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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	SPECIFICS OF INVESTOR SENTIMENTS: ANALYSIS OF CHINESE MARKET <i>JOHN WEI-SHAN HU & ASKAR KOSHAEV</i>	1
2.	DETERMINANTS OF THE FLOWER PRODUCERS & EXPORTERS PERFORMANCE IN ETHIOPIA <i>DR. GETIE ANDUALEM IMIRU</i>	9
3.	IMPACT OF DEMOGRAPHIC VARIABLES ON QUALITY OF WORK LIFE: AN ANALYSIS ON POLICE PERSONNEL'S OF TAMIL NADU POLICE DEPARTMENT IN TIRUNELVELI CITY <i>M. NIROSHA KAMALI & DR. SUSAN CHIRAYATH</i>	18
4.	STRATEGIES IMPLEMENTED IN ORGANIZED RETAIL SECTOR <i>RIJWAN AHMED MUSHTAK AHMED SHAIKH & DR. DILIP B. SHINDE</i>	24
5.	EVALUATION OF CUSTOMER RELATIONSHIP MANAGEMENT IN APSRTC: A CASE STUDY OF EMPLOYEES OF GUNTUR DISTRICT <i>M. V. SUBBA RAO & DR. M. S. NARAYANA</i>	28
6.	A STUDY ON FINANCIAL PERFORMANCE IN MAYURAM CO-OPERATIVE URBAN BANK LTD. WITH SPECIAL REFERENCE TO MAYILADUTHURAI, TAMILNADU <i>DR. R. SRINIVASAN</i>	35
7.	IMPACT OF PSYCHOSOCIAL FACTORS ON DOCTORS PRESCRIBING BEHAVIOR <i>ANKUSH & DR. DEEPAK KAPUR</i>	38
8.	DIMENSIONS IN GROWTH OF SMALL SCALE INDUSTRIES (MSMEs) IN ODISHA: AN IMPACT OF EMPLOYEES <i>GOLAKH KUMAR BEHERA, RUDRA PRASANNA MAHAPATRA & SALMAMANI TUDU</i>	43
9.	A STUDY ON KNOWLEDGE, ATTITUDE AND PRACTICE ASSESSMENT ABOUT BIO –MEDICAL WASTE MANAGEMENT AMONG HEALTHCARE PERSONNEL <i>T UMAMAHESWARA RAO, DR. V. N. SAILAJA & DR. N. BINDU MADHAVI</i>	47
10.	DIFFUSION OF PERCEIVED RISK: A KEY TO SUCCESS <i>DR. RUPINDER SINGH</i>	52
11.	THE ROLE OF BANCASSURANCE IN DIGITAL ERA <i>SREENISH S R & DR. S A SENTHIL KUMAR</i>	54
12.	VALUATION OF HERO MOTOCORP LTD. AND BAJAJ AUTO LTD.: AN ANALYTICAL PERSPECTIVE <i>SURENDER SINGH & DR. SHARMILA DAYAL</i>	57
13.	PRADHAN MANTRI JAN DHAN YOJANA - AN EXPLORATORY STUDY OF BANKS PARTICIPATION IN FINANCIAL INCLUSION IN INDORE DISTRICT <i>VAISHALI WAIKAR & DR. YAMINI KARMARKAR</i>	61
14.	IMPACT OF BANKING SOFTWARE PRODUCT OF INFOSYS AMONG BANK EMPLOYEES WITH SPECIAL REFERENCE TO CHENNAI <i>DR. S. SARAVANAN & DR. S. VELAYUTHAM</i>	65
15.	A STUDY OF NON PERFORMING ASSETS IN INDIAN PUBLIC SECTOR BANKS <i>DR. A. C. PRAMILA</i>	71
16.	DEMONETISATION: ANALYSIS OF ITS CURRENT KEY EFFECTS ON THE INDIAN ECONOMY <i>MOHD SAZID</i>	74
17.	A STUDY ON FACTORS AFFECTING BRAND LOYALTY OF FMCG USERS <i>DR. SWAYAMBHU KALYAN MISHRA</i>	76
18.	PORTFOLIO MANAGEMENT: A DECISION MAKING TOOL IN THE HANDS OF INVESTORS <i>SIMRAN SAINI</i>	80
19.	PERFORMANCE EVALUATION OF STATE BANK OF INDIA AND ITS ASSOCIATE BANKS THROUGH CAMEL ANALYSIS <i>VIJAY KUMAR SHARMA</i>	84
20.	FACTOR AFFECTING QUALITY OF WORK LIFE IN PUBLIC & PRIVATE SECTOR BANKS IN LUCKNOW <i>ISHA GUPTA</i>	92
	REQUEST FOR FEEDBACK & DISCLAIMER	98

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VALUATION OF HERO MOTOCORP LTD. AND BAJAJ AUTO LTD.: AN ANALYTICAL PERSPECTIVE

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ABSTRACT

This research paper focuses on an analytical valuation perspective of Hero Motocorp Ltd. (HMCL) and Bajaj Auto Ltd. (BAL). HMCL is the no. one motor bike maker in India and BAL takes place second position. The companies were valued on the basis of 9 financial parameters. In the present era of Liberalization, Privatization and Globalization, the Market has become globally competitive; hence the survival of an enterprise depends upon the efficiency and accuracy, it is necessary to evaluate the financial performance of sampled units to know where these companies stand in the market and how these companies can improve further in the future by knowing their shortcomings.

