelation |
| NH | No Heteroskedasticity |
| KLSE | Kuala Lumpur Stock Exchange |
| GDP | Gross Domestic Bruto |

# CHAPTER ONE

# INTRODUCTION

## 1.0 General Background

The first part of this chapter discusses the theory of financial management, agricultural sector, agribusiness firms, stock return and stock market in Malaysia. Subsequently, the various purposes of financial ratios based on past literatures are explored. The specific problems on the predictability of financial ratios with stock returns in Malaysian agribusiness firms are discussed comprehensively. Later, the objectives are drafted based on the problem statement as shown. The importance of the study is then discussed in the final part of the chapter.

## 1.1 The theory of financial management

The theory of modern financial management states that a company's purpose is to maximize the wealth of its stockholders based on maximizing stock price and increasing returns on asset (Kirana, 2005). Maximizing stock price usually comes from any investments in stock market that the return of investment may augment high stock return. Increasing return on asset normally emerges when the investment of a company's asset returns swiftly in order to generate good profitability. In this case, the model of various investments can effectively raise attention and attract potential investors to participate in the firms' business.

As shareholders hold entry to a well functioning financial market, it is a rational goal to take full advantage of the wealth of shareholders. Financial markets permit shareholders to share risks and transport savings across time while providing the flexibility to administer their own savings and investment strategies, thus abandoning the enterprise's financial managers with no choice but to amplify market value.

## 1.2 Agriculture sector in Malaysia

Agriculture is the foundation of a country's economy. Agriculture contains essential product outcomes that may supply the country's food demand. Agriculture in Malaysia is one of the potential sectors that contribute to the country's Gross Domestic Product (GDP). The Malaysian agribusiness and agriculture sectors have been poised to face any challenges and tough turbulence but the sectors are still able manage and adapt into a crucial sector in Malaysia. In the era of 1984-91, Harron et al (2001) explained that the agricultural sector hold the key to essential development and transformation in the Malaysian economy and has been a dominant aspect for Malaysia's economic growth where the contribution of agriculture in the GDP constituted 28.8% in 1970 prior to the downward trend and the overtaking of

manufactures, industrial and service sectors. The decline of the agriculture sector was due to the increasing cost of farm inputs, labor shortage, and the rise of land use, favorable policy, and unreliable pricing of agricultural products. The Malaysian agricultural sector consists of several sub sectors such as oil palm plantations, forestry, fisheries, livestock, and rubber plantations. Oil palm plantations consistently play a dominant role in the agriculture sector which highly contributes to Malaysia' GDP. The results show that the fluctuation trend of the Malaysian agriculture sector (Figure 1.1).
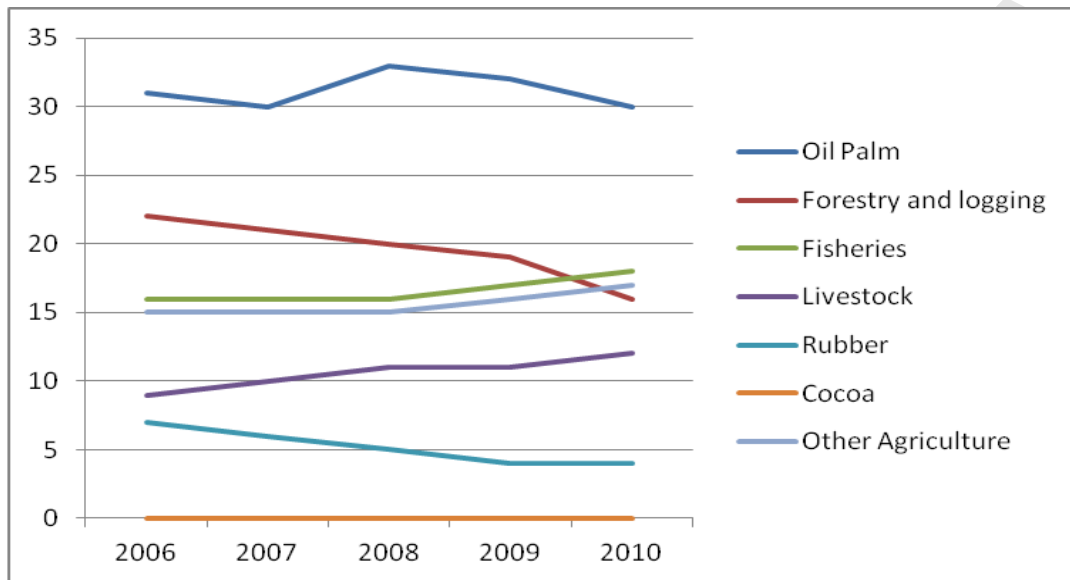


