

FINANCIAL PERFORMANCE COMPARISON BETWEEN PVR LTD & INOX LEISURE LTD USING FUNDAMENTAL ANALYSIS

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ABSTRACT

Fundamental Analysis (FA) is a proven stock selection approach for long-term investing. Investment decisions taken after analyzing key financial parameters can help investors in filtering and comparing peer companies before narrowing down to a single company that might be of interest to the investor who can further do a risk-reward evaluation before investing. While investors chase stock prices, it is the stable and superior long-term financial performance of the company that will ultimately impact the share price over the long-term.

This paper does a comparative study between PVR Ltd and Inox Leisure Ltd - two Indian stock exchange-listed companies from the entertainment industry. Stock-specific data for the period 2009 to 2019 is taken up, and overall rating based on financial performance on parameters including PE Ratio, ROE, ROCE, Sales Growth, Dividend Yield, Debt Equity Ratio, and Profit Growth is arrived.

KEYWORDS: fundamental analysis, financial performance, financial ratio, stock comparison

JEL CLASSIFICATION: G11, G12

I. INTRODUCTION

The Efficient Market Hypothesis (EMH) proclaims that typical stock investors cannot consistently beat the stock market in terms of returns based on market or company information. (Fama & French, 1988) However, investors and market intermediaries continue to build investment strategies trying to predict stock prices in a bid to get superior performance and thereby build wealth.

The Fundamental Analysis (FA) and Technical Analysis (TA) approaches of security analysis are most considered as practical tools for analyzing the qualitative and quantitative aspects of security, respectively. (Petrusheva & Jordanoski, 2016) While the former is more suitable for investing for the medium to a long time, the latter is more suitable for intraday or for shorter timeframes. The FA approach involves studying company performance based on its financial performance obtained from financial statements and indicators (Baresa, Bogdan, & Ivanovic, 2013) over several years to find its strength or weakness of the management in implementing strategies to make profits for the company and thereby wealth to its stakeholders. (Pathade, 2017) The process involves understanding the underlying business of a company based on specific qualitative and quantitative economic parameters, industry conditions, and financial performance. Qualitative parameters like management background, business ethics, corporate governance, the interest of minority shareholders, and promoter integrity play a significant role in fundamental analysis. It helps the investor to determine

the underlying health of the company by examining the core numbers of the business. Share prices of companies with strong fundamentals will eventually tend to go up over time, while fundamentally weak companies might see their stock prices fall. This makes Fundamental Analysis essential and valuable for long-term investments.

II. DISCUSSION

Fundamental analysis of stock selection has two major approaches: The Top-Down approach and the Bottom-Up approach. (Sabatier, 1986) The Top-Down approach, also called EIC (Economy-Industry-Company) approach, refers to drilling down from the top wherein an investor tries to identify economies (countries) across the world that are performing well or growing at a faster pace than others. The next stage is to study potential high growth industries/sectors. After identification of a top potential sector, investors need to find possible high growth companies within it. An investor putting money in these companies can gain from the advantage of higher earnings accruing from the sectors and companies.

The bottom-up approach involves identifying companies that are expected to grow their business without restricting the stock-picking search to any industry or economy (country). All the stocks listed on all stock exchanges in the world, irrespective of country or industry of operation, are open for selection. Investors usually use different selection criteria to identify suitable companies for investments. Sometimes, this criterion could differ for each sector. These criteria include identifying fast-growing companies across all industries and preferring companies with reasonable stock prices compared to their book value and peers of the same industry. Identifying a suitable company can help investors to invest and look forward to benefiting from its future growth.

Investors following the top-down approach focus on companies that are expected to do good in high growth economies, and these are often growth-oriented and overpriced because the market already discounts the potential of the company. The top-down approach limits the choice of stocks available for investments unless the investor decides to overpay for them. The bottom-up approach helps an investor to focus on the right companies irrespective of the industries and economies.