KEYWORDS

HMCL, BAL, parameters, ratios.

INTRODUCTION

It is a basic fact that managers who focus on building shareholder value will create healthier companies that who do not. Healthier companies will in turn, lead to stronger economies, higher living standard and more career and business opportunities. The objective in corporate finance is the maximization of firm's value, then the relationship between financial decisions, corporate strategy and firm value has to be delineated. The value of a firm can be directly related to decisions that it makes, on which projects it takes, on how it finances them and on its dividend policy.

APPROACHES TO VALUATION

Basically there are two approaches to valuation. The first and most fundamental approach is discounted cash flow valuation, which extends the present value principles used to analyze projects to value a firm. The value of a firm is determined by four factors: Its capacity to generate cash flow from assets in place, the expected growth rate of these cash flow, the length of time it will take for the firm to reach stable growth rate and cost of capital.

The second way of valuing a firm or its equity is based on how the market is valuing similar or comparable firms. This is called relative valuation.

ROLE OF VALUATION

Valuation is useful in a wide range of tasks. The role it plays however is different in different arenas. Valuation is the central focus in fundamental analysis. The underlying theme in fundamental analysis is that true value of firm can be related to its financial characteristics-its growth prospects, risk profile and cash flow. Some analysts use discounted cash flow models to value firms, while others use multiple such as the price/earnings and book value ratios. Thus valuation plays a key role in many areas of finance in corporate finance, in merger & acquisition and in portfolio management.

1. **Corporate Finance:** - It the objective in corporate finance is the maximization of firm's value, then the relationship between financial decisions, corporate strategy and firm value has to be delineated. The value of a firm can be directly related to decisions that it makes, on which projects it takes, on how it finances them and on its dividend policy.
2. **Merger & Acquisition:** - It plays a central in acquisition analysis. The bidding firm or industry has to decide on a fair value for the target firm before making a bid and the target firm has to determine reasonable value for itself before deciding to accept or reject the offer.
3. **Portfolio Management:** - The role that valuation plays in portfolio management is determined in larger part by the investment philosophy of the investor. Valuation plays a minimal role in portfolio management for a passive investor, whereas it plays a larger role for an active investor. Even among the active investor, the nature and role of valuation are different for different types of active investment.

METHODOLOGY

The data set for the study was collected from the CMIE Prowess database. Two companies, HMCL and BAL have been taken into study for a period of 2006 to 2015 from automobile sector. The companies were valued on the basis of 9 financial parameters.

The following parameters were utilized for the study:

1. Average Growth Rate
 2. Sales
 3. Market Capitalization
 4. Research & Development
 5. Cash Flows
 6. Shareholder Wealth
 7. Ratio Analysis
 8. Profitability Analysis
 9. Market Value Analysis
- The values of market capitalization & sales represent the valuation dimension from the perspective of the stock market performance and operating performance.
 - The central focus is on cash flow because they represent the actual economic benefits generated by the assets.
 - The study also uses the liquidity, profitability, efficiency and solvency ratios to examine the top value creators.
 - Liquidity ratios measure the firm's ability to meet current obligations.
 - Profitability ratios measure overall performance and effectiveness of the firm.

- Efficiency ratios or Activity ratios are employed to evaluate the efficiency, with which the firm manages and utilizes its assets.
- Leverage ratios are helpful in understanding the long-term financial position of the firm.

RESULTS AND INTERPRETATION

1. VALUATION ON THE BASIS OF AVERAGE GROWTH RATE OF SALES

Sales figures for the last 10 years from 2006 to 2015 were taken for the analysis. First the growth rate for each year was calculated and the average of the growth rate for all years was taken.

TABLE 1: HIGHER GROWTH RATE COMPANY

Average Growth Rate (2006-2015)		
Rank	Company	Growth Rate (%)
1	HMCL	4.2
2	BAL	2.2

Source of Data: CMIE Prowess database

It is observed that HMCL is having the higher growth rate as compared to BAL. The growth rate of HMCL is 4.2% in comparison to the 2.2% of BAL.

2. VALUATION ON THE BASIS OF SALES

The methodology involved finding out the cumulative sales for both the companies to determine the top company in terms of sales for the past 10 years.

