Unit - 4

1. Define Fundamental Analysis

Fundamental analysis is a technique that attempts to determine a security's value by focusing on underlying factors that affect a company's actual business and its future prospects.

2. Technical Analysis

Technical analysis is a term used for predicting the direction of prices of a stock through the study of past market data, primarily price and volume.

3. Term Earning per share

Earnings per share is one of the most important variables for determining a company's share prices. A high EPS indicates that the company is more profitable and has more profit to distribute to shareholders. Calculated as,

$$EPS = \frac{\text{Net Income} - \text{Dividends on Preferred Stock}}{\text{Average Outstanding Shares}}$$

4. The price Earning ratio

The price to earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earning (EPS). The price to earnings ratio is also sometimes known as the price multiple or the earnings multiple.

5. Bonus Shares

Bonus shares are additional shares given to the current shareholders without any additional cost, based upon the number of shares that a shareholder owns. These are company's accumulated earnings which are not given out in the form of dividends, but are not given out in the form of dividends, but are converted into free shares.

6. Stock Split

When a company declares a stock split, the number of shares of that company increase, but the market cap remains the same. Existing shares split, but the underlying value remains the same. As the number of shares increase, price per shares goes down.

7. Blue chip company

A Blue chip company is a type of public company that is very well-recognized, big and has a history of robust financial performance. They are generally expensive and gives above market average in long run. They are 100 highest companies on a stock exchange.
Ex:

8. Expand

FEMA - Foreign Exchange Management Act

FERA - Foreign Exchange Regulation Act

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1. Blue-chip Company or Blue Chip-Stock

Blue chip Stocks are highly priced market stocks, which have emerged as a preferred investment option over recent years. The companies that issue blue chip stocks are highly esteemed in the stock exchange.

market and tend to have a stable financial record and credibility. Besides their repute, the fact such companies extend attractive dividend pay outs can be credited for the growing popularity of the said stock. However, before investing in blue-chip companies, individuals should equip them with a few essential details. Stock that are issued by blue-chip companies (ie) companies with a large market capitalisation are termed as blue-chip companies.

I. Features of Blue-chip stocks

• **Assured returns**

Blue chip stocks generate returns quarterly in the form of dividends. The fact that companies that are well-established also serve as a safe investment avenue for most investors. With this safety comes the assurance of earning steady but guaranteed returns.

• **Credit Worthiness**

Blue chip companies have enough capital to clear their financial dues and obligations easily. This in turn makes the shares issued by such companies high in creditworthiness.

• **Investment horizon**

The term of investment is usually over 7 years. Such extended term makes Blue-chip suitable for achieving long-term financial goals owings to its long investment horizon.

II. Reasons to Invest in Blue chip stock

* It offers higher returns that are paid quarterly
* Facilitates corpus building

* Facilitates portfolio diversification
* Cushions the impact of the recession inflation and economic stagnation.

2. Earning per shares

EPS can be defined as that share of a company's profit that is distributed to each share of stocks. Further it is considered to be a significant financial parameter as it helps to gauge a company financial health. To elaborate, higher EPS reflects greater financial health. To elaborate, higher EPS reflects greater profitability from the company and its overall ventures.

$$EPS = \frac{(\text{Net Income} - \text{Preferred Dividends})}{\text{End of period Common shares Outstanding}}$$

For instance, a company XYZ is left with a net income of Rs. 10 lakh and must also pay Rs. 2 lakh as preferred dividends and has Rs. 4 lakh common share outstanding. at the current period. Therefore, the EPS of XYZ company as per earning per share formula would be,

$$EPS = 10,00,000 - 2,00,000 / 4,00,000$$

$$= Rs. 2 \text{ per share.}$$

Typically, the company balance sheet and its income statement are relied upon for EPS calculation.

I. Types of EPS

Generally, EPS is divided into 3 broad categories, namely, i) Trailing EPS - It is entirely based on the previous years figures.

ii) Current EPS - Mostly based on the ~~previous~~ current projections and available figures.

iii) Forward EPS - Depends on anticipated future projections and ~~essential~~ estimated figures.

There are 5 types of EPS, overview of the different types of EPS,

1. Reported EPS - Calculated as per generally accepte accounting principles.

2. Ongoing EPS - Does not include a subject unusu one-time income in the net income.

3. Retained EPS - Summation of net earnings and current retained earnings is subtrated from divied paid. The outco is further dived by the total numbe of outstanding shares.

