iJRASET
International Journal For Research in Applied Science and Engineering Technology

INTERNATIONAL JOURNAL FOR RESEARCH

IN APPLIED SCIENCE & ENGINEERING TECHNOLOGY

Volume: 7 **Issue:** IX **Month of publication:** September 2019

DOI: http://doi.org/10.22214/ijraset.2019.9085

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International Journal for Research in Applied Science & Engineering Technology (IJRASET)
ISSN: 2321-9653; IC Value: 45.98; SJ Impact Factor: 7.177
Volume 7 Issue IX, Sep 2019- Available at www.ijraset.com

A Study on Fundamental Analysis of Indian IT Sector with Reference to Selected IT Companies

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Abstract: ***Fundamental analysis is a method of forecasting the future price movements of a financial instrument based on economic, political, environmental and other relevant factors and statistics that will affect the basic supply and demand of whatever underlies the financial instrument.***
Fundamental analysis is the cornerstone of investing. It insists that no one should purchase or sell a share on the basis of tips and rumors.
The fundamental approach calls upon the investors to make his buy or sell decision on the basis of a detailed analysis of the information about the company, about the industry, and the economy.
Fundamental analysis is really a logical and systematic approach to estimating the future dividends and share price. It is based on the basic premise that share prices are determined by a number of fundamental factors relating to the economy, industry and company. Hence, the economy fundamentals, industry fundamentals and company fundamentals have to be considered while analyzing a security for investment purpose.

I. INTRODUCTION

Fundamental analysis is, in other words, a detailed analysis of the fundamental factors affecting the performance of companies. Each share is assumed to have an economic worth based on its present and future earning capacity. This is called its intrinsic value or fundamental value.

The purpose of fundamental analysis is to evaluate the present and future earning capacity of a share based on the economy, industry and company fundamentals and thereby assess the intrinsic value of the share. The investor can then compare the intrinsic value of the share with the prevailing market price to arrive at an investment decision. If the market price of the share is lower than its intrinsic value, the investor would decide to buy the share as it is underpriced. The price of such a share is expected to move up in future to match with its intrinsic value. Fundamental analysis thus involves three steps:

1) Economy Analysis.
2) Industry Analysis.
3) Company Analysis.

A. Definition of Equity Market

The market in which shares are issued and traded, either through exchanges or over-the-counter markets also known as the stock market, it is one of the most vital areas of a market economy because it gives companies access to capital and investors a slice of ownership in a company with the potential to realize gains based on its future performance.

B. IT industry

The IT industry can serve as a medium of e-governance, as it assures easy accessibility to information. The use of information technology in the service sector improves operational efficiency and adds to transparency. It also serves as a medium of skill formation.

1) Economies of scale for the information technology industry are high. The marginal cost of each unit of additional software or hardware is insignificant compared to the value addition that results from it.
2) Unlike other common industries, the IT industry is knowledge-based
3) Efficient utilization of skilled labor forces in the IT sector can help an economy achieve a rapid pace of economic growth.
4) The IT industry helps many other sectors in the growth process of the economy including the services and manufacturing sectors.

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C. Scope of the study

The study is based on the selected IT companies listed in NSE which are Oracle Financial Services, L&T Infotech, Mind Tree, Larsen & Toubro Infotech, Hexaware Technologies.
The companies are selected with respect to their market capitalization, revenue, sales and performance.
The scope of the study is limited for a period of ten years.
The scope is limited to only fundamental analysis of the selected stocks.

D. Need of the Study

To start any business capital plays major role. Capital can be acquired in two ways by issuing shares or by taking debt from financial institutions or borrowing money from financial institutions. The owners of the company have to pay regular interest and principal amount at the end. Stock is ownership in a company, each share of stock represents a tiny piece of ownership. The more shares a person own, the more of the company he owns.
In the financial world, ownership is "Equity". Hence it is necessary to study the fundamental analysis in order to find out the best company to invest.