III. LITERATURE REVIEW

A. PREVIOUS STUDIES

The origin of fundamental research on stocks goes back to 1966. Research studies in the stock valuation based on Fundamental Analysis, according to (Bauman, 1996), return for these three main articles: The first study by (Lev & Ohlson, Market-Based Empirical Research in Accounting: A Review, Interpretation, and Extension, 1982) identified the need to create a stock valuation approach to enhance traditional correlation studies. The second article was a stated study by (Lev B. , On the Usefulness of Earnings and Earnings Research: Lessons and Directions from Two Decades of Empirical Research, 1989) that financial statement analysis and our understanding need to be beyond financial ratios and discussed the need for new approaches for research. Finally, the third article by (Bernard, 1994) criticized the generic values of empirical research regarding the role of accounting data in valuation stock. Among his suggestions for future research calls for more methodology modeling and the studies that use samples of firms within a particular industry or economic sector, thus allowing researchers to exploit their knowledge of the detailed disclosures and institutions.

Following this research, several researchers tested the analytical and experimental relations for the accounting data and non-accounting data to identify the valuation of equity firms. Based on US market indicators such as NYSE, AMEX, between 1983 – 1990, the study by (Abarbanell & Bushee,

1997) examined the relations between the accounting data signals between stock prices, using the earnings, monthly returns, and financial data that reflected on Fundamental Analysis, based on the analytical view via (Penman, 1992) and (Lev & Thiagarajan, 1993).

The relationship between financial ratios analysis and equity valuations are examined by (Nissim & Penman, 1999). The study indicated that earnings and earnings growth and analysis of the financial position are helpful in the equity valuation. The ability of earnings and cash flow to interpret the future equity value of a stock is tested by (Subramanyam & Venkatachalam, 2007).

In the Asian Capital Markets, based on the Hong Kong Stock Exchange, the study (Cheung, Chung, & Kim, 1997) created two strategies: the first; the earnings to price ratio (P/E ratio) strategy, the second; book value to price ratio (BV/P ratio) strategy. The results indicated that these two strategies had achieved extraordinary returns.

B. RESEARCH GAP

This research work envisages using key quantitative parameters derived from Financial Statements over time. It identifies itself as a crucial part of the Fundamental Analysis required for good stock selection.

IV. RESEARCH METHODOLOGY

A. RESEARCH OBJECTIVES

1. To understand and identify suitable quantitative parameters to carry out a fundamental analysis of companies.
2. To use back-tested data to validate the model with the help of data, two multiplex operator stocks from the entertainment industry.

B. RESEARCH METHOD

A complete fundamental analysis for comparison can best be done when data of the entire industry and the overall economy are analyzed. However, this paper gives specific focus to the performance of the two selected companies by analysis through different parameters. The following study uses the Bottom-Up approach by selecting two equally good stocks from an industry that offers a long runway for an under-penetrated movie screening business. The purpose of the study is to analyze the financial performance of companies based on selected parameters and compare the financial performance of PVR Ltd and Inox Leisure based on key financial ratios.

C. DATA COLLECTION

This Fundamental Analysis study is based on secondary data collected from Annual Reports and quarterly reports of companies, previous research papers, books, journals, and numerous other articles and websites. The relevant data are collected from the previous financial years and through companies' Financial Reports, including Balance Sheet, Profit & Loss Statements, Account, and Corresponding Schedules that are available by Yearly Review of the selected companies. The ratios for fiscal years are collected wherever available while they are calculated as per requirements when not readily available. Data for ten years from FY 2009-10 to 2018-19 is taken. In this present study, Fundamental Analysis and ratio analysis techniques and parameter ratings were used to measure, evaluate, and compare the selected company's financial performance.

The convenience method of sampling data is used for this study.

V. DISCUSSION

A. INDUSTRY & COMPANY PROFILE

This research used stocks from the Indian Entertainment industry to understand and develop Fundamental Analysis and rating mechanisms. The Indian movie industry is one of the largest globally, but heavily under-screened with eight screens per million, unlike in the US where there are 117 screens per million. The movie exhibition industry has also expanded its supply by penetrating Tier II and Tier III markets. The Indian entertainment industry, with its favorable demographics, enjoys its position in the economy. Multiplexes in India revolutionized the entire movie-going experience for movie lovers. While multiplexes are increasing, single-screen theatres are found to be decreasing.

