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Equity research: Fundamental analysis for long term investment

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Abstract
Long term investment decision in capital market instrument is strongly depend on fundamental factors. The performance of the securities is also depending on the performance of the company itself. However, as companies are a part of industrial and business sector, which in turn are a part of overall economy, so that the industrial and economic factors can affect the investment decision. Fundamental analysis is essential for long term investment decisions. Fundamental analysis evaluates the economic condition, industry performance and company performance before making investment decision. Fundamental research also focuses on identifying and analyzing the factors that influence on stock prices. As per investors perspective fundamental research is important for minimize investment risk and maximize return on investment.

Keywords: fundamental analysis, investment decision, fundamental factor, investment risk, industry analysis

1. Introduction
1.1. Background
Fundamental analysis studies the core underlying elements that influence the economy of a particular entity, like a stock or currency. It attempts to predict price action and trends by analyzing economic indicators, government policy, societal and other factors within a business cycle framework. Fundamental analysis is the examination of the underlying forces that affect the well-being of the economy, industry and companies. In this analysis, the goal is to develop a forecast of future price movement and profit from it. Fundamental analysis may involve examination of financial data, management, business concept and competition at the company level. Information technology is playing an important role in India today and has transformed India's image from a slow moving bureaucratic economy to a land of innovative. The IT sector in India is generating 2.5 million direct employments. India is one of the biggest IT capitals of the modern world and all the major players in the world IT sector are present in the country. Tata consultancy Services and Infosys Technologies are selected for the further study.

1.2. Literature Review
The origin of Fundamental analysis for the share price valuation can be dated back to reports on the use by foreign exchange dealers in Hong Kong of fundamental and technical analyses to form their forecasts of exchange rate movements.
Presents the findings of a questionnaire and an interview survey on the perceived importance of Technical and Fundamental analysis among foreign exchange traders and financial journalists in Frankfurt, London, Vienna and Zurich. Foreign Exchange traders confirm that, out of both the forecasting approaches, technical analysis is more prominent than the other.
This research work envisages on Financial Statement analysis and identifies that this analysis has traditionally been seen as part of the Fundamental analysis required for equity valuation. This paper outlines a financial statement analysis for use in equity valuation.
Presents the survey which aims at providing insights about the way technical traders operate in the financial market and the trading strategies that they adopt. The survey covered institutional and individual technical traders with a long and active trading record for the

Indian market. In this study also it is observed that the sample respondents tend to use Technical analysis along with Fundamental analysis for security selection.

Jenni L., Bettman, Stephen. J. Sault, Emma J. Schultz (2008), proposes an equity valuation model integrating Fundamental and Technical analysis, they tend to recognize their potential as complements rather than as substitutes. Testing confirms the complementary nature of Fundamental and Technical analysis by showing that in spite of each performing in isolation models integrating both have superior explanatory power

Fundamental research focuses on identifying and analyzing the factors that influence security prices whereas technical analysis is solely concerned with analyzing market behavior, without concern for trying to explain it. Given the sharp differences, it is easy to understand why proponents tend to favor one over the other. The performance of the securities that represent the company can be said to depend on the performance of the company itself. However, as companies are a part of industrial and business sector, which in turn are a part of overall economy, so even the economic and industry factors can affect the investment decision.

1.3 Objectives and Limitations of the Study

- To explain how the basic tools of fundamental and technical analysis may be applied to arrive at investment decisions.
- To interpret the results of ratios and charts prepared using the above tools for selected companies.

The limitations of the study are as follows:

- The fundamental research tools are restricted by the time available and size considerations for the project.
- The interpretation of ratios and charts may vary from one analyst to another.
- The time frame for financial data used in this project is limited to 5 years (April 2011 to March 2016).

1.4 Research methodology

In the current study has made to measure financial performance, evaluate financial performance and comparison of the financial performance TCS and Infosys with the help of key financial ratios. The present study is based on only secondary data which is collected from various books, journals, annual reports of the company's quarterly financial results and various other articles & websites. The relevant data are collected from the past available financial Reports, namely balance sheet, profit & loss Account and Corresponding schedules that were made available by Yearly Review of the selected companies. The ratios for financial year have been collected & calculated. The important ratios selected for study and analysis. The study covers the period of 5 years i.e. from 2011-12 to 2015-16. In this present study, fundamental analysis and ratio analysis techniques were used to measure, evaluate and compare the selected company's financial performance. The yearly trend and movement of ratios have been presented graphically.