E. Objectives of the Study

1) To study the growth and performance of selected Indian IT companies.
2) To study on the Economic, Industry, and Company analysis in order to find out whether the selected Indian IT companies are attractive or not in the light of economic conditions.
3) To analyze the intrinsic value of selected Indian IT companies in order to find out whether to buy or sell the shares.

F. Research Methodology

For this study mainly secondary data is used. Data are collected from sources such as internet websites of selected companies, company balance sheets, annual reports, press release etc. Analysis of data is done with the help of fundamental tools for selected five companies.

1) Selected IT Companies

a) Oracle Financial Services
b) HCL-Technologies
c) Mind Tree
d) Larsen & Toubro Infotech
e) Hexaware Technologies

2) Sample Size

a) Time period considered for this study is Ten years.
b) Five IT companies were selected which are listed under Indian stock market.
c) Four financial ratios: EPS, R.O.E, D.P.R and P/E are calculated for this study.

II. REVIEW LITERATURE

A. Introduction

A literature review is an evaluative report of studies found in the literature related to our selected area. The review should describe, summarize, evaluate and clarify this literature. It should give a theoretical basis for the research and help us to determine the nature of our own research. Select a limited number of works that are central to our area rather than trying to collect a large number of works that are not as closely connected to our topic area .A literature review goes beyond the search for information and includes the identification and articulation of relationships between the literature and our field of research.

B. Literature Review

As per the project six articles were reviewed and summaries of the same are listed below: Hemraj Verma and Prakash Tiwari (2009) In their study headed, "A Fundamental analysis of public sector banks in India" detailed the growth of the Indian banking industry and current performance of the bank with the help of various ratios.

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1) *Sugandharaj Kulkarni (2011):* In his research paper titled, "A study on fundamental analysis of ONGC" explains about the relevance of fundamental analysis along with the attempt to find the intrinsic value of shares.
2) *Venkatesh C. K and Madhu Tyagi (2011):* In their research paper titled, "Fundamental analysis as a method of share valuation in comparison with technical analysis" detailed about different movement of share prices in comparison with fundamental and technical analysis. It also emphasized on the market capitalization and organizational structure.
3) *Ahmed S Wafi, Hassan and Abel Mabrouk (2015):* In their learning headed, "Fundamental analysis models in financial market" presented in third economic and finance conference in Rome. This paper aims to find the better stock valuation model using the fundamental analysis approach.
4) *Mayer (1992):* This research has examined using company balance sheet data, found that internal resources finance bulk of corporate investment in major OECD countries and the roll of the stock market is very limited.

III. DATA ANALYSIS AND INTERPRETATION

A. *Economic Analysis*

1) In security selection process, a traditional approach of Economic Industry Company analysis is employed. EIC analysis is the abbreviation of economic, industry and company. The person conducting EIC analysis examines the conditions in the entire economy and then ascertains the most attractive industries in the light of the economic conditions.
2) At last the most attractive companies within the attractive industries are pointed out by the analyst. The investor carries out the fundamental analysis framework to determine the future of his investment. The first step is to determine the economic conditions in a country. If the economic conditions are favorable for the performance of a particular industry then the company in the particular industry group would expect better prospects.
3) Stock prices react favorably to the low inflation, earnings growth, a better balance of trade, increasing gross national product and other positive macroeconomic news. Indications that unemployment is rising, inflation is picking up or earnings estimates are being revised downward will negatively affect the stock prices.
4) The stock market will forecast an economic boom or recession properly from the signs in front of average citizen. The implications of market risk should be clear to the investor. When there is recession in the economy, the prices of stocks moves downward.
5) All the companies suffer the effects of recession despite of the fact that these are high performing companies or low performing ones. Similarly the stock prices are positively affected by the boom period of the economy.
6) The prices of stocks are always subject to market risk. Therefore utmost precaution is taken before investing in the stocks. The main macro indicators considered for this research are:

a) GDP of A Country
b) Inflation Rate
c) FDI
d) Unemployment

Table No: 6- Indian Economic factors

YEAR	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
GDP	13.8%	11.2%	6.2%	5.4%	8.2%	8.0%	9.5%	7.4%	8.1%	7.4%
INFLATION	10.5%	9.5%	10.0%	9.4%	5.8%	4.9%	4.5%	3.6%	3.48%	3.88%
FDI	7K	6K	7K	7K	5K	11K	13K	9K	8.6K	9.7K
UNEMPLOYMENT	3.54%	3.53%	3.8%	4.7%	4.9%	4.8%	5%	5.4%	4%	4.5%

i) *Interpretation:* GDP has decreased slightly when compared with last year which effect's some sectors but Inflation rate has decreased when compared with previous years which is a good indicator. The flow of FDI has increased due to government initiatives at various levels to attract foreign investors to invest in a country like India. The unemployment rate in the country is increasing. The growth of IT industry may generate more employment opportunities in the country.

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B. Industry Analysis

1) The performance of any industry is relevant to economic conditions of a country. But there are certain stocks which are defensive in nature and do not decline in the recession of the economy. The study of industry analysis helps the investor to analysis the potential growth factors in the adverse economic conditions.

2) In Industry analysis, Information technology industry is studied in terms of its problems and prospects. India is considered as world's leading sourcing destination for the information technology industry, as ion figures it comes to just about 67 percent of the US $ 124-130 billion market.

3) The IT industry has shaped momentous command in education sector, in particular for engineering and computer sciences. Information Technology is fragmented industry and not a concentrated one.

Porter's five force models consist of five major indicators to analyze an industry i.e. existing competition, availability of substitutes, threat of new entrants, bargaining power of suppliers and bargaining power of customers.

a) Existing Competition: IT services such as network management services, data-center services, infrastructure management services, application development and maintenance e.t.c which leads to competition. Many companies in the industry are offering the similar services and therefore difficult to differentiate each other.

b) Bargaining Power of Customers: Buyers bargaining power is large and chance of pressure on rates prevails in the industry. Both the international and Indian IT firms have negated the advantages all the way through global delivery and mature procurement.

c) Bargaining Power of Suppliers: Supplier's bargaining power is very low and as high standardization prevails in the industry there is modest chance for the suppliers to have any thump.

d) Threat of New Entrants: Industry is also characterized by high people dependence and consequently can observe veterans isolate from prevailing companies to devote in new ventures. The innovative technology allows the opportunity of entrants to new niche players which are not dependent on experience constraints or size.

e) Availability of Substitutes: IT sector has been a mixed bag for newer services as well since internal specialization is low and most of the work is outsourced generally. Therefore there is no substantial substitute to information technology industry from internal perspective, and are thinner in numbers and significance.

C. Company Analysis

In company analysis the financial performance of the selected companies are analyzed in order to analyze the profitability of the firm. An investor should be aware of the financial performance of the company to know the risk and return associated with particular share. For the purpose of analysis two ratios were calculated such as EPS, P/E ratio.

1) *Earnings per Share (EPS):* This ratio determines what the company is earning for every share. For many investors, earnings are the most important tool. EPS is calculated by dividing the earnings (net profit) by the total number of equity shares. The computation of EPS is as follows:

Earnings per share = Net profit/Number of shares outstanding

EPS of OFS, HCL, Mindtree, L&T, Hexaware (in rs.cr)

YEAR	CAGR	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
OFS	.066312	78.81	115.4	129.7	122.5	136.5	125.3	105.9	151.5	117.9	149.7
HCL	.145088	15.57	17.40	28.13	53.16	85.50	45.14	33.46	48.17	52.88	60.35
MIND TREE	(0.153061)	52.66	30.93	54.27	82.70	108.50	63.90	36.08	26.56	37.69	45.94
L&T INFOTECH	(0.17985)	72.62	65.00	73.00	80.00	59.00	54.00	57.07	39.00	38.46	47.63
HEXA WARE	0.10555322	6.39	7.91	9.63	11.14	10.58	11.04	11.79	13.85	15.23	17.43

