

How to Analyse a Stock

<https://mysuccessproject.in/>

April 2022



HELLO!

This is Venkatesh Jayaraman

**Follow me in Twitter
@SuccessProject_**

**Links to my
YouTube Channel**

If you have not downloaded this file from the <https://mysuccessproject.in/presentations/>, please check the link for the latest version

Image courtesy: Slidecarnival.com



Overview of this Work

YouTube Video: https://youtu.be/dxFtNsxm5gg?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

Image courtesy: Slidecarnival.com

DISCLAIMER

- This video series is intended to share a high level overview of steps / stages involved in analyzing a stock
- The contents discussed are for a high level understanding with a few pointers for your thoughts to research further, and not a (1) exhaustive nor (2) a 'ready-to-implement' framework / philosophy
- Any examples, sectors, stocks and cases discussed in this video series are only for educational purpose and not BUY or SELL recommendations

Read these slides in conjunction with the corresponding YouTube Videos –
Links shared in the section dividers

Link to entire play list:

https://www.youtube.com/playlist?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

Contd...

DISCLAIMER (Contd.)

- Viewers are requested to do their own research and run their calculations before investing
- I have made the best efforts to ensure accuracy of contents in this presentation, however, errors could have crept – Do bring to my notice
- I shall in no way be responsible to any one (directly or indirectly) for any kind of loss that might arise from using or sharing the information in this video series.

Read these slides in conjunction with the corresponding YouTube Videos –
Links shared in the section dividers

Link to entire play list:

https://www.youtube.com/playlist?list=PL9QC_19RB6uWQ3lQPSviGI5Pe77aGXson

BACKGROUND OF THIS SERIES

- Read multiple books on Investing
- The knowledge was in silos
- Could not see the connection between various facets
- No meaningful process or framework or a investment philosophy
- Viewed Videos of various Indian Fund Managers and Investors
- Led to Bigger picture and connections



Facets of Knowledge – Investment Process / Framework

WHAT IS REQUIRED FOR STOCK ANALYSIS

Qualitative Analysis

Management Quality

Analyse Moat

Analysing Annual Reports

Quantitative Analysis

Financial Analysis

Balance Sheet Analysis

Valuation Methods

Free Cash Flow / ROCE

DCF Way of Valuation

Themes

What Stock to Analyse?

Sector / Cyclic companies

Analyse Holding Company

Others

Future Growth

Red Flags

Tools – Screen / Monitor

ALL ARE CONNECTED

- Few facets in Silos
- Framework
- Big Picture

WHAT TO EXPECT AND WHAT NOT TO...



Is this the only Framework?