TABLE 2 (i): TOP COMPANY IN TERMS OF CUMULATIVE SALES

Cumulative Sales (2006-2015)		
Rank	Company	Total Cumulative Sales (In Crore)
1	HMCL	17662.42
2	BAL	15776.12

Source of Data: CMIE Prowess database

The sales of HMCL is more than the sales of next best its competitor BAL.

TABLE 2 (ii): RANKING BASED ON SALES

Position based on sales (2015)		
Rank	Company	Total Sales (In Crore)
1	HMCL	27585.30
2	BAL	21569.72

Source of Data: CMIE Prowess database

When the sales exclusively for the year 2015 is taken, HMCL leads in the case of higher sales.

3. VALUATION BASED ON AVERAGE MARKET CAPITALIZATION

The following table gives a position of both the companies ranked on the basis of market capitalization.

TABLE 3: AVERAGE MARKET CAPITALIZATION-VALUATION

Market Capitalization (2006-2015)		
Rank	Company	Average Market Capitalization (In Crore)
1	HMCL	1.58
2	BAL	4.16

Source of Data: CMIE Prowess database

From the above table it can be seen that BAL has the higher market capitalization as compared to HMCL.

4. VALUATION BASED ON RESEARCH & DEVELOPMENT EXPENDITURE

The following table gives the ranking of the Average R&D expenditure of HMCL and BAL for the last 10 years (2006-2015):

TABLE 4: R&D TRENDS

Average R&D Expenditure (2006-2015)		
Rank	Company	R&D Expenditures (In Crore)
2	HMCL	0.42
1	BAL	1.23

Source of Data: CMIE Prowess database

From the above table we can see that there is a big difference between the R&D expenditure of HMCL and BAL. Very less attention has been paid by the HMCL in the last 10 years over the R&D expenditure.

5. VALUATION BASED ON CASH FLOWS

The following table gives a position of both the companies that have topped in the operational cash flows.

TABLE 5: CASH FLOW VALUATION

Average cash flow (2006-2015)		
Rank	Company	Average Cash Flows (In Crore)
1	HMCL	8.01
2	BAL	47.86

Source of Data: CMIE Prowess database

From the above table we can see that BAL has higher cash flows followed by HMCL. Figure Rs. 8.01 Crs represents the cash flow position of HMCL whereas the figure Rs. 47.86 Crs represents the cash flow position of BAL.

6. VALUATION BASED ON SHAREHOLDERS WEALTH

The following table gives a position of both the companies that have topped in the shareholders wealth.

TABLE 6: SHAREHOLDERS WEALTH VALUATION

Shareholders Wealth (2006-2015)		
Rank	Company	Shareholders Wealth (In Crore)
2	HMCL	3912.47
1	BAL	5692.37

Source of Data: CMIE Prowess database

From the above table we can see that BAL has higher shareholders wealth followed by HMCL. HMCL's shareholder wealth was Rs. 3912.47 Crs whereas BAL's shareholder wealth was Rs. 5692.37 Crs.

7. VALUATION BASED ON GENERAL RATIO ANALYSIS

The ratios used were categorized into liquidity, profitability, efficiency and leverage ratios. The ratios were calculated for a period of 10 years from 2006 to 2015 on an average basis. The companies were ranked on the basis of each ratio type; points were given to the companies in each ratio type

TABLE 7.1: RATIO ANALYSIS-LIQUIDITY AND PROFITABILITY (2006-2015)

Rank	Company	Liquidity Score	Rank	Company	Profitability Score
2	HMCL	0.98	2	HMCL	44.18
1	BAL	1.55	1	BAL	10.19

Source of Data: CMIE Prowess database

TABLE-7 2: RATIO ANALYSIS-EFFICIENCY AND LEVERAGE (2006-2015)

Rank	Company	Efficiency Score	Rank	Company	Leverage Score
1	HMCL	103.05	2	HMCL	13.28
2	BAL	45.17	1	BAL	8.04

Source of Data: CMIE Prowess database

TABLE 7.3: RATIO ANALYSIS-MARKET VALUE (2006-2015)

Rank	Company	Market Value Score	Rank
1	HMCL	42.08	2
2	BAL	42.73	1

Source of Data: CMIE Prowess database

TABLE 7.4: RANKING OF COMPANIES ON THE BASIS OF RATIO ANALYSIS POINTS (2006-2015)

Average Ratio Analysis Ranking (2006-2015)		
Rank	Company	Total Points
1	HMCL	8
2	BAL	7

Source of Data: CMIE Prowess database

HMCL leads as it got 8 points in comparison to the 7 points of BAL. In the case of Liquidity Analysis BAL has got 2 point as compared to the 1 point of HMCL.

8. VALUATION BASED ON PROFITABILITY

The three ratios of ROI, ROE and ROA were taken as indicators of profitability. All the three ratios were given equal weightage in arriving at a single figure called profitability score that will signify the profitability of the company.