2. Conceptual Framework

Fundamental analysis

For stocks and equity instruments, this method uses revenues, earnings, future growth, return on equity, profit margins and other data to determine a company's underlying value and potential for future growth. In terms of stocks, fundamental analysis focuses on the financial statements of the company being evaluated. Fundamental analysis is the foundation of solid investing. It helps the investor determine the underlying health of a company by examining the business' core numbers. Shares of companies with strong fundamentals will tend to go up over time, while fundamentally weak companies will see their stock prices fall. This makes fundamental analysis especially valuable to long-term investors.

The following tools have been studied for financial performance analysis of the respective automobile companies.

1. Earnings per Share
2. Current Ratio
3. Return on Capital Employed
4. Inventory Turnover Ratio
5. Debtors Turnover Ratio
6. Gross Profit Ratio

1. **Earnings per Share:-** This is one of the important indicators of performance of a company. Earnings per share indicate the amount of profit available for distribution amongst the equity shareholders. This ratio is calculated as shown below:

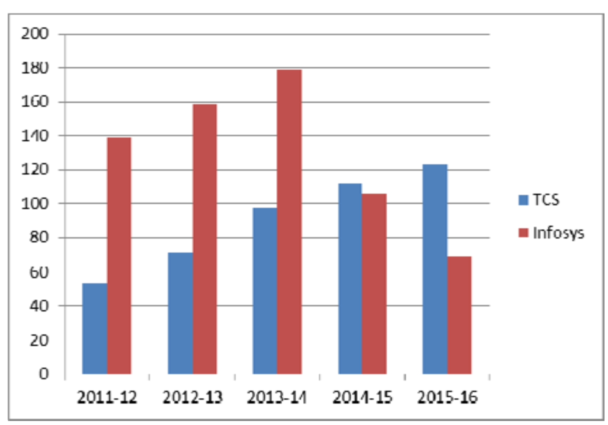
$$\text{EPS} = \frac{\text{Net Profit after Tax \& Preference Dividend}}{\text{Number of Equity Share}}$$

As mentioned above, EPS is one of the important criteria for measuring the performance of a company. If EPS increases, the possibility of higher dividend per share also increases. However, the dividend payment depends on the policy of the company. Market price of shares of company may also show an upward trend However, it should be remembered that EPS of different companies may vary from company to company due to the following different practices by different companies regarding stock in trade, depreciation, source of raising finance, tax- planning measure etc.

Table 1: Earnings per Share (in percent)

YEAR	TCS	Infosys
2011-12	53.07	139.07
2012-13	70.99	158.76
2013-14	97.67	178.39
2014-15	111.87	105.96
2015-16	123.28	68.75

(**Source:** Annual Report of TCS and Infosys from 2011-12 to 2015-16)



Source: Annual Reports of TCS and Infosys

Fig 1: Earnings per Share

The above figure represents the earning per share of the companies. Earnings per share represent the amount which is available to the company for paying dividend. It can be seen that the earning per share of TCS is continuously increased. Whereas the earning per share of Infosys has increased in 2012-13 after that it has decreased continuously. As compared to Infosys the performance of TCS is better in terms of earning per share in last five years' time period.

Current Ratio This ratio is calculated by dividing current asset by current liabilities. Current ratio is also known as 'solvency ratio' as it indicates how the expected current claims are covered by current assets. This ratio is calculated with the help of the following formula:

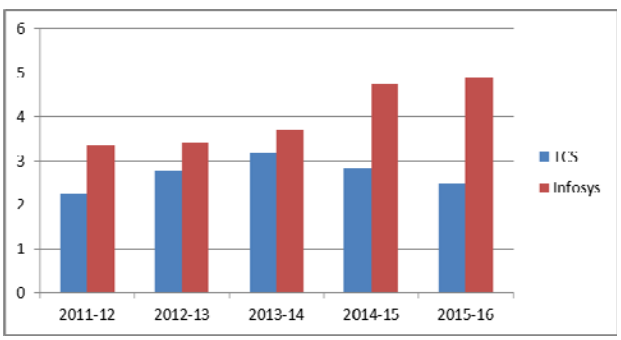
$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

This ratio indicates the coverage of current assets to the current liabilities. In other words, it indicates the proportion of current assets available for meeting the current liabilities. Normally it is expected that the current ratio should be 2:1.