PVR and Inox Leisure are the two leading players in the industry with a combined market share of more than 70 percent and are chosen to test the research methodology. PVR Cinemas started in 1995 as a film entertainment company in India. A joint venture agreement between Priya Exhibitors Private Limited and Village Roadshow Limited with a 60:40 ratio, PVR Cinemas began its commercial operations in June 1997. PVR has a strong presence in India, with 800 screens in 170 locations across 69 Indian cities. INOX Leisure Limited is the second-largest multiplex chain with 143 multiplexes and 600 screens in 67 cities (as of June 2019). INOX is known for redefining movie experiences in India. Each INOX property is unique with its distinct architecture and aesthetics.

B. CONCEPTUAL FRAMEWORK

Fundamental analysis of the two companies is done based on the following parameters: PE Ratio, Sales Growth, ROCE, ROE, Dividend Yield, Profit Growth and Debt to Equity Ratio

VI. DATA ANALYSIS

A. PE RATIO

The Price to Earnings Ratio (PE) is a measure of the share price relative to the net income earned by the company per share. PE ratio is the most widely used parameter to analyze whether the stock of any company is overvalued or undervalued at the given point of time. PE is calculated by dividing the stock's current market price (CMP) by earnings per share (EPS). It presents the price an investor pays to buy one rupee of earnings of a company. Hence, the lower the PE, the higher the recommendation.

PE with less than ten generally offers a better margin of safety. It is prudent to compare PE of stock with Industry PE to get a greater understanding.

Rating for PE has been given, considering the ideal scenarios. However, consumer-facing companies were found to have higher PE ratios. Higher PE companies, in principle, mean a higher cost is being paid for the share.

B. SALES GROWTH

The sales growth of a company achieved in the past is the most crucial parameter. Companies that have a high demand for their products or services show high sales growth in the past. This data allows, to a certain extent, to project future growth. Generally, a good company's growth is always

above the country's nominal GDP growth. So, considering India's real GDP growth rate of 7% plus our average historical inflation of 6%, the following scoring mechanism is evolved.

For companies that are not growing in line with nominal growth (around 13%) would not offer rewards to investors. Ranges were given considering the strong performance shown for three years. If a company records a growth rate above 20% consistently for more than three years, it is indicative that it can sustain its growth for another 2-3 years, which implies growth possibility for the stock. If the growth rate is cyclical, it would mean that the specific industry is heavily dependent on other economic factors outside the company's purview.

C. RETURN ON CAPITAL EMPLOYED (ROCE)

ROCE ratio is the percentage of net profits before interest and tax (PBIT) to total capital employed. ROCE gives comparative earnings data with capital invested in the company. The equation for ROCE is as follows.

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

ROCE ratio is considered as an important parameter as it reflects the overall efficiency of a company in comparison to capital used. ROCE can be compared with other companies in the same sector to provide better insights into the comparative performance of the stock.

ROCE should always be higher than the company's borrowing rate; otherwise, the increase in the borrowing rate will reduce shareholders' earnings. Companies with higher ROCE means earning more revenue for capital employed, and it directly shows the strength of the company to attract customer loyalty and enhanced profitability. ROCE higher than 15% means that it is a reliable company with consistent performance and indicates that the company can sustain different cycles and continue to get stronger over time.

D. RETURN ON EQUITY (ROE)

The Return on Equity (RoE) is also a vital ratio, as it allows investors to assess the return earned for every unit of capital invested. RoE measures the entity's ability to generate profits from the shareholders' investments. In a way, RoE shows the efficiency of the company in terms of generating profits for its shareholders. Higher RoE for a company is better for the shareholders, as it results in more returns. ROEs of 15-20% is generally considered good.

When the opportunity cost is presumed to be 7.5 percent, anything above 7.5 percent can be regarded as useful. However, companies with ROE greater than 15 percent are preferred because they give high profits for investors.

E. DIVIDEND YIELD (DY)

Dividend Yield (DY) data gives about the dividend paid by a stock compared to its current market price (DY = dividend paid / Current market price). If a company with CMP of Rs. 100 pays a dividend of Rs.5 per share in a year; then, its DY is 5%.

