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A Study on Fundamental Analysis of selected Private sector Banks in India

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Abstract:

Many investors prefer to buy shares of various banks in their portfolio. The effectiveness of the banks in the portfolio will be controlled by analytical studies ie both security analysis and portfolio analysis. Security analysis is compared by scrutinizing fundamental and technical aspects. Fundamental Analysis is to judge the future price of a stock which an investor desires to buy. It also analyses the intrinsic worth of a selected organization to relate out whether the current market price is fair or not, whether it is overpriced or underpriced. Analyzing the economy, strategy, management, product, financial studies and other related information will help the investors in investment decision.

Keywords: *overpriced, fundamental analysis, public sector, private sector, Industry analysis.*

1.1 Introduction:

The banking sector comprises all those banks which provide consumers with banking products and banking services. This sector has a great impact on the economy. The stronger the banking sector, the stronger will be economy. Healthy, stable economy requires a strong banking sector. The Indian Banking system consists of public sector, private sector, regional rural, foreign banks, rural and urban cooperative banks. The banking sector comprises of private and public lenders with big players like HDFC Bank, State Bank of India, ICICI Bank Limited, Indian Bank, etc. Many investors prefer to buy shares of various banks in their portfolio. The effectiveness of the banks in the portfolio will be controlled by analytical studies ie both security analysis and portfolio analysis. Security analysis is compared by scrutinizing fundamental and technical aspects. Fundamental

Analysis is to judge the future price of a stock which an investor desires to buy. It also analyses the intrinsic worth of a selected organization to relate out whether the current market price is fair or not, whether it is overpriced or underpriced. Analyzing the economy, strategy, management, product, financial studies and other related information will help the investors in investment decision.

Estimation of real worth of any stock is made by considering the earning potential of the company which depends on the investment environment and factors related to specific industries, competitiveness, quality of management, operational efficiency, profitability, capital structure and dividend policy of an organization. Irrational investors invest their money without doing any type of analysis and so returns on their investments may not be good. As against it, if the investors who want to invest in a particular sector, prefer for fundamental analysis of the stocks. Many investors use fundamental analysis to select a company to invest in and technical analysis to help to make their buy or sale decisions.

Fundamental analysis of security:

For long-term wealth creation, it is extremely important to understand the company investors are going to invest in. This entire process of giving a refined look to a company is known as 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. **Fundamental analysis consists of** Company analysis, Economic Analysis and Industry analysis:

Economic Analysis:

In India, in a mixed economy- public sector plays vital role. Govt budget, policy, tax levies, Govt borrowings programmes, extent of deficit financing etc will have a major influence on performance of Indian economy. The changes in excise and custom duties, corporate taxes etc are all relevant to assess the trends in the economy have an impact on industry and the companies. Macro Economic factors such as growth rate of GDP, savings and investment in country, industry growth rate, price level and inflation, agriculture and monsoon, interest rate, government budget and deficit, the tax structure, balance of payment, infrastructural facilities, demographic factors and sentiments of customers affect on the securities.

Industry analysis:

At any stage in the economy, there are some industries which are growing while others are declining. The performance of Co will depend among other things. If the industry is prosperous, the companies within the industries may also be prosperous. The share price of the particular company is depending up to 50 % on performance of industry and economy. The industry analysis takes into account the various factors which influence on the performance of company. Industry analysis considers nature of Product line, raw material and inputs, capacity installed and utilized industry

characteristics, demand and market, attitude of government with regard to industry, labour condition and industrial problems, nature of competition, management, industrial share and research and development.

Company analysis:

In case of company analysis, company's competitive edge, its market share, growth of annual sale, stability of annual sales etc are considered. Earning capacity, capital structure, efficiency of management, operating efficiency of company, financial performance of the company, etc are considered. The balance sheet data can be used to analyses whether company is doing efficient use of capital, whether the company enjoying leverage in the use of capital, what are the return on net worth or return on equity

1.2 Objectives:

With a purpose of analyzing the financial performance of the selected private sector banks which represent the Indian Private Banking Industry by using different ratio analysis and to find out how fundamentally strong they are?.

- 1: To Analyze the financial performance of selected banks in private sector.
- 2: To study whether the selected banks are fundamentally strong or weak?
- 3, To give suggestions to the prospective investors who desire to invest in banking sector.

1.3 Research methodology:

Methodology:

This study is partially descriptive and partially analytical. This methodology is more suitable for the study of fundamental analysis of the shares.

Data Collection:

For this present analysis, only secondary data is used. Money control, Equity Master Factsheet, Website of selected banks and online journals has been used.

Sample Size:

A total five banks are selected from the Indian private sector banks which are listed on India's leading stock Exchanges viz. BSE and NSE

Sampling Procedure:

The data for this study is selected on the basis of purposive sampling method considering the market capitalization of banks. The selected banks are HDFC bank, ICICI bank, Axis Bank, Kotak Mahindra Bank and IndusInd Bank.