Financial Statement Analysis



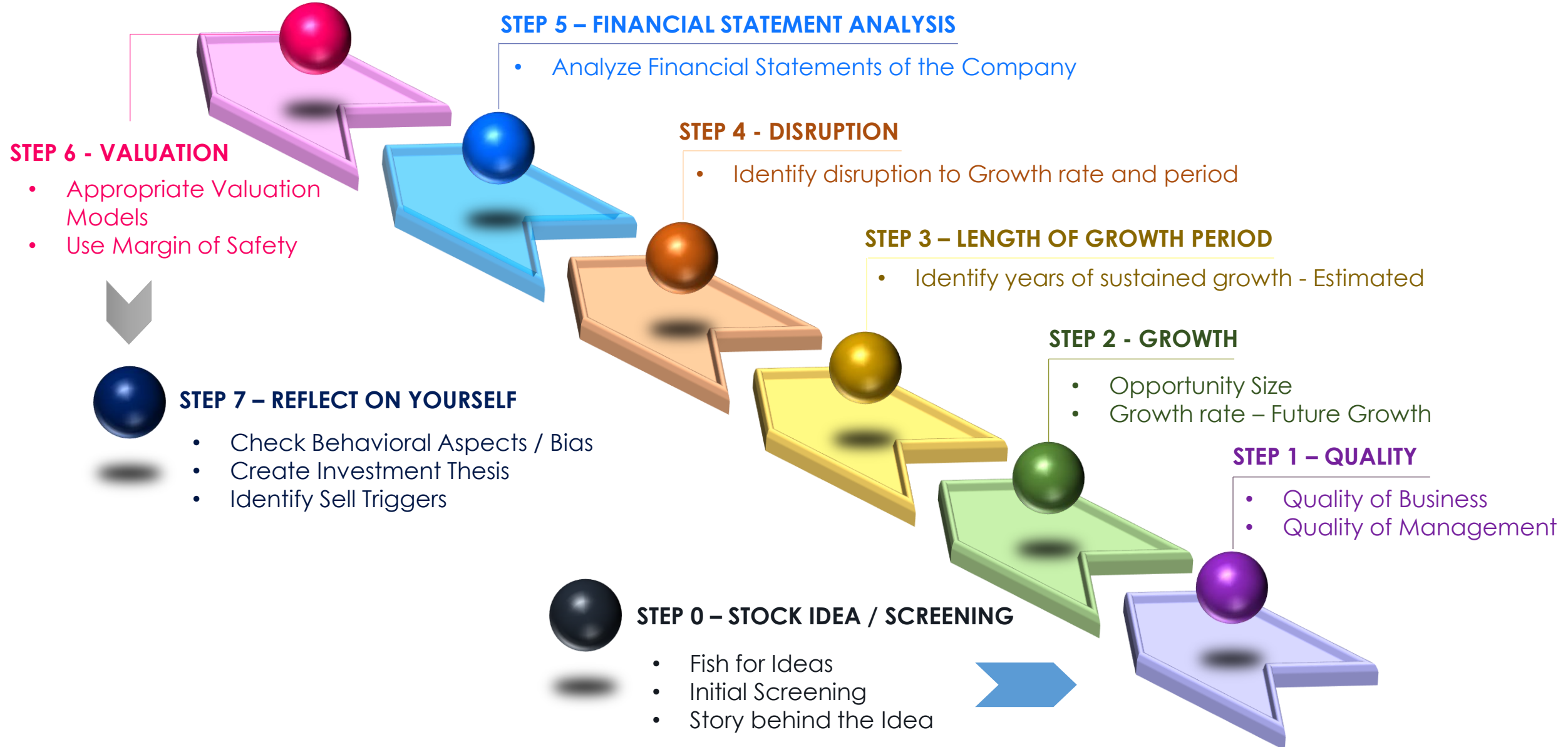
Technical Analysis



Valuation



7-STEPS IN STOCK ANALYSIS



Step 0: Stock Idea / Screening

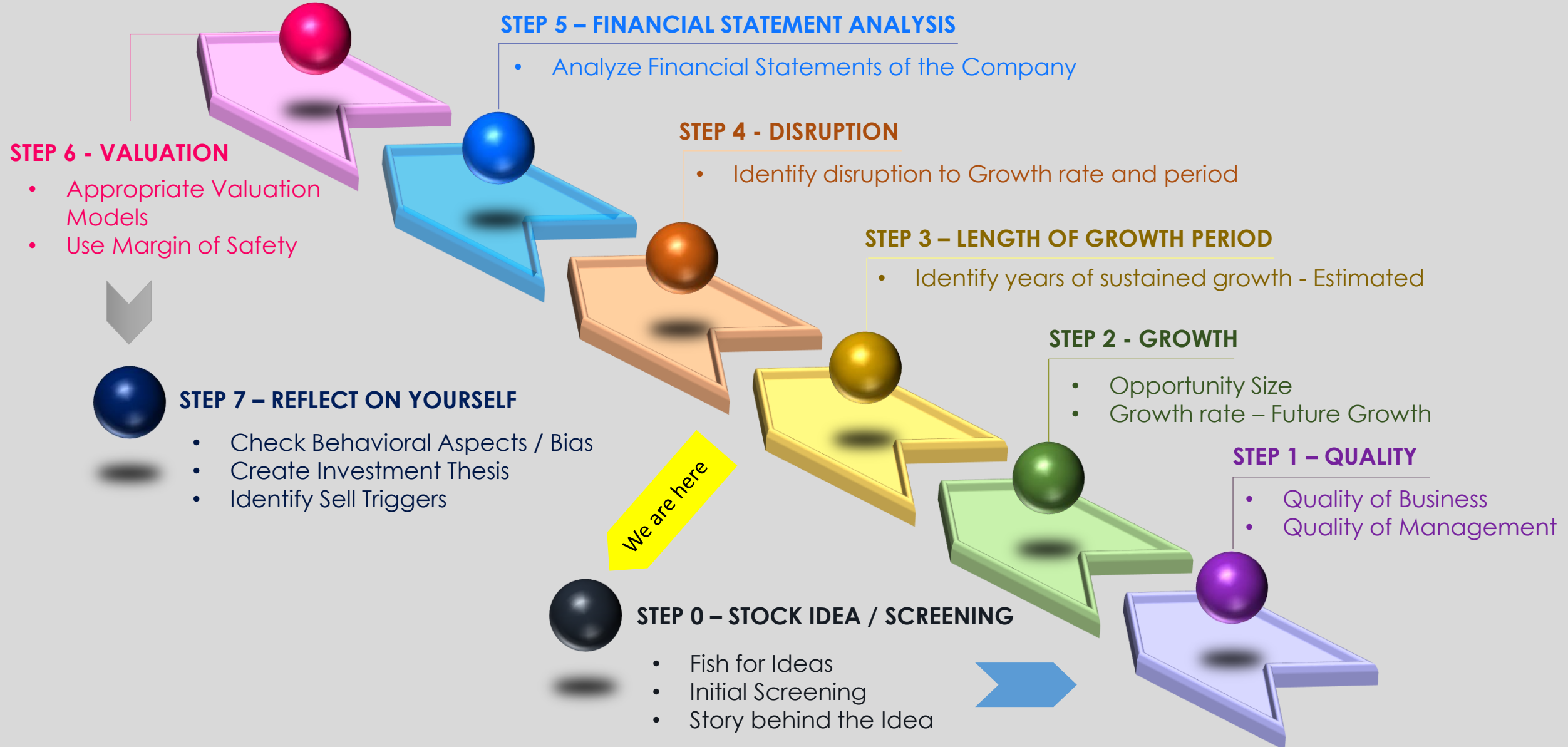
YouTube Video:

https://youtu.be/DrQLM5HHfyY?list=PL9QC_19RB6uWQ3lQPSviGI5Pe77aGXson

https://youtu.be/239xQsu93YQ?list=PL9QC_19RB6uWQ3lQPSviGI5Pe77aGXson

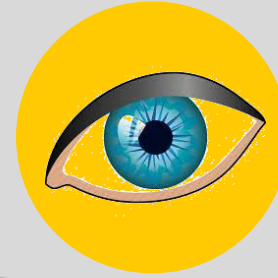
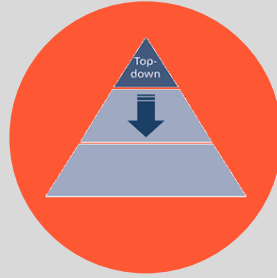
Image courtesy: Slidecarnival.com