High dividend yields mean that share price is lower and low yields mean that share prices are costlier. Stocks with DY of >6% are considered very attractive. Investors need to depend purely on their growth and increase in share price without emphasis on dividends.

F. PROFIT GROWTH

10-Year Profit Growth

Two measures for the profitability of a company are Operating Profit Margin (OPM) and Net Profit Margin (NPM). OPM gives a profit of sales income after deducting costs incurred to produce these sales, e.g., raw material costs, employee costs, marketing costs, power, & fuel costs, amongst others. Operating profit does not consider expenses like depreciation of fixed assets, interest, and tax expenses. NPM gives the net profit that remains after a company has paid its interest, tax, and after consideration of depreciation. Net profit is the final amount after meeting all expenses and is available to the company for reinvesting or distributing to shareholders as a dividend. Sustained profits can help investors get good returns. Companies with high-profit margins are impervious to tough times and can still make money for their shareholders. Here net profit and profit growth % is considered for ten years. Companies with 20% more growth across ten years can make their investors higher profitable.

Table 1: 10-Year Profit Growth comparison of the two companies

Last 10 Yrs Profit Growth %	PVR	INOX
Last 10 Yrs	35.22%	18.67%

Source: Screener.in and Annual Reports of the two companies

Last 5-Year Profit Growth %

5 Years period is also a reasonably good period, and this parameter is considered to rope in benefits for newly started companies. If the company is less than ten years old, this parameter will help to analyze and understand the potential of the company. Even within five years, if a company performs more than a 20% growth rate, it will create good wealth for investors.

Last 3-Year Profit Growth %

This parameter is more useful for relatively new companies, as they will not have the legacy of the long term. Usually, path-breaking companies will have better numbers in this section. All 3-year, 5-year, and 10-year parameters are considered to weigh the profitability growth of companies since their profits will ultimately reflect in share prices.

Table 2: 3-Yr & 5-Yr Profit Growth comparison of the two companies

	3-Yr Profit Growth Rate		5-Yr Profit Growth Rate	
Financial Year	PVR	INOX	PVR	INOX
2014-15	19.58%	35.72%	67.02%	0.78%

2015-16	30.59%	65.09%	65.05%	63.18%
2016-17	19.68%	-6.75%	30.87%	24.57%
2017-18	112.64%	66.31%	23.22%	44.90%
2018-19	23.36%	17.97%	26.86%	29.16%

Source: Screener.in and Annual Reports of the two companies

This parameter shows the volatility in the growth rates of the companies. When more companies in the same sector go through similar volatility, it means that the specific sector had issues in that period. However, PVR has maintained better numbers for three years, and INOX maintained better numbers for two years.

G. DEBT TO EQUITY RATIO

Debt Equity (D/E) ratio provides the data about the funds utilized by the company to buy its assets. The company uses its assets such as factories and machinery to produce goods & services that, in turn, generate sales revenue to the company. D/E shows details about the company's funds employed (shareholder's funds) and borrowed funds from other lenders. D/E of 1 means that equal contribution of own funds and borrowed funds. So, 50 percent of funds come from shareholders. The remaining 50 percent are lender funded. A good company is one with no-debt and hence will have a DE of 0. However, manufacturing companies usually have some debt to invest in facilities. Services-oriented companies such as IT companies are usually Debt Free. The entertainment industry will have some debt as a result of substantial investments in the form of building multiplexes.

Table 3: Comparison of financial parameters for the two companies

	PE Ratio		Sales Growth		ROCE		ROE		Debt to Equity Ratio	
Financial Year	PVR	INOX	PVR	INOX	PVR	INOX	PVR	INOX	PVR	INOX
2014-15	212.54	74.69	41.80%	16.04%	9%	7%	3.11%	2.96%	1.6	0.3
2015-16	38.51	23.11	31.91%	14.57%	17%	13%	11.13%	15.51%	0.6	0.5
2016-17	78.32	89.75	16.27%	11.41%	14%	9%	9.92%	5.23%	0.8	0.5
2017-18	54.57	21.94	16.47%	10.37%	15%	16%	11.59%	16.32%	0.6	0.4
2018-19	44.92	22.03	17.95%	14.01%	19%	23%	14.78%	13.85%	0.9	0.1

Source: Screener.in and Annual Reports of the two companies

H. OVERALL RATING OF COMPANIES

Overall Rating helps make a comparison of the two companies. All nine parameters are allotted equal weights. Profit growth, however, is considered under three parameters, which means that consistently good companies with good profitability growth will have a better rating. Table 4 shows the bird's eye view of fundamental analysis of the two companies.