CAGR of OFS, HCL, Mindtree L&T Infotech, Hexaware

Company	OFS	HCL	Mindtree	L&T	Hexaware
CAGR	0.663	0.145	(0.153)	(0.173)	0.105

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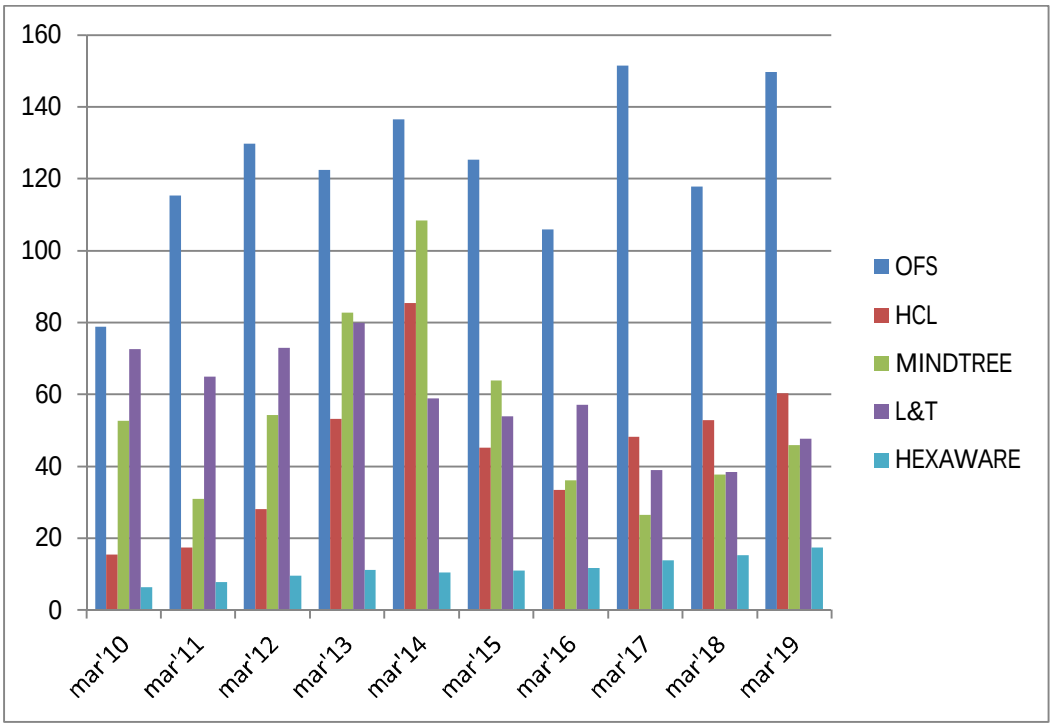

Figure No-1: EPS of OFS, HCL, Mindtree, L&T, Hexaware

a) Analysis: The above graph shows that the EPS of:

i) OFS: Increased in earlier years but there are fluctuations between the years 2016-2018 but in the current year the company is doing well as per EPS.

ii) HCL: The EPS of HCL is increasing at a slow rate by year after year.

iii) Mindree: There are a lot of fluctuations in EPS of Mindtree. The highest is seen in the year 2014 i.e 108.50 and the lowest recorded as 26.56 in the year 2017.

iv) L&T Infotech: EPS of L&T has increased in the earlier years but later it started decreasing.

v) Hexaware: EPS of Hexaware is increasing at a slow rate year after year.

b) Interpretation: CAGR of OFS, HCL and Hexaware are positive and CAGR of L&T and Mindtree are negative. The positive CAGR reveals increase of EPS over years and negative CAGR reveals decrease in EPS over years.

2) Price to Earnings Ratio (P/E): The P/E multiplier or the price earnings ratio relates the current market price of the share to the earnings per share. This is computed as follows:

Price/earnings ratio = Current market price / Earnings per share

This ratio is calculated to make an estimate of appreciation in the value of a share of a company and is widely used by investors to decide whether or not to buy shares in a particular company. Many investors prefer to buy the company's shares at a low P/E ratio since the general interpretation is that the market is undervaluing the share and there will be a correction in the market price sooner or later. A very high P/E ratio on the other hand implies that the company's shares are overvalued and the investor can benefit by selling the shares at this high market price.