7-STEPS IN STOCK ANALYSIS



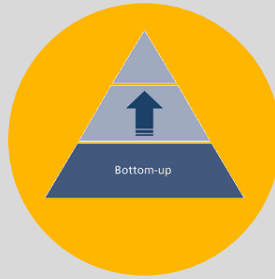
HOW TO IDENTIFY A STOCK

Top Down Approach



Pick what you see

Bottom Up Approach

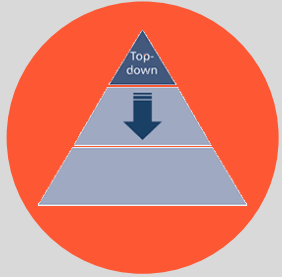


Pick what you do or Know

Cloning Stock Ideas



TOP DOWN APPROACH

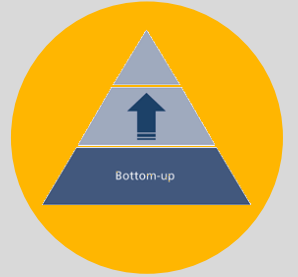


Macro Economic Factors →
Individual Stocks

Good going sectors in the
Economy

Good companies within these
sectors

BOTTOM UP APPROACH



Individual Companies →
Specific Parameters

Stock screens: Valuation or
Profitability Metrics

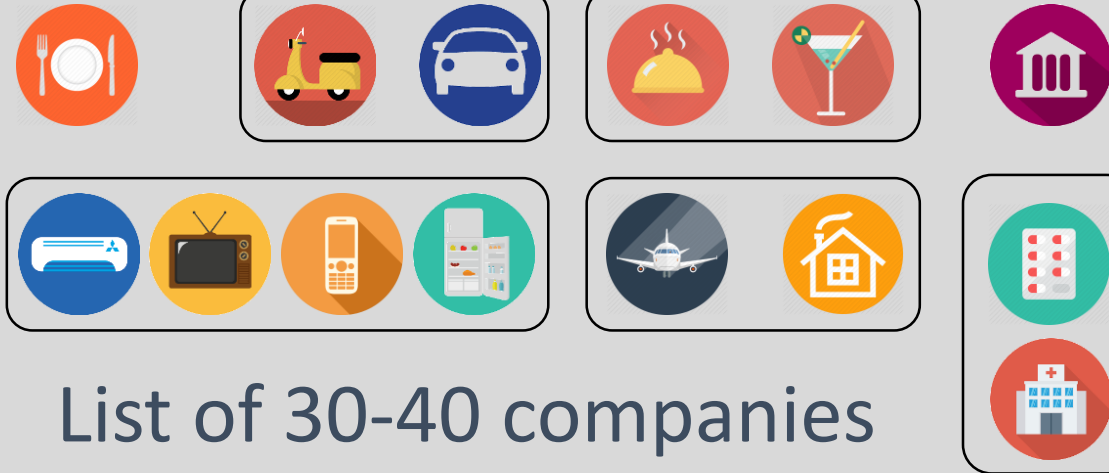
www.screener.in/

In-depth Fundamental Analysis

WHAT YOU SEE



Peter Lynch



Not a immediate “Buy”,
must Analyze further

WHAT YOU KNOW / DO

Invest in what you know
/ understand – Circle of
Competence



Our Profession or Business gives
valuable insights

Insights help to pick stocks with
easy

Easy to Analyse – Greater
chance of Success

CLONING STOCK IDEAS



Stock names from Big investors & Mutual Fund houses.
NOT Coat Tail Investing – Pick ONLY the stock names for further analysis

How to know the holdings?

Big Investors

- Media / Websites

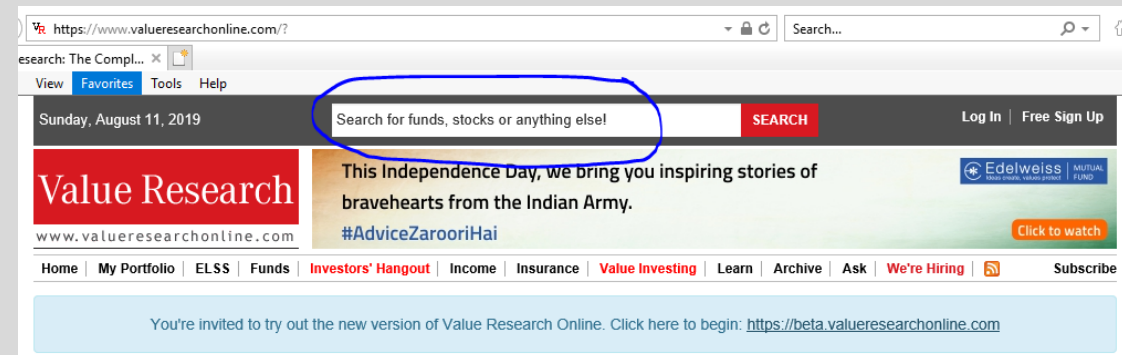
Mutual Funds

- Respective MF websites
- Value Research



Confirmation bias and Halo effect

We may ignore further analysis



STORY BEHIND...

What is the story behind the company?

Details of Promoter, Market Share, Other products of the company, Competitor details, years in business etc.

High level details are sufficient.



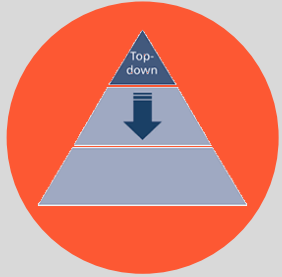
ACTIONS

Time for Actions...

- Identify stock using all of any of these approaches
- Go by the approach which you are confident
- The picked stock can be used for hand-on approach



TOP DOWN APPROACH



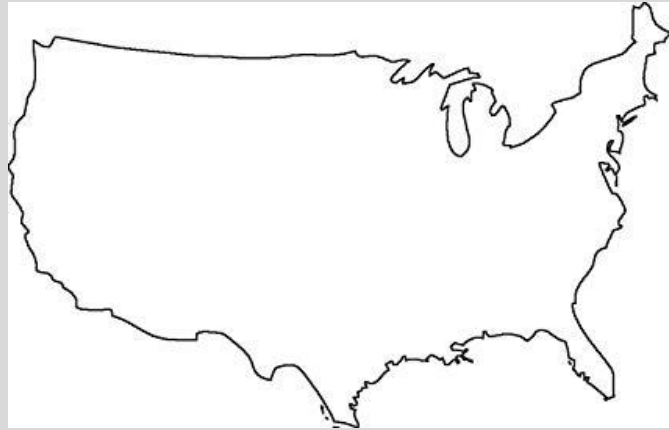
- Macro Economic Factors → Individual Stocks
- 3-5 Good going Sectors in the Economy / Sectors with high future growth
- Look of Good companies within sectors, based on Market Share or Market Capitalization – **Investible Universe**
- Fundamental analysis of stocks from the Investible Universe

How to know the best performing Sectors?

This approach may not be “Everyone’s cup of Coffee”



TOP DOWN APPROACH



Sector 1



Sector 2

Sector 3



These are not immediate investments

Repeat this for the other 2 identified sectors



1. Many sectors eliminated – Less Diversification
2. Missing good opportunities in other sectors
3. Many variables – Not easy for retail investors

BOTTOM UP APPROACH

Individual Companies → Investible Universe → Deep dive

Challenge: 5500+ companies in Indian Markets

Stock Screeners → Using filters/parameters

Stock Screeners

<https://in.investing.com/>

www.screener.in/

Parameters...

- Market Cap – Large, Mid & Small
- Sectors
- Valuation and Profitability Metrics
- Financial Ratios i.e. Debt-Equity

BOTTOM UP APPROACH

Parameters...