4. Cash EPS - Total operating cash is divided by outstanding diluted shares.

5. Book value EPS - Take the current balance sheet into account to compute the EPS.

Importance of EPS

GAAP is very specific in regard to its calculatio
EPS is calculated for common shares
Provides insight to common shareholders about:
- Future dividend payout
- The value of their shareholdings
- Impact of other financial instruments on their potential earnings. (Diluted EPS)

3. Advantages and Disadvantages of Bonus share

Advanttages

- No tax on dividend income
- Important for long term investment
- Increases the investment oer belief in operations
- Investor recieves more in case company starts paying cash dividend in future.
- Company can conserve cash
- Gives positive sign to market
- Increase the participation of small investors
- Increase the perception of company size.

Disadvantages.

- Bonus shares sale reduces the stake in company
- Does not give extra wealth to investor
- Increase in number of shares decreases the EPS and cash dividend yield.
- Company ability to raise cash reduce.
- Cost of administering the bonus share is more than paying cash dividend.

4. Factors determine economic analysis

1. Population

Population gives an idea of the kind of labour force in a country. In some countries, the population growth has slowed down whereas in india and some other third world countries there has been a population explosion.

Population explotion will give demand for more industries like hotels, residence, service industries like health, consumer demands like refrigerators and cars, Increase in population, therefore shows a great need for economic development of the country. It does not shows the exact industry which will be expanding but in those countries where there is a high rate of population growth, the labour intensive industries will have a large generation of demand. Likeotherwise investors should prefer to invest in industries which have a large amount of labour force.

2. Research and technological development

The economic forces relating to investment would be depending on the amount of resources spent by the government on the particular technological development affecting the future. Broadly, the investors should invest in those industries which are getting a large amount of share in the funds of the development of the country. For example.

3. Capital Formation

Another consideration of the investor should be the kind of investment which a company makes in capital goods and the capital it invests in modernisation and country. The gross national product replacement of assets. These, to a large extent are dependent on the economic factors of the country. The gross national product of a country should be carefully analysed. A particular industry or a particular company in which an investor who would like to invest can also be viewed with the help of the economic indicators such as the place, value and property position of the industry, group to which it belongs and the year-to-year returns through corporate profits.

4. Natural resources and Raw material

The natural resources are to a large extent responsible for a country economic development and over all improvement in the condition of corporate growth. The discovery of oil in middle-east countries and the discovery of gas in countries. In Japan, the government found raw material in the form of labour force much suited to a developing country. Technological discoveries in recycling of material, nuclear and solar energy and new synthetics should give the investor an opportunity to invest in untapped or recently tapped resources which would also produce higher investment opportunity.

1) Factors determine Industry Analysis

Industry is the group of organisations that offers products or services that serve the same needs and wants of the target market. these offerings can be similar to the company offering, or can be each others substitutes.

The factors to be considered are -

Industry size and growth gives the marketer an idea of the demand. Information on the sales, profits, costs, number of firms and employees helps a marketer do the analysis on the growth of the industry in recent years.

The life cycle of the Industry demand in the market and Industry size help in formulating strong marketing strategies. The organisation should have concrete data on

Industry structure is the nature and competition intensity among the firms basis their number, their size and differentiation of the offerings.

Entry, Mobility and Exit barriers refer to the barriers a firm faces at different stages in the industry.

• Entry into a retail business is different as compared to an airline business. Major entry barriers are investment brand image, access to resources like raw-materials, suppliers, distributors, skilled staff, legal or political environment, patents and licensing.

• Mobility is the entry of the firm within the segments inside the industry. For example, Samsung electronics entering into laptop manufacturing. There can be challenges that a company can face from other competit like manufacturing facility, opening service centres in target markets, skilled staff for presentations, distribu agreement, etc.

Few exist barriers are—

Assets

plant, equipment or other expensive assets are diffic to utilize for other operations. Sometimes the sale of these assets is not feasible or have less salvage value.