Tools for the Analysis:

For analyzing the collected data, the ratio analysis is used. Ratio analysis technique is adopted to analyze and interpret financial statements to assess the financial position of selected banks. While doing fundamental analysis various financial indicators are used. To assess the

profitability position and its financial health, Net Profit margin, EPS, Return on Equity are studied. To check their asset quality, Gross NPAs and Net NPAs are considered. For assessing the liquidity position, liquidity coverage ratios are calculated. To check the solvency position, Liquidity coverage ratios are calculated. For assessing stock valuation, P/E ie Price to Earnings ratio and Price to book value ratio has been considered.

1.4 Scope of the study:

The scope of the study is to conduct a fundamental analysis of the top five banks viz HDFC, ICICI, Kotak Mahindra Bank, Axis Bank and IndusInd Bank for a period of five years.

1.5 Importance of the study:

Fundamental analysis of the banks gives the clear financial picture of the selected banks. This study will help the investors while selecting the investment avenues if they are banking sector lovers. It will help to do comparative analysis of different banks in the same sector.

1.6 Limitations of the study:

1. The present study has considered only quantitative data.
2. Only some of the ratios are considered for fundamental analysis of selected Bank's stock.
3. As the present study is based on secondary data, accuracy of the study is based on reliability of the secondary data.

1.7 Presentation and discussion:

Table 1: Private Sector Banks and their Market Capitalization (Amt. in Crores)

Sr. No	Banks	2019	Rank
1	HDFC Bank	679602.56	I
2	ICICI bank	339958.56	II
3	Kotak Mahindra Bank	315932.53	III
4	Axis Bank	263744.40	IV
5	IndusInd Bank	101808.81	V

Source: www.moneycontrol.com

Market capitalization means the total value of all a company's shares of stock. It is calculated by multiplying the price of a particular stock by its total number of outstanding shares. Through the market capitalization, investors can understand the relative size of one company versus another. The above table shows that, HDFC bank's market capitalization tops as compared to other selected private sector banks. Among the selected banks, HDFC bank is the preferred pick for investors.

Table 2: Table showing Net Profit Margin Percentage

Indian Private Sector Bank	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
1)HDFC	21.1	20.3	20.8	21.7	21.2
2)ICICI	22.3	17.2	16.7	12.4	5.9
3)Kotak Mahindra Bank	22.9	17.0	22.1	27.7	54.1
4)Axis Bank	31.4	35.0	16.5	1.8	19.6
5)IndusInd Bank	18.5	19.3	19.9	20.9	14.8

Source: Equity master fact sheet

The above table depicts the net profit margin of selected private sector banks. The net profit margin is the percentage of net income generated with respect to revenue. HDFC bank, Kotak Mahindra bank and IndusInd bank are showing good net profit margin. Especially, HDFC bank has been consistently maintaining a net profit margin in last five years. Kotak Mahindra Bank is also having good net profit margin and showing increasing trend.

Table No 3: Earning Per Share of Selected Banks

Indian Private Sector Bank	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
1)HDFC	42.6	50.6	59.5	71.3	82.0
2)ICICI	21.2	17.6	17.5	13.2	6.6
3)Kotak Mahindra Bank	39.4	18.9	26.8	52.5	37.7
4)Axis Bank	31.4	35.0	16.5	1.8	19.6
5)IndusInd Bank	33.9	38.4	47.9	60.1	54.8

Source: www.moneycontrol.com

Every organization earns the profit and some of its part is distributed to the share holders. Earnings per share are the portion of profit to be distributed to each equity share holder. It is the good indicator of the profitability of any organization. EPS gives an idea about earning power of the organization when its performance is compared with similar type of organization in the industry. The above table shows EPS of selected banks. The EPS of HDFC banks has highest EPS. Following HDFC, IndusInd bank has good EPS and year after year EPS of both the banks are showing increasing trend.

Table No 4: Return on Equity, Liquidity Coverage Ratio and Adequacy capital ratio of selected Banks in 2019.

Indian Private Sector Bank	ROE	LCR	ACR
1)HDFC	18.18	132.53	17.1
2)ICICI	9.11	123.56	16.9
3)Kotak Mahindra Bank	13.53	120.7	17.7
4)Axis Bank	9.26	119.72	15.8
5)IndusInd Bank	15.28	114.19	14.2

Source: Equity master fact sheet and website of selected banks

ROE: Return on equity ratio shows how much profit an organization earned in comparison to total amount of shareholders equity fund on balance sheet. ROE is an important measure to compare itself against its peers. Higher the ROE, the investors can chose as a better investment option. The above table depicts the ROE of selected banks. The ROE of HDFC, Kotak Mahindra and IndusInd bank have attractive returns on equity. It means they have generated maximum profit in comparison with the share holder's equity.

LCR: Liquidity Coverage ratio refers to the proportion of highly liquid assets held by the bank and ensures that bank maintains an ongoing ability to meet its short term obligation ie to fund cash outflows for 30 days. The LCR is calculated by dividing a bank's high quality liquid assets by its total net cash flows. HDFC banks LCR as per Basel III guidelines is 132.53. HDFC has excellent LCR as compared to other private sector banks. Following HDFC bank,

ACR: Adequacy Capital Ratio is a measure of how much bank's capital has available, reported as a percentage of a bank's risk-weighted credit exposures. A higher CAR shows that bank is able to withstand a financial down run or other foreseen losses. This ratio is calculated by dividing a bank's capital by its risk-weighted assets. Kotak Mahindra bank's total adequacy ratio is 17.7, where as HDFC bank's ACR is 17.1 and followed by this, ICICI bank has ACR of 16.9.