- Market Cap – Large, Mid & Small
- Sectors
- Valuation and Profitability Metrics
- Financial Ratios i.e. Debt-Equity



Which Parameter /
Range of Value



Answer lies in you

1) Market Cap – Large, Mid & Small

3) Valuation / Profitability Metric

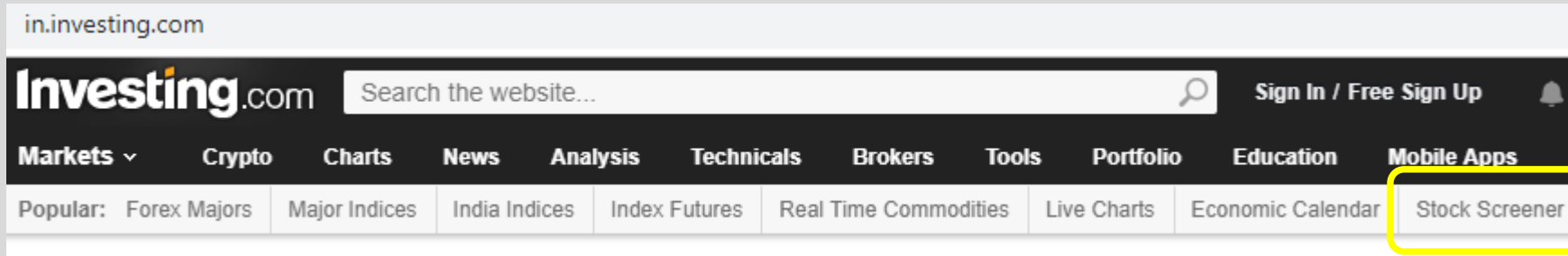
2) Sectors – Good understanding

4) Financial Ratios

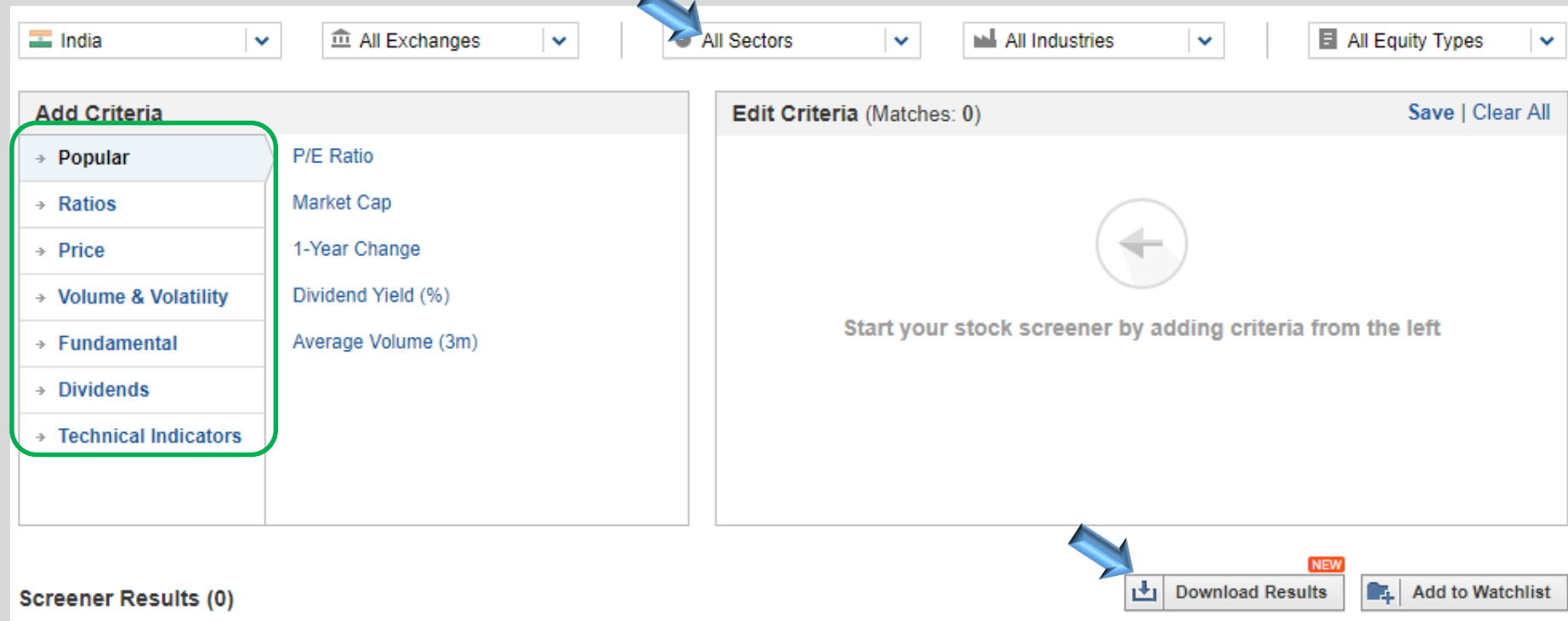
Be Flexible! Don't be Precise

BOTTOM UP APPROACH

<https://in.investing.com/>



Stock Screener Page



BOTTOM UP APPROACH

India | All Exchanges | All Sectors | All Industries | All Equity Types

Add Criteria

- Popular
- Ratios
- Price
- Volume & Volatility
- Fundamental
- Dividends
- Technical Indicators

Edit Criteria (Matches: 2855) Save | Clear All

P/E Ratio 0.04 680.90K

India | All Exchanges | All Sectors | All Industries | All Equity Types

Add Criteria

- Popular
- Ratios
- Price
- Volume & Volatility
- Fundamental
- Dividends
- Technical Indicators

