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PERFORMANCE ANALYSIS OF INFORMATION TECHNOLOGY SECTOR IN INDIA

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ABSTRACT

The EBIT – EPS analysis is a method to study the effect of leverage, essentially involves the comparison of alternative methods of financing under various assumptions of EBIT. A firm has the choice to raise funds for financing its investment proposals from different sources in different proportion. The world IT industry has changed drastically in the last twenty to twenty five years. An attempt has been made in this paper to analyse the applicability of EBIT- EPS analysis for this sector.

KEY WORDS: EBIT, EPS, IT Sector, Security returns, Ratio analysis.

INTRODUCTION

The EBIT – EPS analysis is a method to study the effect of leverage, essentially involves the comparison of alternative methods of financing under various assumptions of EBIT. A firm has the choice to raise funds for financing its investment proposals from different sources in different proportion. For this a firm can exclusively use equity capital or exclusively use debt. Firm can also exclusively use preference capital or use a combination on equity capital, debt and preference capital in different proportion.

The choice of the combinations of the various sources would be one which gives the level of earnings before interest and tax which would ensure the largest EPS. Generally cost of debt is lower than cost of equity. Therefore raising debt increases EPS and it gives benefit to the shareholders. However, excess of debt will create more risk and therefore it is not advisable. A firm can identify an ideal level of quantum of debt and equity so that it will be within proportion.

EBIT - EPS analysis allows managers to see how different capital structures affect the earnings and levels of the firm. Specifically, it shows the graphical relationship between the firm's operating earnings or earnings before interest and taxes (EBIT) and its earnings per share (EPS). Scenario analysis with different levels of EBIT can help analysts to see the effects of different capital structures of the firm's earnings per share.

OBJECTIVES OF THE STUDY

1. To understand the EPS- EBIT analysis of BSE 10 companies in IT sector.

2. To conduct a comparative study of EPS - EBIT Analysis and security returns IT companies.

3. To understand the ratios which are the part of the EPS and EBIT analysis.

SOURCES OF DATA

The data collected for the purpose of the study was secondary data. The data was collected from the "prowess database". 15 years data were considered for analysis of EBIT and EPS in BSE 10 companies under IT sector. Literatures relating to EBIT and EPS analysis are collected from various reference books and websites. The study intends to examine the average profitability, debt fund level and earnings per shares over a period of 15 year from 1999 to 2013.

METHODOLOGY USED FOR THE STUDY

Simple statistical techniques like ratio calculation and averages of ratios are considered. Further f test is carried out for better understanding and presentation. To conduct f test excel software was used, which generated the ANOVA table for analysis. Ratios like Debt equity ratio, Debt ratio, and Interest cover ratio by using PAT and Interest cover ratio by using PBDIT are deployed.

EBIT ANALYSIS

In accounting and finance, earnings before interest and taxes (EBIT), also called operating profit or operating income is a measure of a firm's profit that excludes interest and income tax expenses. It is the difference between operating revenues and operating expenses. When a firm does not have non-operating income, then operating income is sometimes used as a synonym for EBIT and operating profit. Accountants like EBIT and consider it to be an important indicator. It measures profits and avoids distortions that result if companies use different capital structures or tax rates. That makes it a handy ratio for comparing profit figures from different businesses.

EBIT is more than just a number, it is a yardstick often used to value a business. The price someone is willing to pay to buy a business may be calculated as a multiple of its EBIT. A ratio of 2-4 times EBIT is common in many purchases. There are a variety of benefits that this calculation affords, including the ability to compare companies that have different tax and financial structures. By eliminating tax and interest, different accounting techniques are less likely to adversely affect a more equitable comparison of companies. This allows an investor to better understand how efficiently each company operates and to determine which is the most profitable, despite any structural or procedural differences.

The financial performance of an enterprise may be measured by looking at what is known as cash earnings per share. This calculates the cash the enterprise generates from its operations during an

accounting period, or operating cash flow. To obtain cash earnings per share, operating cash flow is divided by the number of shares in the company. This measure normally would use the fully diluted shares, or the number of shares that could be held if instruments such as options and warrants are converted into shares by those holding them. Cash earnings per share are different from basic earnings per share, because the former uses cash flow as a measure rather than profit. To arrive at the figure for cash arising from business operations, it is necessary to include non-cash items in profit.