TABLE 8: VALUATION IN TERMS OF PROFITABILITY

Value based on Average Profitability (2006-2015)		
Rank	Company	Profitability Score
1	HMCL	44.18
2	BAL	10.19

Source of Data: CMIE Prowess database

From the above table we can see that HMCL leads the list in terms of profitability followed by BAL. HMCL Profitability Score was 44.18 in the comparison of 10.19 score of BAL.

9. VALUATION BASED ON MARKET VALUE RATIOS

The three ratios of EPS, P/E Ratio and BVPS were taken as indicators of market valuation. All the three ratios were given equal weight age in arriving at a single figure called market score that will signify the market valuation of the company.

TABLE 9: VALUATION IN TERMS OF MARKET VALUE RATIOS

Value based on Average Market Valuation (2006-2015)		
Rank	Company	Market Value Score
1	HMCL	42.08
2	BAL	42.73

Source of Data: CMIE Prowess database

From the above table we can see that BAL leads the list in terms of market valuation. HMCL market value score was 42.08 in the comparison of 42.73 of BAL. Let's take the hypothesis that sales growth is not positively related to the value of firm.

TABLE 10: ANNOVA TABLE AND SALES GROWTH

Source of Variation	Sum of Square	Degree of freedom	Mean Square
Between Sample	43454444.2	1	43454444
Within Sample	591724147.5	18	32873564

For the given value of V1-1 and V2-18, the F=4.41 and the calculated value of F (1.321) is less than this value, so our hypothesis is accepted, and therefore, we conclude that sales growth is not positively related to the value of a firm.

Let's take the hypothesis that profitability is not positively related to the value of firm.

TABLE 11: ANNOVA TABLE AND PROFITABILITY

Source of Variation	Sum of Square	Degree of freedom	Mean Square
Between Sample	5674.51	1	5674.501
Within Sample	2303.16	18	127.95

For the given value of V1-1 and V2-18, the F=4.41 and the calculated value of F (44.35) is greater than this value, so our hypothesis is rejected, and therefore, we conclude that profitability is positively to the value of a firm.

Let's take the hypothesis that Leverage is not positively related to the value of firm.

TABLE 12: ANNOVA TABLE AND LEVERAGE

Source of Variation	Sum of Square	Degree of freedom	Mean Square
Between Sample	140.97	1	140.97
Within Sample	2019.69	18	112.21

For the given value of V1-1 and V2-18, the $F=4.41$ and the calculated value of $F(1.26)$ is less than this value, so our hypothesis is accepted, and therefore, we conclude that Leverage is not positively related to the value of a firm.

Let's take the hypothesis that market value are not positively related to the value of firm.

TABLE 13: ANNOVA TABLE AND MARKET VALUE RATIOS

Source of Variation	Sum of Square	Degree of freedom	Mean Square
Between Sample	18.22	1	18.22
Within Sample	1005.98	18	55.89

For the given value of V1-1 and V2-18, the $F=4.41$ and the calculated value of $F(0.33)$ is less than this value, so our hypothesis is rejected, and therefore, we conclude that market value is not positively related to the value of a firm.

POINTS BASED ON RANKING

TABLE 14

Particulars	Points	
	HMCL	BAL
Others Parameters	8	10
Liquidity Analysis	1	2
Profitability Analysis (sales)	2	1
Efficiency Analysis	2	1
Leverage Analysis	2	1
Market Valuation (old ratios)	1	2
Total Points	16	17

CONCLUSION AND IMPLICATIONS

1. The HMCL (4.2) has the highest average sales growth rate as compared to BAL (2.2%).
2. The most valuable company in terms of average market capitalization was BAL in comparison to HMCL. The contribution of BAL was Rs. 4.16 crore whereas HMCL's share was Rs. 1.58 crore in market capitalization.
3. On the basis of Ratio Analysis, BAL has got 7 points in comparison to the 8 Points of HMCL. BAL has got 2 for liquidity, 1 for profitability, 1 for leverage and 1 for efficiency analysis, and 2 for market value, whereas HMCL has got 8 points, 2 for efficiency, 1 for liquidity, 2 for profitability and 2 for leverage analysis and 1 for market value
4. In terms of profitability HMCL was the most profitable company. HMCL's share was 44.18 whereas BAL's share was only 10.19.
5. From the perspective of stock market wealth creation, it can be stated that HMCL was the most valuable company during the period 2006 to 2015.
6. In terms of cash flows, which represent the actual economics benefits generated by the assets, BAL was the largest value maximizers. HMCL's cash flow was Rs. 3912.47 crore in comparison to the Rs. 5692.37 crore of BAL's.
7. In terms of market value HMCL score was more than the BAL, it was 42.08 whereas BAL was 36.32.

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