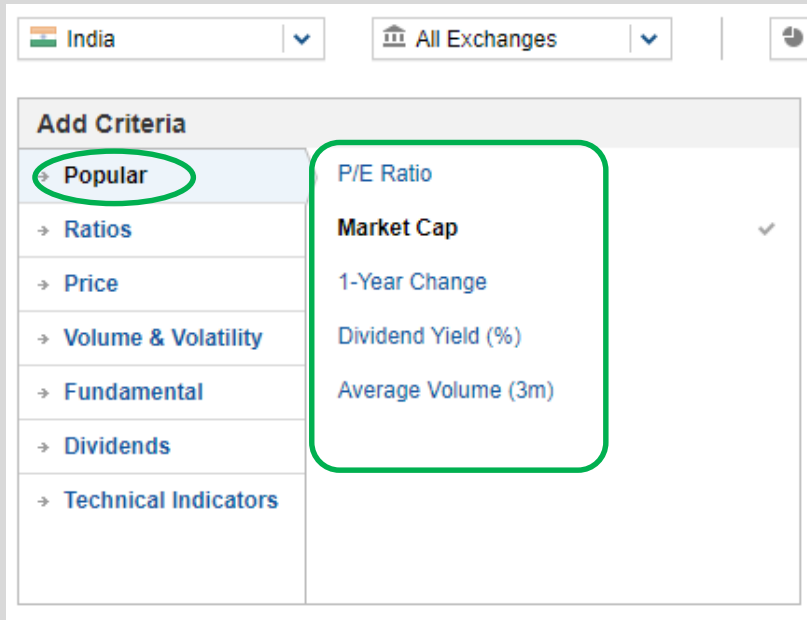
Edit Criteria (Matches: 1751) Save | Clear All

P/E Ratio 0.04 680.90K

Market Cap 1.00 995.00B

Dividend Yield (%) 0.02 44.64

BOTTOM UP APPROACH

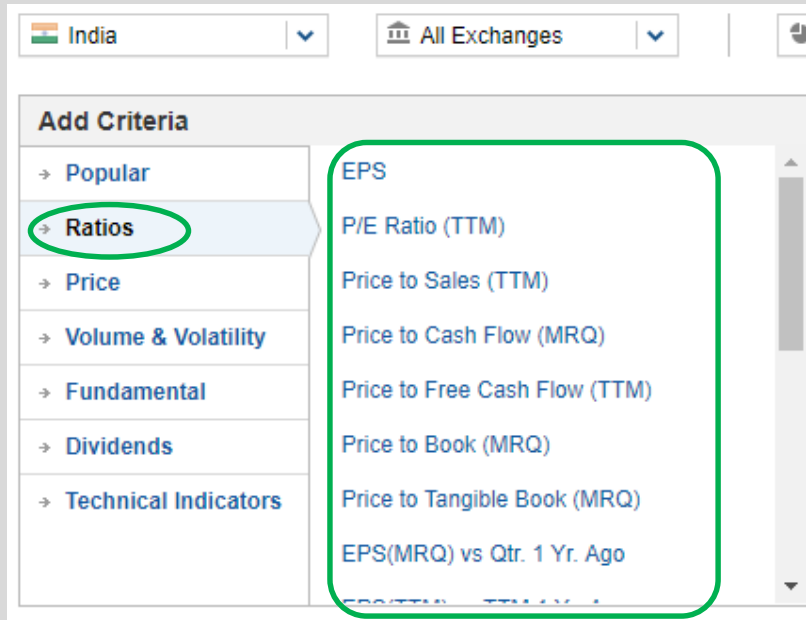


India All Exchanges

Add Criteria

- Popular
- Ratios
- Price
- Volume & Volatility
- Fundamental
- Dividends
- Technical Indicators

P/E Ratio
Market Cap
1-Year Change
Dividend Yield (%)
Average Volume (3m)

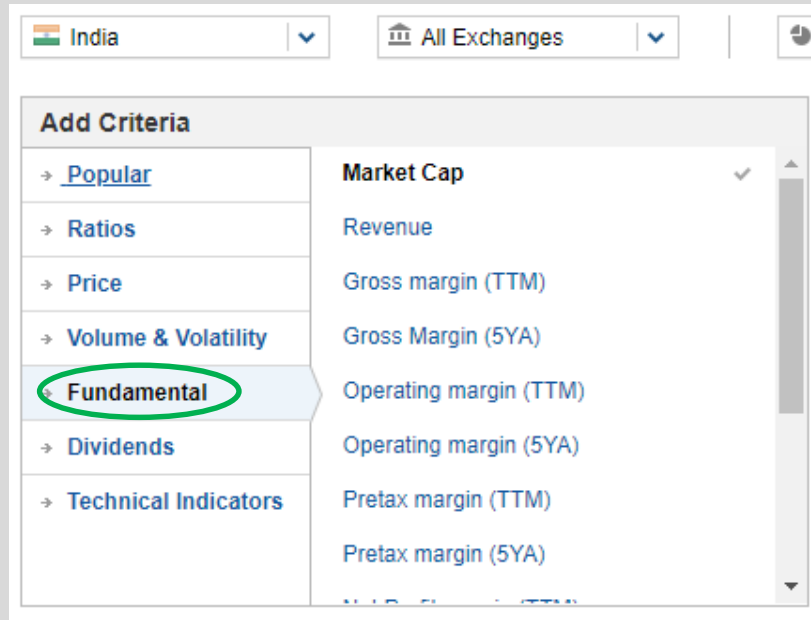


India All Exchanges

Add Criteria

- Popular
- Ratios
- Price
- Volume & Volatility
- Fundamental
- Dividends
- Technical Indicators

EPS
P/E Ratio (TTM)
Price to Sales (TTM)
Price to Cash Flow (MRQ)
Price to Free Cash Flow (TTM)
Price to Book (MRQ)
Price to Tangible Book (MRQ)
EPS(MRQ) vs Qtr. 1 Yr. Ago



India All Exchanges

Add Criteria

- Popular
- Ratios
- Price
- Volume & Volatility
- Fundamental
- Dividends
- Technical Indicators

Market Cap
Revenue
Gross margin (TTM)
Gross Margin (5YA)
Operating margin (TTM)
Operating margin (5YA)
Pretax margin (TTM)
Pretax margin (5YA)

What parameter to choose and range of values – Individual choice based on requirement

Put some time to understand Metrics and Ratios

BOTTOM UP APPROACH

<https://www.screener.in/>

Create a Search Query

Query

Custom Query Example

Market Capitalization > 500 AND
Price to earning < 15 AND
Return on capital employed > 22%

[Detailed guide on Creating Screens](#)



Simplicity of the approach

BOTTOM UP APPROACH

Other Screeners...

<https://trendlyne.com/>

<https://stockedge.com/>

<https://marketsmithindia.com>

<https://www.tickertape.in/screener>

<https://www.valueresearchonline.com>

<https://www.moneyworks4me.com>

<https://chartink.com/screeners>

WHAT YOU SEE



Three circular icons at the top: a fork and plate, a steaming bowl, and a martini glass.