Relationships with other business units

- of the firm or intermediaries. For example, an IT company may have BPO operations in the same facilit and may be serving the same customers. So if the fi ... BPO facility, it will have impact of the operat

Government Regulations

There sometimes government intervention to ensure the customers or the staff of the organisation doesn't suffers because of organisations exit from the market. For example, if an automobile manufacturer shuts down its operations, in some countries it is an obligation for that firm to provide the automobile parts for 15 years after shut down.

Social Barriers

The organisation itself may feel an emotional attachment with its employees. For example, an Airline had to cut down its staff members because of market crunch. But later the same day, the owner of the airline re-inducted the staff bases emotional attachment.

Degree of vertical integration is the forward or backward integration within the supply chain. For example a firm can have its own access to raw material and distribution apart from manufacturing. This offers advanta as there is complete control on various functions

Marketing Strategies. in the industry also help a marketer make correct decisions. these are the marketin objectives most relevant to the industry ; target market segments (local, international, sub-segment; etc) and marketing mise variables like product features and characteristics, commonly used terms, price variations Promotion tools used and channels used.

2. Factors influencing Company Analysis

Evaluating the financial performance of the company on the basis of qualitative factor and quantitative factors is company analysis.

I. Qualitative Factors

The qualitative factors that affect the value of a company are

1. Business Model

The way in which a company makes money. It describes company's operations, mode of revenue generation, nature of expenses, organization structure and its sales and marketing effort.

2. Management

Good and capable management teams generate profits. Management should attain the stated objectives of the company and create value for all the stake holders. The criterion used for managent analysis is management discussion and analysis, management ownership of equity stake.

3. Corporate governance

It refers to the set of system and practices put in place by the company to ensure accountability, transparency and fairness in order to safeguard the interest of the stake holders. Areas of corporate governance are, a) Structure of board of directors

b) Financial and information transparency

c) Stake holders rights

4. Corporate Culture

It refers to the collective beliefs, values, systems and processes of the company. Every company has set of values and goals that helps to define what the business is about. The basis of corporate culture is expressed in terms of the policies and procedures adopted in the company's functioning.

5. Quantitative Factors

1. Earnings of the Company

Earnings decide its stock value in the market. Growing earnings result in high valuation of the stock. Earnings are operating profits. Earning are generated from operating sources and non operating sources. The following factors have an effect on the earnings of a company.

a) Change in sales
b) Change in Cost
c) Depreciation method
d) Wages, salaries
e) Income tax & other taxes
f) Depletion of resources.

Measurement of earnings

* Gross profit = Sales - Cost of Goods Sold

* EBT = EBIT - Interest

* EAT = EBT - Tax

EPS: EPS gives the overall picture of the performance of the company.

$$EPS = \frac{\text{Net Income} - \text{Dividends on Preferences Shares}}{\text{Average Outstanding Shares}}$$

2. Financial Leverage

The degree of utilization of Borrowed money in a business is known as the financial leverage. It involves the selection of appropriate financing mix, proportion of long term debt and equity capital (Net worth) ie., capital structure of a company. A high degree of financial leverage results in high interest payments. This will affect the net profits to equity holders

$$\text{Financial Leverage} = \frac{\text{Total Debt}}{\text{Share holder's equity}}$$

3. Operating Leverage

The extent to which an organization uses fixed costs in its cost structure is called operating leverage. The operating leverage is greatest in firms with a large proportion of fixed costs, low proportion of variable costs, and the resulting high contribution - margin ratio. A high degree of operating leverage implies other factors being constants, a relatively small change in sales results in a large change in return on equity.

$$\left.\begin{array}{r}\text{Degree of Operating} \\ \text{leverag (DOL)}\end{array}\right\} = \frac{\text{\% Change in Operating Income}}{\text{\% Change in Sales}}$$

4. Competitive Edge

The competitiveness of a company can be assessed by looking at the following aspects

Growth of Sales

A company with rapid growth in sales is better for share holders than one with stagnant growth rate. Investors prefer a large company because it is able to withstand the business cycle. Growth in sales result in growth in profits.

Market Share

The market share of annual sales helps determine a company's relative position within the industry. If market share is high the company will be to meet the competition successfully. While assessing the market share the size of the company should also be considered.

Production Efficiency

Production efficiency means producing the maximum output at minimum cost per unit of output. This measures how well the production process is performing. Increasing efficiency boosts the capacity of the business without any change in number of inputs employed.