Cash earnings per share are a measure using fully diluted earnings per share. The figure includes the shares held by investors at the time the calculation is made, as well as the total number of shares that would be in the hands of investors if all investors holding warrants or options to buy shares or convert their holding into shares were to exercise this right. The fully diluted earnings per share figure is used because it is a more conservative measure of earnings potentially available to shareholders. It is useful to know cash earnings per share, because the figure for cash generated in an accounting period is not as dependent on subjective judgments as the profit figure is. The profit for a period may depend on the company's capital structure, depreciation policy, policy on amortization of intangible assets and decisions on leasing or buying assets. The figure for cash generated is more independent of these judgments and accounting policies. As with all accounting and financial ratios, the cash earnings per share number is most useful when used to compare the performance of an enterprise with its competitors in the same industry, or to compare the performance of one enterprise in two different periods. Investors performing this type of comparison must ensure that they are comparing the same ratio in each company, because different earnings per share measures are computed in different ways.

Table No: 01 Difference between Debt Equity Ratios of Information Technology Sector (Anova)

Source of Variation	SS	df	MS	F	P-value	F crit
Between Groups	10124.67107	31	326.60229	6.24727	6.99872	1.48782
Within Groups	16467.93067	315	52.27914			
Average	3.8836					
Total	26592.60174	346				

From the above statistical table the average debt equity ratio of information technology sector is 0.038836. The f test result reveals that there is significant difference between the debt equity ratios of information technology sector. The average high debt equity indicates that there is no more debt fund in the information technology sector. It is clear from the above result that all the companies in this sector are following different strategy with respect to debt funding.

Table No: 02 Difference between Debt Ratios of Information Technology Sector Anova

Source of Variation	SS	df	MS	F	P-value	F crit
Between Groups	9889.70195	31	319.0226	6.10036	2.3375	1.4878
Within Groups	16473.13925	315	52.2956			
Average	3.7931					
Total	26362.84121	346				

From the above statistical table the average debt ratio of information technology sector is 0.037931. The f test result reveals that there is significant difference between the debt ratios of information technology sector. The average high debt indicates that there is no more debt fund in the information technology sector. It is clear from the above result that all the companies in this sector are following different strategy with respect to debt funding.

Table No: 03 Difference between EPS of Information Technology Sector (Anova)

Source of Variation	SS	df	MS	F	P-value	F crit
Between Groups	1.56156	32	4.87989	9.64365	3.9917	1.4793
Within Groups	1.64457	325	5.06021			
Average	2.39087					
Total	3.20613	357				

The average EPS of information technology sector is 0.0239087 for the period of 15 years. The f test result reveals significant difference between the EPS of information technology sector. A higher EPS is the sign of higher earnings and strong financial position. It is clear from the above result that all the companies in this sector are following different strategy with respect to investing fund.

Table No: 04 Difference between Interest Cover (PBDITA) Ratios of Information Technology Sector (Anova)

Source of Variation	SS	df	MS	F	P-value	F crit
Between Groups	196543505.7	31	6340113.086	1.28080	0.15129	1.48853
Within Groups	1529586785	309	4950119.045			
Average	504.4676					
Total	1726130290	340				

The average interest coverage ratio (PBDITA) of information technology sector is 5.044676. The f test result reveals that there is insignificant difference between the interest coverage ratios of information technology sector. The average high interest rate indicates that there is no more debt fund in the information technology sector. It is clear from the above result that all the companies in this sector are following same strategy with respect to debt fund.

Table No: 05
Difference between Interest Cover (PBT) Ratios of Information Technology Sector (Anova)

Source of Variation	SS	df	MS	F	P-value	F crit
Between Groups	143977418.5	31	4644432.855	1.231724	0.19069	1.48853
Within Groups	1165139063	309	3770676.579			
Average	403.4071					
Total	1309116481	340				

The average interest coverage ratio (PBT) of information technology sector is 4.034071. The f test result reveals that there is insignificant difference between the interest coverage ratios of information technology sector. The average high interest rate indicates that there is more debt fund in the information technology sector.