Not a immediate "Buy", must Analyze further

WHAT YOU DO



Most of us are associated with a profession or a Business

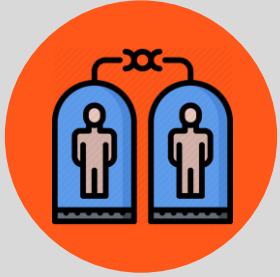
The experience from our Profession or a Business gives valuable insights about a sector

These sector insights helps to analyse and compare the companies in the sector

Doctor, IT Professional, FMCG, Automobile

This approach may not be suitable if...

CLONING STOCK IDEAS



Stock names from Big investors & Mutual Fund houses.

Holding of Mutual Fund houses

<https://www.valueresearchonline.com/>

Regular | Direct Plan Status: Open for subscription | **Invest Now**

| | | |
|---|--|--|
| 0.30% <i>Change from previous, NAV as on Aug 16, 2019</i> | Growth: ₹ 40.39 | Category: Equity: Large Cap |
| | Dividend: ₹ 20.35 | Assets: ₹ 21,125 crore (As on Jul 31, 2019) |
| NAV of Other Plans | Expense: 1.83% (As on Jul 31, 2019) | |

Add To Watchlist Add To Portfolio Share

Snapshot Performance **Portfolio** Analysis Download Reports

CLONING STOCK IDEAS

| Top Holdings | | | | | | |
|----------------------------|---------------|-------|---------|--------|----------|--|
| Company | Sector | PE | 3Y High | 3Y Low | % Assets | |
| LIC Bank | Financial | 27.62 | 9.73 | 2.35 | 9.36 | |
| SBI Bank | Financial | 50.19 | 7.80 | 5.35 | 6.83 | |
| Infosys | Technology | 21.19 | 6.37 | 3.02 | 6.37 | |
| Bharti Airtel | Communication | 0.00 | 4.43 | 1.83 | 4.19 | |
| IDFC | Financial | 34.02 | 4.89 | 0.00 | 3.85 | |
| SBI Life Insurance Company | Financial | 62.15 | 3.84 | 0.00 | 3.84 | |
| TPC | Energy | 9.91 | 4.60 | 1.72 | 3.73 | |
| ITC | FMCG | 24.22 | 4.56 | 2.18 | 3.72 | |
| Larsen & Toubro | Construction | 20.44 | 3.77 | 1.87 | 3.41 | |
| Axis Bank | Financial | 33.11 | 4.69 | 1.98 | 3.31 | |
| Hindalco Inds. | Metals | 49.57 | 3.01 | 0.00 | 2.65 | |
| Reliance Industries | Energy | 20.13 | 3.84 | 0.27 | 2.59 | |
| Indian Oil Corp. | Energy | 8.48 | 2.69 | 0.00 | 2.31 | |
| Mutherson Sumi Systems | Automobile | 20.63 | 3.96 | 1.85 | 2.20 | |
| TVS Motor Co. | Automobile | 26.90 | 2.74 | 0.00 | 1.79 | |
| ONGC | Energy | 6.09 | 3.58 | 0.00 | 1.69 | |

ACTIONS



Time for Actions...

- Identify stock using all or any of these approaches which ever you are comfortable
- Go by the approach which you are confident
- The picked stock can be used for hand-on approach

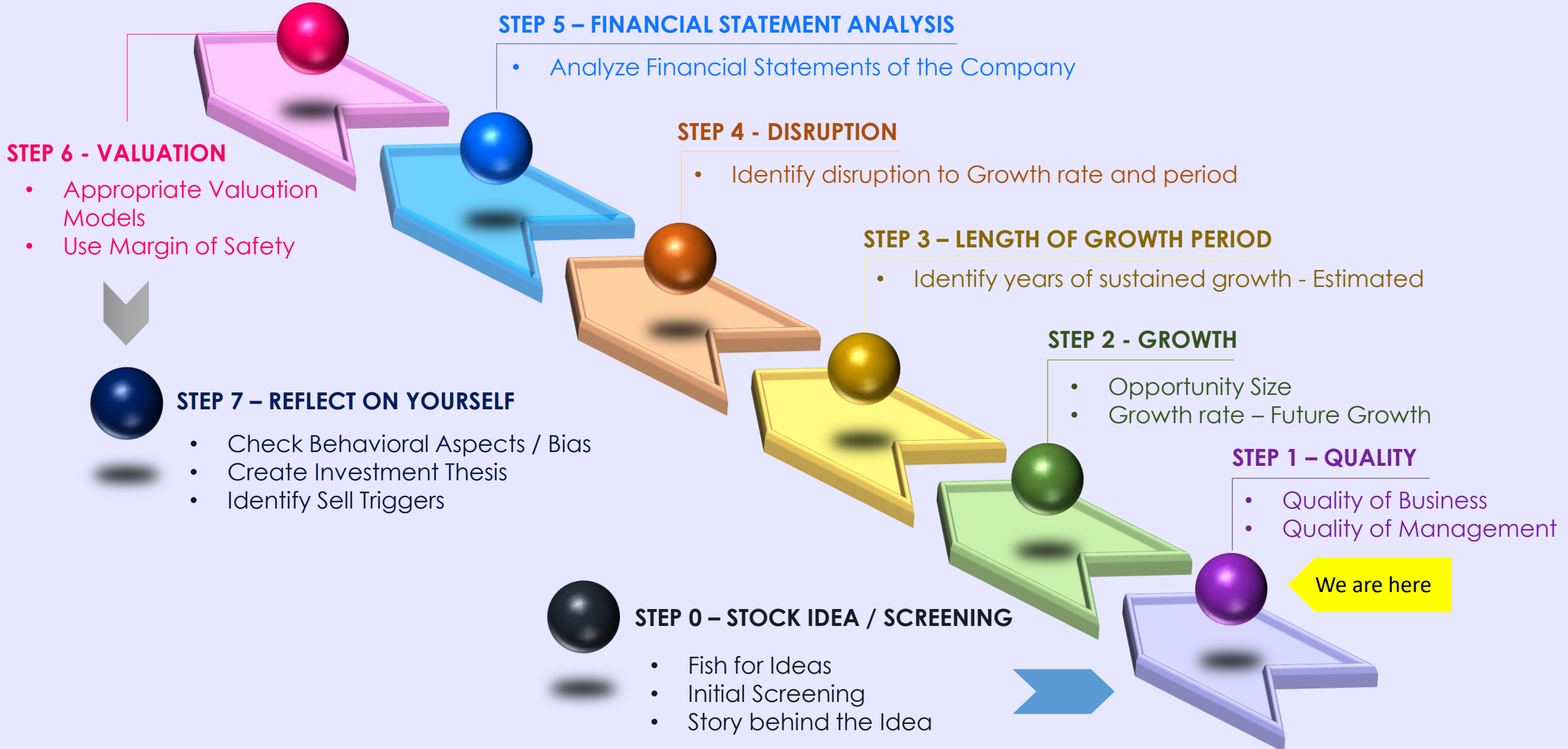
Step 1: Quality

Quality of Business

YouTube Video: https://youtu.be/Tkh-zVrcEcU?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