Table 4: Measurement scale for various parameters

Parameter	1 Star	2 Stars	3 Stars	4 Stars
PE Ratio	Above 30	15 to 30	5 to 15	Below 5
3-Year Sales Growth %	Below 5	5 to 15	15 to 20	Above 20%
ROCE	Below 5	5 to 15	15 to 20	Above 20%
ROE	Below 7.5	10 to 7.5	15 to 10	Above 15%
Dividend Yield %	Below 1	3 to 1	6 to 3	Above 6%
Debt Equity Ratio	Above 1	0.5 to 1	0.5-0.1	0
10 Yrs Profit Growth %	Below 6	5 to 15	15-20	Above 20%
5 Yrs Profit Growth %	Below 6	5 to 15	15-20	Above 20%
3 Yrs Profit Growth %	Below 6	5 to 15	15-20	Above 20%

Source: Author compilation

Table 5: Analysis of data as per computation

Parameter	PVR	PVR Rating	INOX	INOX Rating
PE Ratio	54.97%	1	24.93%	2
3 Years Sales Growth %	18.67%	3	14.01%	2
ROCE	19.22%	3	22.75%	4
ROE	15.78%	3	17.04%	3
Dividend Yield %	0.10%	1	0.00%	1
Debt Equity Ratio	1.18	1	0.08	4

10 Yrs Profit Growth %	34.54%	4	19.14%	3
5 Yrs Profit Growth %	28.79%	4	30.04%	4
3 Yrs Profit Growth %	22.73%	4	19.14%	3
Overall Rating*	83%	4	75%	3.5

Source: Sharespectrum.com; Data is as of October 31, 2019

V. RESEARCH FINDINGS

1. Though both companies suffer from higher PE, INOX is relatively lower than that of PVR.
2. Average sales growth of 15% for more than three years demonstrates the potential of the company. In this case, both PVR & INOX displayed good performances, and yet, PVR seems to have an absolute advantage with higher average growth rates.
3. PVR has an advantage of higher ROCE till 2016-17 than INOX, while INOX has done well subsequently. However, it also depends on additional Capex through additional screens, which in turn will help in future increased ROCE.
4. The ROE of PVR can be observed to be better than INOX except for 2017-18.
5. The Dividend yield for PVR stands at around 0.10, and for INOX, it is about 0.00, which means that both share prices are too high and its dividend yields are either minimal or nominal. PVR has an overall edge over INOX for all 3-year, 5-year, and 10-year time frames regarding Profit Growth.
6. Debt to Equity for both companies is in the range of 0.5 to 1 for more years. However, INOX seems to have a better advantage in this parameter.

VI LIMITATIONS OF THE STUDY

The data set used in the study is historic data and does not cover the future growth projections of the companies, which vary from time to time based on the financial strength, market conditions, regulatory interventions, raising real estate prices, amongst others.

VII. CONCLUSION

Fundamental analysis is pivotal in analyzing the financial performance of the organization for potential suitability for investors. It is more critical for a long-term investor to include Fundamental Analysis since it considers multiple perspectives from macro to micro to understand if stock is overvalued or undervalued. Fundamental analysis helps investors make a safer and well-reasoned bet when they are investing.

A scoring mechanism is prepared that helps investors analyze a company with a good profit over long periods. ROE and ROCE which as above benchmark lending rate, offer sustainable returns to its shareholders. This model is also useful for companies with a legacy of more than ten years and simultaneously for companies with just three years track record. However, companies that perform well over a long period gain a better rating.

It also demonstrates that dividend yield is not much for capital hungry companies like PVR and INOX. However, their efficient use of capital will compensate for the dividends with stock price

appreciation. It also showcased that PVR with its superior scores in profit growth over extended time tilted scales when compared to INOX, which is catching up with the industry leader.

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