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Value investing

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Abstract

Building a portfolio of good stocks is very important for any investor. When this decision becomes the long term decision, the investor gets more concerned about the concept of Value investing. The concept was introduced by Ben Graham and David Dodd in the year 1934. This paper makes an attempt to analyse various stocks across the sectors on the basis of value investing.

Keywords: Value investing, intrinsic value, margin of safety, Relative Graham Value

1. Introduction

When an investor invests in stocks which are less than its intrinsic values it is called value investing. It means buying those stocks which are underpriced. The method of value investing has been explained with a formula by Benjamin Graham. The formula is as follows:

$$V = \text{EPS} (8.5 + 2g) * 4.4 / Y$$

Where

V=Intrinsic Value

EPS=Earnings per Share of a company for the last 12 months

8.5= Constant growth value proposed by Graham

g=company's growth estimate

4.4= the average yield on corporate bonds

Y= the current yield on corporate bonds

Further, to take the decision of buy and sell each company's relative Graham Value (RGV) was determined by dividing stocks intrinsic value (V) with its current price (P).

$$RGV = V/P$$

Literature Survey:

Even though value investing has taken numerous approaches and methodologies since its inception, it is commonly requires trading of stocks that appear to be lower in value based on its intrinsic values. Theoretically, stocks can be categorized as value stocks and growth stocks (Ding et al., 2005). Furthermore, value stocks can be grouped as stocks that are characterized by low ratios. Ding et al. (2005) added that these ratios could be the starting point in identifying the type of stocks either it is a value or growth stocks. Growth stocks, however, is characterized by the highs of these ratios.

Problem Definition:

There has been a debate between value investing and growth investing since ages. The investor would always like to study the stocks which are performing well and also are available at the discounted price. Finding this price is very critical to any investor. The present paper takes into consideration this factor and 6 stocks are randomly chosen which are listed in BSE. The formula developed by Graham is taken as a tool for analysis of these stocks.

Objectives of the study:

1. To identify the value stocks across the sectors based on graham's value investing concept.
2. To understand and differentiate between value stocks and other stocks.
3. To guide the investors on investment options.
4. To select the best value stocks for investment.

Research Methodology:

For the purpose of research the formula of Benjamin Graham was taken into consideration. The study covers 18 stocks and the names of the stocks are depicted in the table.

The current share prices of each of these stocks were then taken from Bombay Stock Exchange. The stocks were then taken from Bombay Stock Exchange.

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The stock which had Relative Graham Value less than one was considered as overvalued stock and the stock which had Relative Graham Value of more than one considered as Undervalued stock.

Table 1: The calculation can be seen in the table below:

Name of the stock	Earnings Per Share for last 12months	Growth rate of the company (%)	Current Yield on corporate bonds	Intrinsic Value	Current Share price	Relative Graham Value	Investment Decision
Dewan Housing Finance Corporation	41.23	20	9	1099	498	2.206	Invest
Bank of Baroda	107	10	9	1677	173	9.693	Invest
Oriental Bank of Commerce	39	16	9	868	229	3.790	Invest
National Aluminium Company	2.49	7	9	32	48	0.666	
Vardhman Textiles	102	24	9	3169	500	6.338	Invest
Bharat Earth Movers	1.12	12	9	20.2	964	0.020	
Wipro Ltd	30.09	14	9	604	650	0.929	
Tech Mahindra Ltd	115	26	9	3401	2817	1.207	Invest
Tata Motors Ltd	1.03	80	9	84.85	572	0.148	
Tata Consultancy Services Ltd	94.15	30	9	3153	2604	1.210	Invest
ICICI Bank Ltd	85	24	9	2348	335	7.009	Invest
Hero MotoCorp Ltd	106	-0.82	9	355	2609	0.136	
HCL Technologies Ltd.	86	50	9	4561	2041	2.235	Invest
Gabriel India Ltd	2.97	6.5	9	31.22	89.10	0.350	
Coal India Ltd	23.76	7.1	9	263	366	0.719	
Century Ply Boards(I) Ltd	3.01	25	9	86	243.5	0.353	
Ashok Leyland Ltd	0.11	-12.27	9	-0.863	74	-0.011	
Ahluwalia Contracts(India) Ltd.	3.47	20	9	82	253	0.324	

Results and Discussion

Benjamin Graham suggested that if the Relative Graham value is more than 1, that stock is undervalued and needs to be bought as it is a good buy in the long run. Among the six stocks taken for the research, four stocks have the value more than 1. These stocks can be considered by the investor for purchase. The stocks are Dewan Housing Finance Corporation, Bank Of Baroda, Oriental Bank of Commerce, Vardhman Textiles, Tech Mahindra Ltd, Tata Consultancy Services, ICICI Bank Ltd and HCL Technologies. The relative graham values for these are 2.206, 9.693, 3.790 and 6.338, 1.207, 1.210, 7.009, 2.235 respectively.

On the other hand National Aluminium Company, Bharat Earth Movers, Wipro Ltd, Tata Motors, Hero Motorcorp Ltd, Gabriel India Ltd, Coal India Ltd, Century Ply Boards (I) Ltd, Ashok Leyland Ltd and Ahluwalia Contracts (India) Ltd are overvalued stocks and should not be bought by the value investors.

Limitation of the Study:

The interpretation has been developed purely on the basis of calculation of Relative Graham Value. The suggestion done on this basis is limited for a period of one year i.e., 2014-15.

Conclusion:

Value investing as proposed by Benjamin Graham helps the investors to identify the intrinsic value of a share and also to take informed decisions. For the purpose of research intrinsic value and relative Graham Value has been taken. The growth rate of the company and also the existing yield on corporate bonds also acts as a major factor for deciding these two values. The values are taken for a period of one year which might prove as a limitation to the study.

Future Scope:

The investor interested in long term investment would be more interested in buying stocks at a lesser price. The same stocks when held for longer period, would give good returns in the long run. The

Relative Graham Value formulated by Benjamin Graham can be used by the investor for the stocks they think of buying.

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