P/E Ratio of OFS, HCL, L&T, Mindtree and Hexaware (in rs.cr)

YEAR	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
OFS	31.257	19.874	15.152	27.118	23.460	26.654	35.294	21.417	34.150	25.348
HCL	145.401	130.399	68.963	62.304	37.994	74.292	108.777	66.543	75.647	61.023
MINDTREE	46.779	74.151	36.930	40.175	29.940	53.295	98.754	120.685	108.710	80.164
L&T	9.052	12.096	6.625	8.996	11.288	20.427	12.941	23.822	37.232	28.152
HEXAWARE	7.347	7.711	8.670	8.209	13.232	20.380	18.4011	15.397	24.546	18.723

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Compounded annual growth rate of all companies

COMPANY	OFS	HCL	MINDTREE	L&T	HEXAWARE
CAGR	0.044201	0.04986	0.041031	0.073884	0.213961

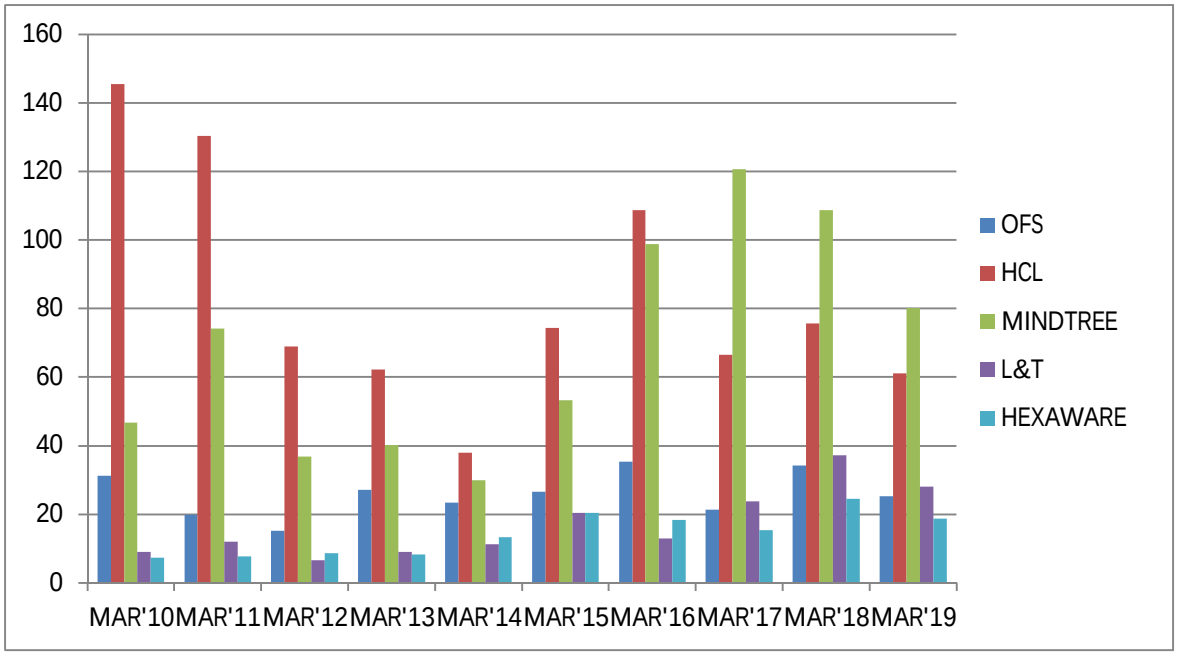

Figure No-2: P/E ratio of OFS, HCL, Mindtree, L&T, Hexaware

a) Analysis: The above graph shows the P\E ratio of

i) OFS: Is fluctuating year after year.

ii) HCL: Is at decreasing ratio year by year.

iii) Mindtree: P/E ratio of mindtree fluctuated in earlier years but later it started increasing.

iv) L&T and Hexaware: the P/E ratio of these two companies is also fluctuating every year.

b) Interpretation: CAGR of all companies is positive that is appreciation in value of shares is increasing every year. Hexaware has the highest CAGR as its P\E ratio is at increasing rate.