**Figure 1.1 Percentage share of GDP for the agricultural sector, Malaysia, 2006 - 2010**
Source: Department of Statistics and Government of Malaysia.

According to GDP results, the Malaysian Government should take a serious view on this phenomenon. Recently there has been a high takeover of the manufacturing sector by the services sector as the highest contributor to Malaysia's economic growth. However, the agricultural sector still has a major role to play in boosting the income of agro-based industries, farmers, fishermen, as well as make certain that the nation's food supplies stay adequate. However, if the total agribusiness sector were to be considered, the percentage of agricultural GDP will amplify to boost the total work force and employment rate in the agriculture sector. The proactive, supportive and government policies regarding the agricultural sector should be more intensive in order to haul this sector to be a trigger sector on the Malaysian economy. The figure below shows the contribution of agricultural sector to the GDP in 2012 (Figure 1.2).

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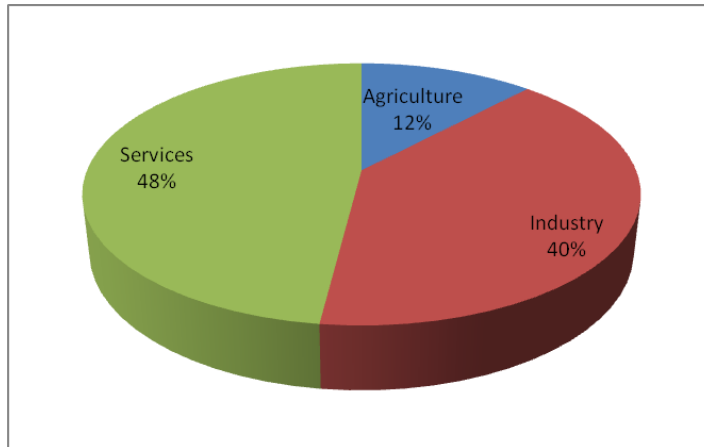
**Figure 1.2 Malaysian GDP in 2012**
Source: CIA World Factbook

Hence, due to fluctuation, the downward trend and the small percentage of the agricultural sector in Malaysia's GDP, the Malaysian Government plan (2012) stated that the Malaysian Government's intention is to shine the spotlight on developing the country's agricultural sector so it is possible to thrust as Malaysia's third engine in contributing to the growth of the economy. Various forms of support and schemes are being rewarded by the Malaysian Government in order to encourage investments. The Government is providing various. So that, the opportunity to venture and invest into agricultural business activities is wide open.

## 1.3 Agribusiness firms and capital market

Nowadays, agriculture has evolved into agribusiness and has become a complex and vast system encompassing beyond farms to embrace all companies that are involved in providing fiber and food to consumers. Agribusiness comprises of the people or firms which provide the input, process the output, manufacture food products, and transport the product to consumers. Specifically, Baruah (2012) stated that agribusiness firms are companies involved in the value chain of the agribusiness system, which is either engaged in the entire agribusiness system or solely focus on specific parts of the agribusiness chain. Agribusiness firms run a rapid transformation as new industries, obtaining larger farming operations, more specialized and highly complicated. The firms either just focus on the input system or output system. Due to complicated activities of processing in the supply chain of agribusiness firms, agribusiness firms absorb enormous labor forces and huge amount of funds. The availability of funds is essential for companies to expand their business activities, while lacking funds will drag the companies into an unstable cash flow position. In this situation, firms should be considered to acquire alternative funds. The capital market is one of many alternative methods for a company to acquire capital by associating pubic investors as business partners. Capital market is the market for trading long term securities such as ordinary shares, long term debt security unsecured loan stock and convertible bonds. Government bond and other public sector security are also traded on capital markets. In order to gain economic

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productivity, the capital market promotes partnerships in the public-private sector as a form of encouragement to attract participation of private sectors. The participation in dynamic investments and economic efficiency has shifted the powerhouse of economic growth from public to private. Effective capital market needs a good firm foundation that may create a well developed financial system to enhance macroeconomic performance (Andries, 2009). Because of the difficulty in acquiring funds, many agribusiness firms that are registered in the Malaysian capital market are hoping to achieve good results since an improved company performance may relate positively to stock returns.