Table 2: Current Ratio (IN PERCENT)

YEAR	TCS	Infosys
2011-12	2.24	3.36
2012-13	2.78	3.41
2013-14	3.18	3.70
2014-15	2.85	4.75
2015-16	2.48	4.91

Source: Annual Report of TCS and Infosys from 2011-12 to 2015-16



Source: Annual Reports of TCS and Infosys

Fig 2: Current Ratio

The above figure represents the current ratio of both the companies. Current ratio represents the amount which is available to the company for paying its short term liabilities. It can be seen that the current ratio of Infosys is showing increasing trends. In the year 2011-12 current ratio of Infosys was 3.36% and in 2015-16 was 4.91%. In the case of TCS it seen that the current ratio is showing increasing and decreasing trends. Current ratio increased in 2012-13 and 2013-14 again it decreased in 2014-15 and 2015-16. It means TCS's current assets position with compared to its current liabilities gradually increased and decreased. It is clear from above information that Infosys is in better position than TCS in term of current ratio.

Return on Capital Employed

This ratio indicates the percentage of net profits before interest and tax to total capital employed. The employed is calculated as follows.

$$\text{Return on Capital Employed} = \frac{\text{Net Profit before Interest and Tax}}{\text{Capital Employed}} \times 100$$

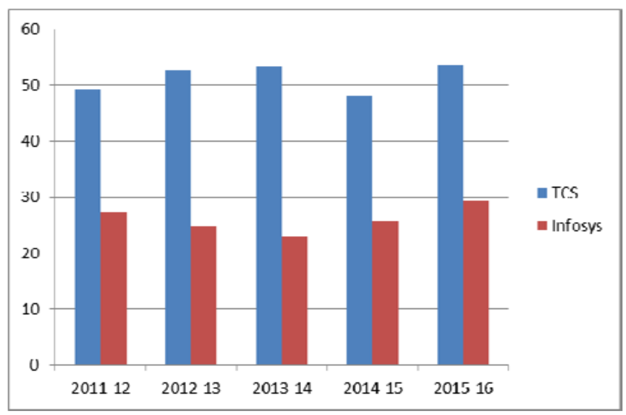
This ratio considered to be a very important one because it reflects the overall efficiency with which capital is used. The ratio of a particular business should be compared with other business firms in the same industry to find out the exact position of the business.

ROCE compares earnings with capital invested in the company. ROCE should always be higher than the rate at which the company borrows; otherwise any increase in borrowing will reduce shareholders' earnings. A variation of this ratio is return on average capital employed (ROACE), which takes the average of opening and closing capital employed for the time period.

Table 3: Return on Capital Employed (IN ERCENT)

YEAR	TCS	Infosys
2011-12	49.34	27.10
2012-13	52.77	24.79
2013-14	53.39	22.99
2014-15	48.07	25.71
2015-16	53.63	29.24

Source: Annual Report of TCS and Infosys from 2011-12 to 2015-16



Source: Annual Reports of TCS and Infosys

Fig 3: Return on Capital Employed

The above figure represents Return on Capital Employed of TCS and Infosys. It can be seen from the figure that Return on Capital Employed of TCS have increased in 2012-13 and 2013-14 but in 2014-15 it has decreased and again it increased in 2015-16. Return on Capital Employed of Infosys has decreased in 2012-13 and 2013-14and again increased in 2014-15 and 2015-16. Return on Capital Employed of Infosys was 27.10 % in 2011-12 and it was 29.24% in 2015-16.