3) Valuation of Intrinsic Value

Table No: 18-Valuation of Intrinsic value.

RATIOS	OFS	HCL	MINDTREE	L&T	HEXAWARE
Avg. DPR (sum of DPR/no. of. years)	0.286	0.342	0.421	0.348	0.335
Avg. Rentention ratio (1-DPR)	0.237	0.284	0.459	0.371	0.285
Growth in equity (A.R.R*A.R.O.E)	0.169	0.186	0.265	0.241	0.189
Avg. P/E ratio (sum of P/E/no. of years)	25.54	19.2	28.02	19.06	8.75
Projected EPS (current EPS)*(1+growth in equity)	83.24	81.59	146.98	41.67	42.89
Intrinsic value (proj. EPS*Avg. P/E ratio)	2854.32	1585.23	820.52	989.20	420.85
Market value (as on 31/7/2019)	3306.85	1034.55	716.30	1387.15	353.55

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4) Decision

a) OFS: Intrinsic value < Market value, it is undervalued, so it is recommended to buy the stock as the value of the share may increase in future.

b) HCL: Intrinsic value > Market value, it is overvalued, so it is recommended to sell the stock as the value of the share may decrease in future.

c) Mindtree: Intrinsic value > Market value, it is overvalued, so it is recommended to sell the stock as the value of the share may decrease in future.

d) L&T Infotech: Intrinsic value < Market value, it is undervalued, so it is recommended to buy the stock as the value of the share may increase in future.

e) Hexaware: Intrinsic value > Market value, it is overvalued, so it is recommended to sell the stock as the value of the share may decrease in future.

IV. FINDINGS, SUGGESTIONS AND CONCLUSION

A. *Findings*

1) As concerned with EPS: OFS, HCL and Hexaware are increasing whereas L&T Infotech is at decreasing trend and Mindtree has a fluctuating EPS ratio.

2) In case of Price Earnings ratio all companies except HCL are fluctuating every year where as HCL is showing a decreasing rate of P/E ratio.

3) Intrinsic value of Mindtree, HCL and Hexaware are overvalued than the Market value whereas OFS and L&T Infotech are undervalued than the market value of shares.

4) GDP is found decreasing compared with last year which indicates that certain sectors have not performed well.

5) Inflation rate is gradually decreasing every year which is a good indicator for an economy.

6) FDI is also increasing which boosts the service sector and reduces unemployment which results in economic growth.

B. *Suggestions*

1) It is recommended to invest in a company whose county's economy is strong so that it enables that company to perform well and also makes investor profitable.

2) It is recommended to buy and hold the shares which are undervalued such as OFS and L&T Infotech.

3) Companies which are not so popular in stock market must adapt certain strategies to attract and encourage investor.

4) It is suggested to sell shares of HCL, Mindtree and Hexaware which are overvalued.

5) Every investor is recommended to make a thorough analysis of the stock market, about the company and industry before making any investment decisions.

6) Among the selected IT companies HCL-Technologies stood at 5^{th}, L&T Infotech stood at 6^{th}, Mindtree at 7^{th} and Oracle Financial Services at 9^{th} position among the top ten Indian IT companies 2019 list.

C. *Conclusion*

Global recession had an effect on the growth of IT industry but it was a short term phenomenon. The industry is bouncing back. One factor favoring this point is that India has become a hot destination for companies of diverse nature to invest in.

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Indian context, IT sector industries are major contributors of GDP of India

Information technology sector of India has been significantly contributed to the growth of Indian economy in terms of gross domestic products, generation of employment and foreign exchange earnings. In Indian context, IT sector industries are major contributors of GDP of India.

In spite of it being a tough year for all the companies across the globe, Indian market has given good performance as compared to other companies in the world. A continuous effort at cost cutting and improving productivity will help the companies in making reasonable profits despite the impact of higher commodity prices and weaker rupee.

The IT industry continues to be the largest private-sector employer in India. India is the second-largest start-up hub in the world with over 3,100 technology start-ups in 2018–19.