Table No 5: Gross and net NPAs of selected Banks in 2019

Indian Private Sector Bank	Gross NPA	Net NPA
1)HDFC	2.79	0.42
2)ICICI	3.91	1.6
3)Kotak Mahindra Bank	7.65	0.85
4)Axis Bank	5.97	1.99
5)IndusInd Bank	6.98	1.12

Source: Equity master fact sheet

Above table depicts the Gross and Net NPAs of banks. Gross NPAs refers to the sum of all the loans that have been defaulted by the borrowers within the provided period. The gross NPA does not amount to the actual loss of the organization because the provision for unpaid debts has not been deducted. As against it, Net NPA are the amount that results after deducting provision for unpaid debts from gross NPAs. Net NPA amount to the actual loss of the bank because the provision for unpaid loans has already been deducted.

Kotak Mahindra Bank has highest gross NPA ie 7.65 %, following this, IndusInd Bank has 6.98 %. Again HDFC is a good bank because it has lowest Net NPA ie 0.42 % .where as Axis bank has highest net NPA as compared to other selected banks. It means HDFC bank shows stead growth in profits and bad loans remained in check.

Table No: 6 Price to Earning and Price to Book Value Ratio of selected Banks as on

Indian Private Sector Bank	PE Ratio	Book value Ratio
1) HDFC	28.16	4.49
2) ICICI	50.57	2.96
3) Kotak Mahindra Bank	40.86	5.48
4) Axis Bank	43.74	3.02
5) IndusInd Bank	24.35	3.80

Source: www.moneycontrol.com and screener.in

The above table depicts Price to Earnings Ratio and Price to book value. A higher P/E ratio indicates that an investor is paying more for each unit of net income against every dollar of earnings. Generally, P/E ratio between 12-15 is acceptable. The P/E ratio indicates that what the market is willing to pay today for a stock its past or future earnings. A high P/E ratio means that a stock's price is high relative to its earnings and stock is overvalued.

Among the selected banks, IndusInd bank and HDFC bank has a better Price Earnings Ratio i.e. 24.35 and 28.16 respectively whereas ICICI bank has highest P/E ratio means this stock is overvalued.

The price to book value ie P/B ratio is widely used by market analysts. This ratio is calculated by diving the price of a share of stock by the book value per share. P/B ratio is used to compare a stock's market value with its book value. Book value per share is a good measure to value bank stocks. Above one P/B ratio means the stock is being valued at a premium in the market to equity book value, where as below one P/B ratio means the stock is being valued at a discount to equity book value.

ICICI bank, Axis Bank and IndusInd bank have good price to book value ratio. On the other hand, Kotak Mahindra bank and HDFC bank both have above the generally accepted price to book value ratio. It means these stocks are valued at premium.

1.8 Findings:

1. HDFC bank, Kotak Mahindra bank and IndusInd bank are showing good net profit margin. Especially, HDFC bank has been consistently maintaining a net profit margin in last five years.
2. The EPS of HDFC banks and IndusInd bank both have good EPS and year after year EPS of both the banks are showing increasing trend.
3. The Return On equity of HDFC, Kotak Mahindra and IndusInd bank has attractive returns on equity as they have generated maximum profit in comparison with the share holder's equity.
4. HDFC has excellent LCR as compared to other private sector banks.
5. Kotak Mahindra Bank and IndusInd Bank have highest gross NPA among the selected private sector banks.
6. HDFC bank is a good bank because it has lowest Net NPA and Axis bank has highest net NPA as compared to other selected banks. It means HDFC bank shows steady growth in profits and bad loans kept in check.
7. Among the selected banks, IndusInd bank and HDFC bank has a better Price Earnings Ratio whereas ICICI bank has highest P/E ratio means this stock is overvalued.
8. ICICI bank, Axis Bank and IndusInd bank have good price to book value ratio. On the other hand, Kotak Mahindra bank and HDFC bank both have above the generally accepted price to book value ratio. It means these stocks are valued at premium.

Conclusion:

Fundamental analysis ie examining the economic, financial and other qualitative and quantitative factor related to a particular security to recognize its intrinsic value. It helps the investor to understand whether the stock is trading above the intrinsic value then that security is overvalued. The banking business is different from other businesses. So we need to look at different parameters to analyze the baking stock. Some of the key financial ratios investors use to analyze banks such as return on equity, net income margin, Liquidity coverage ratio, Adequacy of capital ratio, EPS, P/E ratio, Price to book value ratio are some of the important ratios used for fundamental analysis of stocks of banks.

If proper fundamental analyses of securities are done, investors will bag over 1000% returns across their portfolio. Buying right stock at right time is the need. In the present study, considering all these ratios, HDFC bank is performing well. HDFC bank's attractive valuation makes it a good long term buy. It is suggested that investors can invest in stocks of private sector banks like HDFC bank.

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