

An Analysis On The Risk Of The Investors And Their Earnings Of Future Lifestyle Fashions Limited

Mrs. Judith Priya R,
Assistant Professor, Department of B.Com PA
PSGR Krishnammal College For Women, Coimbatore.
Mobile No.: 81900 79990, E-mail – judithpriyar@gmail.com

Ms.Srinidhi S, Ms.PoojaGiridharan, Ms.Soundharya P
Final Year B.Com PA Students
PSGR Krishnammal College For Women, Coimbatore
Mobile No.: 96559 87820, 94875 08939, 63746 07011
E-mail – srinidhi2807@gmail.com

Abstract

Fundamental analysis uses the degree of financial leverage (DFL) to determine the sensitivity of a company's earnings per share (EPS) when there is a change in its earnings before interest and taxes (EBIT). When a company has a high DFL, it generally has high interest payment. The high level of interest payments negatively affects EPS. A higher DFL ratio means that the company's EPS is more volatile. Since leverage results from using borrowed capital as a funding source when investing to expand the firm's asset base and generate returns on risk capital, the investors risk of interest payments are carefully analyzed so as to reduce the risk of the investors and also to increase the returns. The relationship between the earnings per share and degree of financial leverage is that of an 'inverse relationship', i.e when the level of earnings increases, there is a decline in the level of degree of financial leverage. When a company is referred to be "highly leveraged", it means that the company's funds consists of more debts than equity. The concept of leverage is used by both companies and investors. The investors use it to increase the returns that can be provided on an investment. The 'return' that the investors expect is in the form of earnings per share they acquire due to capital appreciation. The earnings available to the equity shareholders after external payments is allocated among the shareholders as their return.

Keywords: Risk, Return, EPS, DFL, Shareholders

I. INTRODUCTION

Every experienced company knows which debt capital structure is suitable for them and from which sources they should collect their debt fund. The impact of using leverage to sales revenue is that, if the debt financing increases, the sales revenue will increase that indicates the potential profitability of a company. On the other face, if the leverage drops down, the sales revenue decreases that indicates potential loss of a company. Generally, the profit of the company after netting off fixed interest rate [(i.e.,) Preference dividend and interest on debt] are considered as earnings available to Equity holders of a company. The degree of Financial leverage (DFL) is used to determine the level of sensitivity of company's earnings per share (EPS) when there is a change in its earnings before interest and tax (EBIT). When a company has a high DFL, it generally has high interest payments. The high level of interest payments negatively affects EPS and vice versa.

Basically, the Degree of Financial Leverage (DFL) states that if the leverage (risk) is high then the earnings of the shareholders of the company will be less, which indirectly states that investing in the company may be risky for the shareholders, who invest in the company in the motive to earn a steady return. And if the leverage (risk) is low then the earnings of the shareholders will also be more, which will encourage them to invest more in the company as their income by investing in the company is steadily increasing.

II. OBJECTIVE

To analyse the risk of the investors and their earnings using the Leverage effect.

III. REVIEW OF LITERATURE

G. S. Nagalakshmi (2015)^[1], in her article "A Study on Financial Leverage and its Impact on Earnings Per Share" states that using leverage introduces (or magnifies) risks, most of all liquidity risks, that have to be controlled. These controls are operational measures needed to monitor and modify aspects of liquidity, leverage and counter party risk.

Hussan J (2016)^[2], in his article "Impact of Leverage on the Risk of the Company" states that, the leverage is employed by every company which is intended to earn more return on the fixed charge funds than their cost. The leverage mainly involves the effective utilization of debt fund obtained at a fixed cost in the hope of increasing the return to the shareholders.

IV. RESEARCH METHODOLOGY

This study is based on the secondary data taken from the financial statements of the Future Lifestyle Fashions Limited, the journals and other articles.

V. LIMITATION

This analysis is done for the data of Future Lifestyle Fashions limited and pertains to a period of five years only.

VI. DATA ANALYSIS

Calculation of financial leverage

(Rs. In crores)

Table :1

Earnings available to the equity shareholders

PARTICULARS	2014 - 15	2015 - 16	2016 - 17	2017 - 18	2018 - 19
EBIT*	169.6	170.6	288.74	234.93	280.73
Less : Interest	146.12	125.62	111.87	79.36	81.63
EBT**	23.48	44.98	176.87	155.57	199.1
Less : Tax	4.93	15.51	34.32	45.06	53.73
EAT***	18.55	29.47	142.55	110.51	145.37

Source: Computed Data

The above table shows the earnings that are available to the equity shareholders after the payment of interest and tax. The EBIT and EBT will help in obtaining the leverage effect.

* EBIT - Earnings Before Interest and Tax

** EBT - Earnings Before Tax

*** EAT - Earnings After Tax

(Rs. In crores)

Table 2:

Financial Leverage of the Company

YEAR	EBIT	EBT	FINANCIAL LEVERAGE
2014 – 15	169.6	23.48	7.22
2015 – 16	170.6	44.98	3.79
2016 - 17	288.74	176.87	1.63
2017 - 18	234.93	155.57	1.51
2018 - 19	280.73	199.1	1.41

Source: Computed Data

The above table represents the financial leverage of the future lifestyle fashions limited.

Interpretation:

The Financial Leverage is calculated by using the formula $EBIT \div EBT$. From this analysis we understand that with an increase in EBIT the risk of the investors is gradually decreasing.

Calculation of Earnings Per Share:

(Rs. In crores)

Table 3:

Earnings per share of future lifestyle fashions limited

YEAR	EAT (earnings after tax)	NO. OF EQUITY SHARES	EPS (earnings per share)
2014 - 15	18.55	17.3	1.07
2015 - 16	29.47	18.95	1.56
2016 - 17	142.55	18.99	7.51
2017 - 18	110.51	19.02	5.81
2018 - 19	145.37	19.36	7.51

Source :Computed Data

The above table represents the earnings per share that are available to the equity shareholders after the payment of interests and tax.

Interpretation

The Earnings Per Share of the company Future Lifestyle Fashions Limited is obtained by dividing the Earnings After Tax with the Number of Equity Shares in the company

FINDINGS AND CONCLUSION

From the above analysis we can understand that when the DFL is high, the EPS of the shareholders of the company is less and when the DFL is less, there is an increase in the EPS of the shareholders. From the above table we find that in the financial year 2014 – 15, the DFL is high at 7.22 and the EPS for that year is 1.07 and in year 2018 – 19, the DFL is at 1.41 and the EPS is 7.51. These findings will help the investors of the company to invest wisely in the company. It is also useful for the company where the company can decide on how to use its debt funds effectively so that the earnings of the investors is increased.

REFERENCES

G.S. Nagalakshmi (2015)^[1], a study on financial leverage and its impact on earnings per share, Global Journal of Finance and Management

M.d. Juman Hussan (2016)^[2], impact of leverage on risk of the companies, Journal of Civil & Legal Sciences

Web Reference:

<https://www.investopedia.com/ask/answers/062215/ho-how-does-degree-financial-leverage-dfl-affect-earnings-share-eps.asp>