## 1.4 Stock returns

The assumption of market practitioners explain about stock return is closer and simpler as the sum of the dividend yield and the capital gain also known as total stock return. Capital gain is normally active to investors who tend to create a short-term investment or being as a speculator. Capital gain is based on the change of stock price over a period as one of the predominant factors of stock return. Conversely, long-term investors hope the sake of dividend yield and total stock returns used by certain shareholders may forecast earnings per share for their investment and measure the amount investment on a common stock over a period. Essentially, stock return predictability may contribute the highest return with a lower risk that would attract investor to engage on open investment and donate a critical role to the government's economic growth (Ehrmann, 2005). In order to increase the validity of stock return predictability, more researchers and the application of various samples are needed. Karami (2013) stated that two decades ago, financial experts and economist have been trying to identify the possibility to forecast returns in the stock market. They have been sequence looking for any parameters which has capability to predict future share price as shareholder performance on stock market by a large measurement of return on investments. Futhermore, stockholders as the impressed entity on the capital market, are more likely to take risks when involving investment and trying to find any useful information in order to maximize their interest. As a result, stock returns are associated by several imperative influences of macro economy, interest rate and financial ratios derived from financial statement information.

## 1.5 The Purpose of financial ratios

There are a number of variables that contribute to the effect of stock returns between using technical and fundamental analysis. One of the fundamental analyses is using financial statements as considerable information. The financial statements contain valuable information about firm's financial and business health. One analysis of using financial statement is financial ratio analysis. This type of analysis is the most essential and oldest method that involves the construction of ratios using specific element from financial statements in ways that help identify the enterprise's strengths and weakness. Kumbirai (2010) stated that financial ratios are of high value, and

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mostly occur when the ratios are compared with other numbers and also designed to evaluate the plan of any investment and control the firm's financial performance. Subsequently, the ratios will help measure the relative performance of different financial benchmarks that characterize the firm's financial health. Chin, (2008) emphasised a good performance of financial ratios is able to increase the stock value and investment worth, so that stockholders will eventually gain in terms of higher wealth. A large number of standards and various ratios may be used when investigating a firm's financial position and its credit. Most studies apply financial ratios as an experimental nature in spite of the tendency towards theoretical approach. The main consideration behind the use of financial ratio analysis is the possibility to present financial information in the form of compact set of ratios rather than detailed and comprehensive financial statement. But in a common situation, the choice of ratios used relies on the typical activity of organization and the purpose of analysis. Thus, Financial Variables of financial ratios on this study consist of Dividend Yield (DY), Earning Yield (EY), Book Market (BM), and Debt to Equity Ratio (DER) Return on Asset (ROA). These variables are selected based on the theory linking each financial ratio on the stock returns and the outcome of previous studies.

## 1.6 Problem statements

According to the figures from Malaysian statistics and CIA World factbook, the downward trend of agriculture sector and the minimum contribution of agriculture sector in Malaysia's GDP, have urged the Malaysian Government to develop its agricultural sector by providing various supports and schemes in encouraging investments. One of the ways to encourage investments comes from a public investor. A public investor may be applied in a stock market. Normally, the public companies listed in the stock market are associated with global investors due to the anticipation of the best performance in the firm's management. Since tremendous investors have participated in the stock market, the public company may operate rapidly the viable ventures, since the adequate capitals are preserved to assist the company's goal and drag positive outcomes for the government in terms of economic growth and the role of stock market plays very significant contribution in the country's economic growth.

