What is fundamental analysis?

Fundamental analysis is a method of determining the real value of a stock, which helps an investor decide whether to buy the stock or not.

For investors, in-depth research is the key to create a strong financial portfolio. While there are several methods to determine the company's ability to grow and sustain in any type of market condition, fundamental analysis is one of the most important ones.

The concept

Fundamental analysis is the method of determining a company's health by examining not only its balance sheet and income statements, but also other unquantifiable factors that could possibly affect the share price of the company. These 'fundamentals' help investors determine whether the stock is undervalued, overvalued or fairly valued.

While this analysis begins with a study of the individual stock, it extends to other factors like the competitiveness of the company within the sector, long-term outlook of the industry as compared to other industries, etc.

Quantitative and qualitative analysis

Fundamental factors can be grouped under two categories: quantitative and qualitative.

Quantitative analysis evaluates quantifiable factors like:

- Price to earnings (P/E) ratio
- Earnings per share
- Dividend payout
- Return on equity (RoE), etc

Qualitative analysis examines less tangible factors like the company's ability to sustain in the long run, management strategy, etc.

A fundamental analysis is a combination of both these factors, besides an economic, industry as well as company analysis to determine a 'fair value' of the stock. Depending on the difference between its current stock price and its fair value, the stock is rated as undervalued, overvalued or fairly valued by the analysts. Experts believe that the stock price gradually moves towards its fair value in the long run.

Companies with strong fundamentals are likely to perform well in the long run as compared to those with weaker fundamentals. Fundamental analysis is, therefore, very useful for long-term investors.