Image courtesy: Slidecarnival.com

7-STEPS IN STOCK ANALYSIS



Types of Business

How can Businesses be classified based on Quality?

Three categories - Great, Good and Gruesome



Warren Buffett classifies business as Great, Good and Gruesome - Details in 2007 Berkshire Annual Report (Page 6 to 8).

Businesses – The Great, the Good and the Gruesome

Let's take a look at what kind of businesses turn us on. And while we're at it, let's also discuss what we wish to avoid.

Charlie and I look for companies that have a) a business we understand; b) favorable long-term economics; c) able and trustworthy management; and d) a sensible price tag. We like to buy the whole business or, if management is our partner, at least 80%. When control-type purchases of quality aren't available, though, we are also happy to simply buy small portions of great businesses by way of stock-market purchases. It's better to have a part interest in the Hope Diamond than to own all of a rhinestone.

Businesses – The Great, the Good and the Gruesome

<https://www.berkshirehathaway.com/2007ar/2007ar.pdf>

Types of Business (Contd.)

“Think of three types of savings accounts.

- The **Great** one pays an extraordinarily high interest rate that will rise as the years pass.
- The **Good** one pays an attractive rate of interest that will be earned also on deposits that are added.
- Finally, the **Gruesome** account both pays an inadequate interest rate and requires you to keep adding money at those disappointing returns.”



- Berkshire Hathway, 2007 Annual Report, Page 8

Understanding the Basics

Cost of Capital

- Business, needs capital which may be borrowed (or internally funded)
- This capital has a cost associated which depends on mode of financing i.e. Equity or Debt

Competitive Advantage

- When a company earns above Cost of Capital, more players (Competitors) enter the business who operate at lower returns.
- Company can protect its returns only if it has a competitive advantage

Product
Differentiation

Unique Value
proposition

Strong Brand

Customer pull

Low Cost of
Production

Low cost in comparison to
Competitors



Pricing Power

Understanding the Basics (Contd.)

Pricing Power

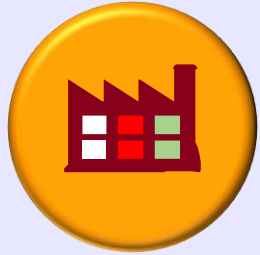
- Ability to increase the price without any (or less) impact to Sales
- Primarily comes from Competitive Advantage i.e. Strong brand, returning customers or product differentiation

Moat

- Sustained Competitive Advantage = Enduring Moat
- Moat protect the company's profit and profitability for a extended periods of time.
- High Moats = High RoE and cash flows.