It can be concluded that the Information Technology sector companies are one most promising platform of investment in capital market and in turns give considerable return for the risk taken by investors.

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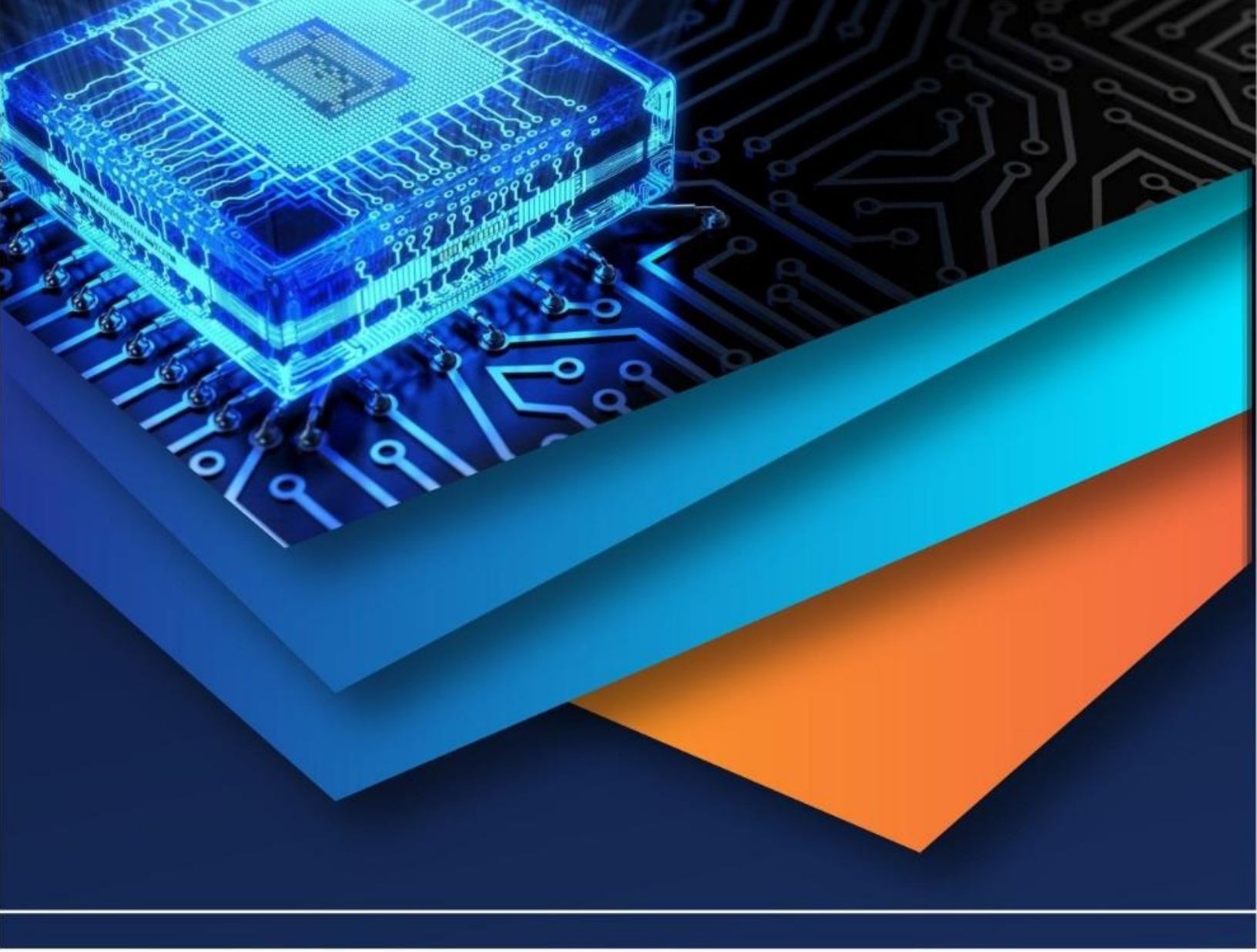

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