Debtors Turnover Ratio: Debtors turnover is an efficiency ratio or activity ratio that measures how many times a business can turn its accounts receivable into cash during a period. In other words, the accounts receivable turnover ratio measures how many times a business can collect its average accounts receivable during the year. Higher debtor turnover ratio is good because higher debtor turnover ratio means, more fast, we are collecting money. Lower debtor turnover ratio is not good because it tells us that we have not managed debtor's better ways. Money from debtors is not collected fast.

$$\text{Debtors Turnover Ratio} = \frac{\text{Net Credit Sales}}{\text{Average Debtors}}$$

Table 4: Debtors Turnover Ratio (in percent)

YEAR	TCS	Infosys
2011-12	4.76	5.86
2012-13	4.67	5.93
2013-14	5.04	6.47
2014-15	4.77	6.25
2015-16	5.59	6.50

Source: Annual Reports of TCS and Infosys

Fig 4: Debtors Turnover Ratio

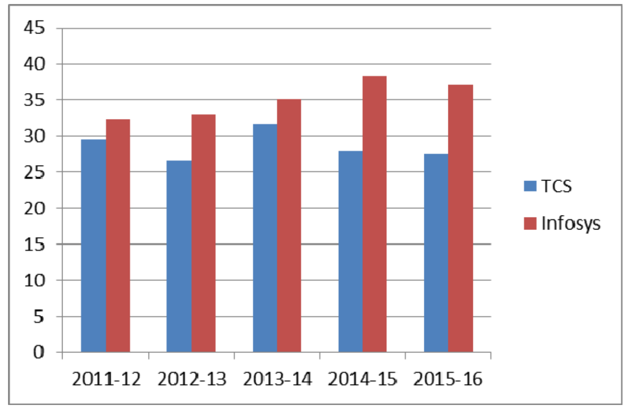
It can be seen that Debtors Turnover Ratio of both the companies has showing increasing and decreasing trends. Debtors Turnover Ratio of TCS in 2011-12 was 4.76% and in 2015-16was 5.59%. Debtors Turnover Ratio of Infosys in 2011-12 was 5.86% and in 2015-16 was 6.50%. As compared to performance Infosys is better than TCS in terms of Debtors Turnover Ratio in last five years' time period.

Gross Profit Ratio:- The gross profit ratio shows the proportion of profits generated by the sale of products or services, before selling and administrative expenses. It is used to examine the ability of a business to create sellable products in a cost-effective manner. The ratio is of some importance, especially when tracked on a trend line, to see if a business can continue to provide products to the marketplace for which customers are willing to pay a reasonable price. The gross margin ratio can be measured in two ways. One is to combine the costs of direct material, direct labor, and overhead, subtract them from sales, and divide the result by sales. This is the more comprehensive approach. Formula

$$\text{Gross Profit Ratio} = \frac{\text{Sales} - (\text{Direct materials} + \text{Direct Labor} + \text{Overhead})}{\text{Sales}}$$

Table 5: Gross Profit Ratio (in percent)

YEAR	TCS	Infosys
2011-12	29.57	32.40
2012-13	26.68	33.11
2013-14	31.62	35.09
2014-15	27.88	38.30
2015-16	27.52	37.04



Source: Annual Reports of TCS and Infosys

Fig 5: Gross Profit Ratio

The above figure represents the Gross Profit Ratio of both the companies. The proportion of profits generated by the sale of product or services before selling and administrative expenses. It can be seen from the figure that Gross Profit Ratio of TCS decreased in 2012-13, 2014-15 and 2015-16 but in 2013-14 it has increased. Gross Profit Ratio of Infosys has improved in 2012-13, 2013-14 and 2014-15 and it has decline in 2015-16.

Findings and conclusions

In order to invest in companies for long term, company analysis is first of all significant in fundamental analysis which enables the investors to understand financial performance of the organization. The below are the main points which are found in the study of two major Indian two wheeler manufacturer.

1) TCS has resulted well in view earning per share as compared to Infosys.
2) Infosys has performed better than TCS on the parameter of current ratio and Infosys has more consistency in current ratio than TCS.
3) TCS have performed well on the basis of return on capital employed as compared to Infosys and TCS has more consistency in return on capital employed than Infosys.
4) The performance of Infosys is better than TCS in case of debtor's turnover ratio and Infosys is more consistent.
5) Infosys well in view gross profit ratio as compared to TCS. Infosys has more consistency in gross profit ratio than TCS.

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