As an investor, predicting investment is massively essential before investing the money into a proper company. Predicting investment may be analyzed by both of the technical and fundamental analysis in the stock market. The technical analysis is one of the methods to assess a firm's health by regarding the stock trend in the graph and providing an efficient amount time. However, precise results are not always accurate. On the other hand, the method of fundamental analysis notices the firm's business health by analyzing the actual financial activities during a period of time. However, since the fundamental analysis utilizes a historical data of economic and financial background, the accuracy of the output analysis may be considerably accepted. One fundamental analysis method is by calculating the financial ratio variables to acquire company's strength, weakness and predict those ratios to the

stock return. Thus, the potential investors can review the return value of the stock investment while considering the company's financial condition.

The natural problem which has emerged is that a specific sector, the agribusiness sector industry, is not clearly assigned in the Kuala Lumpur Stock Exchange or also known as Bursa Malaysia. The agribusiness sector in Bursa Malaysia is still consolidated with other particular sectors such as, plantation, food and beverage sectors. Furthermore, literature review of fundamental analysis in agribusiness firms is not mainly presented. Thus, the problem will face a difficult standing of agribusiness firms to attract potential investors who may support the capital resources. Moreover, the Government will not maximize the opportunity to elevate the positive trends of contributing agribusiness sector in Bursa Malaysia, since investors will not focus to be part of agribusiness firms.

Moreover, the emperical studied showed evidence that the existence of stock return predictability provides significant economic consequences, where potential investors hope to get a highest return with the lowest risk (Schrimpf, 2010). Many researchers have studied the predictability of stock return among various predictors and the finding revealed that the role of financial ratios is more substantial as stock return's predictor. Among the previous studies, Fama and French (1988, 1992, 1995), Kothari and Shanken (1997), Pontiff and Schall (1998) and Lewellen (2004) documented that stock return can be strongly predicted by selected financial ratios as DY ,EY and BM. Furthermore, other researchers also disclose that connection between financial ratios and stock return is normally associated and more effective in order to cover a wide range of prediction (Kheredyar, 2011). Nevertheless, some researchers such as Chairatanawan (2008), Aono and Iwaisako (2010) also discover that the connection sometimes is not firmly related and predictability of stock return by financial ratios is still infrequent in developing market. In addition, Kim (1997) stated that the sample choice will determine stock return validity. Therefore, it will be a question for succeeding researchers to explore tightly the existing problem of stock return predictability by using the various sectors in the stock market.

## 1.7 General objective of the study

The study intends to analyze the effect of financial ratios on the returns of agribusiness stock in Malaysia that is considered by total stock return and capital gain. Hence, in order to fulfill the general objectives, specific objectives must initially be achieved. The specific objectives are as follows:

**Specific objectives**

1. To investigate the performance of Malaysian agribusiness sectors by employing financial ratios.
2. To determine the industry ratios of agribusiness firms in Malaysia.

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3. To compare the effect of financial ratios between total stock returns and capital gain

## 1.8 Significance of the study

The study will provide better understanding and knowledge about agribusiness firms, financial statements, financial ratio variables, assessments, investments, stock return and capital markets. The finding of this study will be beneficial to:

### 1.8.1 Potential investor

Information regarding financial ratios may reveal an illustration of company's financial health which may be rewarding to elaborate the strength and weakness of agribusiness firms. Furthermore, affiliations among stock returns and financial ratios may forecast prospective value of investment. Since the overall result of fundamental information may be predicted, the prospect investors will be properly considered to invest the cash into agribusiness firms without perceiving doubt.

### 1.8.2 Agribusiness Firms

In this study, calculating the financial ratio variables will be worthwhile to analyze the comparison of agribusiness firms. The results will provide an industry ratio of agribusiness firms which may be applied to address whether an agribusiness firm is in the lower value or higher value among the agribusiness firm competitors. Furthermore, the results may also attract potential investors to implant capital in the agribusiness firms. With that, the agribusiness firms will contribute positively to perform business due to tremendous capitals from the investors and without lacking resources.

### 1.8.3 Malaysian Government

If a lot of investors participated in the capital market particularly by investing huge capitals for the agribusiness companies, the agribusiness firms will have enormous resources to accelerate and concentrate on the operational activities. Since the agribusiness firms executed the management operation swiftly, the impact will boost the quality of the agribusiness industry. By expanding the essence industry of agribusiness, the apparent outcome systematically will support Government to achieve the expected goal in the agricultural sector.

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