Table No: 06Difference between EBIT of Information Technology Sector (Anova)

Source of Variation	SS	df	MS	F	P-value	F crit
Between Groups	34008516745	31	1097048927	7.86525	2.5792	1.4886
Within Groups	42959957349	308	139480381			
Average	4170.7655					
Total	76968474094	339				

From the above table the average EBIT of information technology sector is 41.707655million rupees. The f test result reveals that there is significant difference between the EBITs of information technology sector. This result reveals that information technology sector companies maintain different levels of EBIT.

ANALYSIS OF SECURITY RETURNS OF IT SECTOR

Table No: 07 Security Returns of IT Sector

Company	Avg Ri	Avg Rs	Avg Beta	Avg lnRi	Avg LnRs	Avg Ln?
TCS.	3.5504	21.2869	0.8632	-12.1253	17.1805	0.8628
Wipro Ltd.	12.0284	17.0999	1.2768	-15.9304	12.5441	1.2839
Infosys	18.9809	15.8340	1.1144	- 0.8639	11.8031	1.1012
H C L Tech	5.3136	14.3353	1.2746	-15.7939	10.0256	1.2776
Tech Mahindra	27.2762	14.8200	0.9242	12.2141	10.6614	0.9362
Patni Computer	25.4733	21.9496	0.7474	14.2804	18.8274	0.7508
i-flex	32.0813	21.0895	0.9496	18.9814	17.4128	0.9429
Silverline Tech.	70.2158	20.6838	1.9356	-37.3928	8.1415	1.4423
Mphasis	17.2417	12.7230	0.8125	- 5.1493	9.1673	0.8041
N I I T	0.0560	17.2201	1.1962	-30.4522	12.8787	1.1908
Average	**21.22176**	**17.70421**	**1.1094**	**- 7.2232**	**12.8642**	**1.0593**
t- test	**0.600356**			**0.0082**		

As per the above table, all the ten companies are having positive average returns so these companies stocks are giving positive returns. NIIT Ltd average returns are lowest (0.0560). So it's better to invest in those securities which are giving high/ positive returns. In the case of average log return most of the companies showing negative value i.e. negative return, so if the investors want to invest, they can invest on the company showing high/ positive return.

Seeing the above table, average log return shows clear picture than average return. The average return of IT sector is 21.22 and required return is 17.70 it means in this study IT sector's return is more than required. The t-test reveals that there is no significant difference between the security return and required return.

When considering these ten companies the beta value of five companies were below 1.00, but rest of five companies showed it to be more than one which is the indication that these companies stocks are very aggressive in nature .The companies with the aggressive stocks was: Silverline Technologies, NIIT Ltd, HCL Technologies Ltd, Wipro and Infosys. Overall average beta of IT Sector indicates aggressive in nature with a beta value of 1.1094.

The average log return of IT sector is -7.2232% and log required return is 12.86% it means in this study IT sector's return is more than required which indicate negative log return and positive required return in IT sector.

FINDINGS OF THE STUDY

The study on "EBIT And EPS Analysis of BSE, IT Companies" reveals the following findings. All the companies in IT sector are following different strategy with respect to their earnings and debt funding. There is no significant difference between the earnings is companies in information technology sectors and same strategy with respect to their debt fund.

CONCLUSION

EBIT - EPS analysis is allows managers to see how different capital structures affect the earnings and levels of the firm. Specifically, it shows the graphical relationship between a firm operating earnings or earnings before interest and taxes (EBIT) and its earnings per share (EPS).Scenario analysis with different levels of EBIT can help analysts to see the effects of different capital structures of the firm s earnings per share.

The study on EBIT EPS analysis reveals significant difference in the debt policy with in the sectors. The earnings of the different sector also show significant difference with in the sectors. This result reveals that all the companies are following their own strategy with respect to debt funding. Further the rates of return of the company s are also specific to the concerned company. It is clear from the above results that the earning capacity and the debt capacity purely depend on the efficiency and capacity of concerned company.

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