J D Women's College

Course Name- PG professional

MBA

(3rd semester)

Subject- Security Analysis and Portfolio Management

Topic- Company Analysis

Faculty Name – Anjali

Faculty member

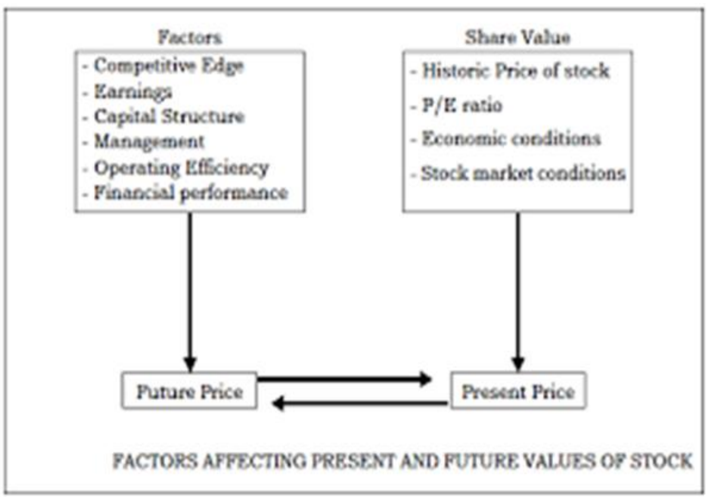
Department of Management Study

Company Analysis

(Part-2)

Factor affecting the company analysis

The present and future values are affected by the following factors:



1) Competitive Edge: Many industries in India are composed of hundreds of individuals companies. These large companies are successful in meeting the competition. Some of them, companies rise to the position of eminence and dominance. The companies who have obtain the guidance position; have proven his ability to withstand competition and to have a sizable share in the market. The competitiveness of the company can be determined by following factors:

a) Market share: The market share of the company helps to determine a company's relative position within the industry. If the market share is high, the company would be able to meet the competition successfully. The size of the company should also be considered while analyzing the market share, because the smaller companies may find it difficult to survive in the future.

b) Growth of annual sales: Investor generally prefers to study the growth in sales because the larger size companies may be able to withstand the business cycle rather than the company of smaller size. The rapid growth keeps the investor in better position as growth in sales is followed by growth in profit. The growth in sales of the company is analyzed both in rupee terms and in physical terms.

c) Stability of annual sales: If a firm has stable sales revenue, other things being remaining constant, will have more stable earnings. Wide variation in sales leads to variation in capacity utilization, financial planning and dividends. This affects the company’s position and investor’s decision to invest.

2) Earnings: The earning of the company should also be analyzed along with the sales level. The income of the company is generated through the operating (in service industry like banks- interest on loans and investment) and non-operating income (ant company, rentals from lease, dividends from securities). The investor should analyze the sources of income properly. The investor should be well aware with the fact that the earnings of the company may vary due to following reasons:

• Change in sales.

• Change in costs.

• Depreciation method adopted.

• Inventory accounting method.

• Wages, salaries and fringe benefits.

• Income tax and other taxes.

3) Capital Structure: Capital structure is combination of owned capital and debt capital which enables to maximize the value of the firm. Under this, we determine the proportion in which the capital should be raised from the different securities. The capital structure decisions are related with the mutual proportion of the long term sources of capital. The owned capital includes share capital

a) Preference shares: Preference shares are those shares which have preferential rights regarding the payment of dividend and repayment of capital over the equity shareholders. At present many companies resort to preference shares. The preference shares induct some degree of leverage in finance. The leverage effect of the preference shares is comparatively lesser than that the debt because the preference shares dividend are not tax deductible. If the portion of preference share in the capital is large, it tends to create instability in the earnings of equity shares when the earnings of the company fluctuate.

b) Debt: It is an important source of finance as it has the specific benefit of low cost of capital because interest is tax deductible. The leverage effect of debt is highly advantageous to the equity shareholders. The limits of debt depend upon the firm's earning capacity and its fixed assets.

4) Management: The basic objective of the company is to attain the stated objectives of the company for the good of the equity holders, the public and employees. If the objectives of the company are achieved, investor will have a profit. Good management results in high profit to investors. Management is responsible for planning, organizing, actuating and controlling the activities of the company. The good management depends upon the qualities of the manager.

5) Operating Efficiency: The operating efficiency of the company directly affects the earnings capacity of a company. A growing company that maintains high operating efficiency with a low breakeven point earns more than the company with high break-even point. If a firm has stable operating ratio, the revenues also would be stable. Efficient use of fixed assets with raw materials, labour and management would lead to more income from sales. This leads to internal fund generation for the expansion of the firm.

6) Financial Performance:

a) Balance Sheet: The stability of earnings are powerful forces in the determination of security prices. Balance sheet shows the assets, liabilities and owner's equity in a company. It is show the financial strength of a company. Accounting principles dictate the basis for assigning values to assets. When assets are reduced by liabilities, the book value of shareholder's equity can be ascertained. The book value differs from current value in the market place, since market value is dependent upon the earnings power of assets and not their cost of values in the accounts.

b) Profit and Loss account: It is also called as income statement.It expresses the results of financial operations during an accounting year i.e. with the help of this statement company know the how much profit or loss has taken place from the operation of the business during a period of time. For analyzing the financial position of any company following factors need to be considered for evaluating present situation and prospects of company.

The questions that need to be answered for company analysis are:

a) Availability and Cost of Inputs: Is the company well placed with respect to the availability of basic raw materials, power, fuel and other production inputs? What are the costs advantages/disadvantages of the company vis-à-vis its competitors?

b) Order Position: What is the order position of the company? How many months or years of production does it represent? Is the order position improving or deteriorating?

c) Regulatory Framework: What is the licensing policy applicable to the industry to which the firm belongs? Are there any price and/or distribution controls applicable to the company? If so, what are their implications for profitability?

d) Technological and Production Capabilities: What is the technological competence of the firm? What is the state of its plant and machinery? Does the company have unutilized capacity to exploit favourable market developments?

e) Marketing and Distribution: What is the image of the company in the marketplace? How strong is the loyalty of its customers/clients? What is the reach of the distribution network?

f) Finance and Accounting: What are the internal accruals? How much access the companies have to external financing? What are the products in the portfolio of the company? How competitive is the position of the company in these products?

g) Human Resource and Personnel: How competent and skilled is the workplace of the company? Is the company over-staffed or under-staffed? What is the extent of employee turnover ?