Six Parameters for Evaluating Business



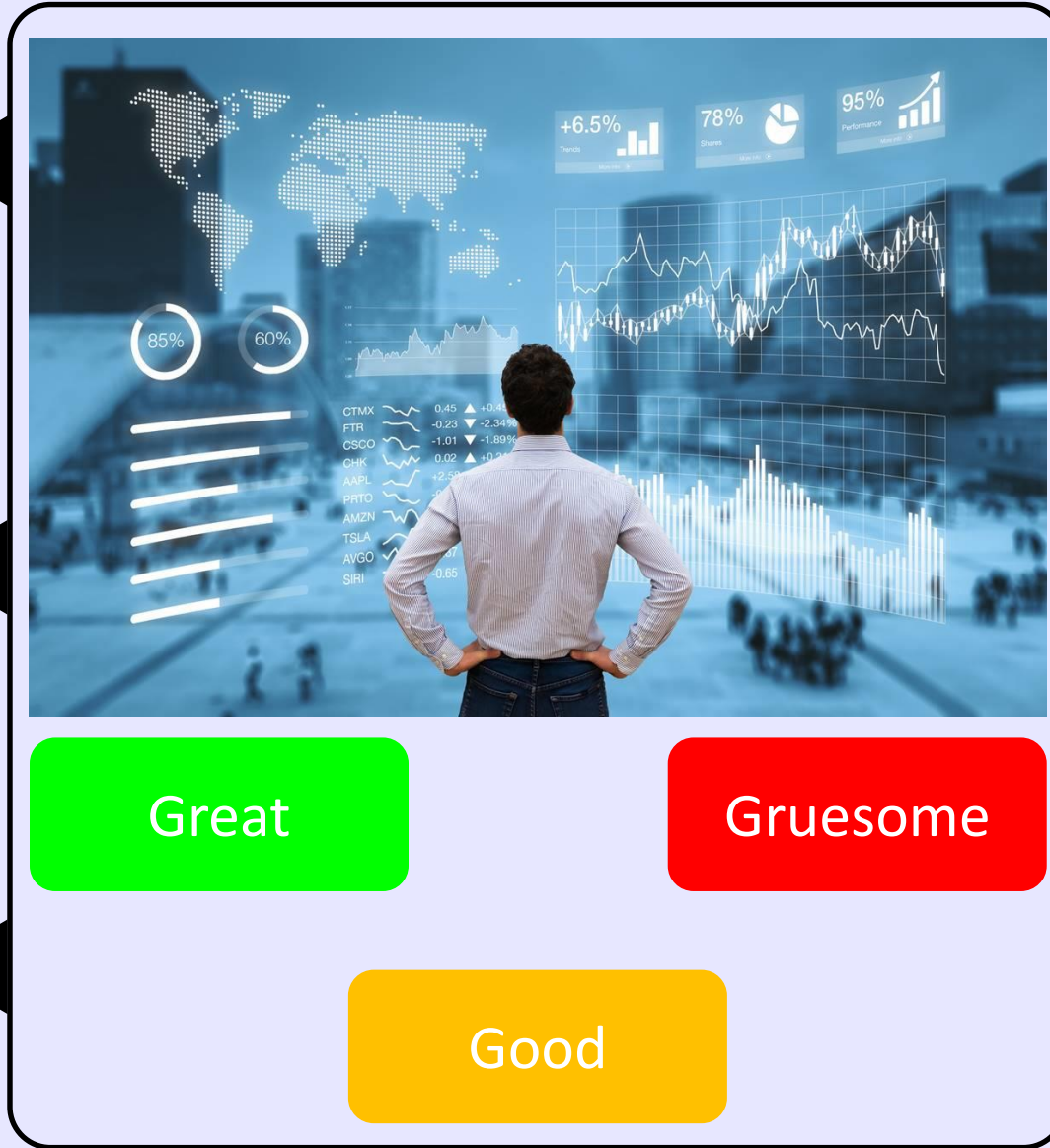
Nature of Business



Cost of Capital



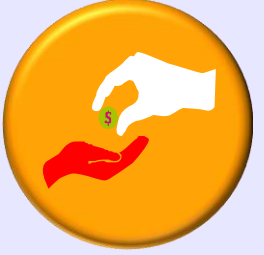
Growth



Competitive Advantage



Pricing Power



Financial Numbers



Great Business



Stable Business, Asset Light (Less Physical Assets, More Intangible assets – No huge Capex)



Earn significantly higher than Cost of Capital



Less than Good and Gruesome companies. The growth comes from very little addition capital



High and increasing competitive advantage – Brand & Low cost of Production



High Pricing Power



High and Rising RoE (10Y Avg. > 25%), High FCF and High Dividend Payout

Good Business



Moderate Change



Earn higher than Cost of Capital (But lesser than Great Business)



Grow at healthy rates, but need additional capital to support the growth



High competitive advantage – Primarily from economies of scale





Moderate Pricing Power




Steady & Attractive RoE (10Y Avg. between 10 – 25%), other parameters relative less than Great companies

Gruesome Business


 Rapid Changes, Capital Intensive and frequently need huge Capex

 Earn lower than Cost of Capital

 High growth rates, which actually is a curse

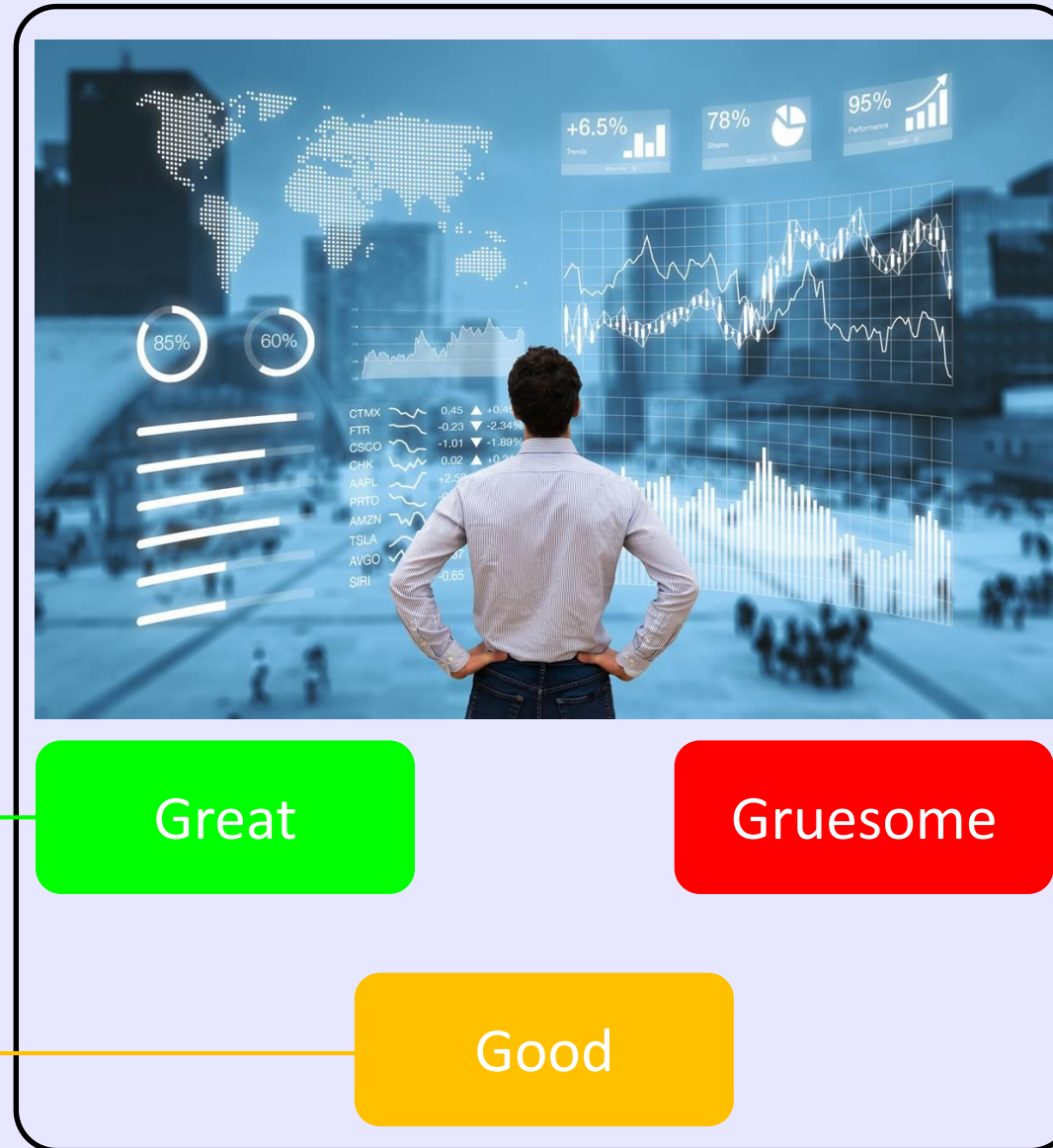
 No competitive advantage

 No Pricing Power

 Low and declining RoE (10Y Avg < 10%), Low or Negative FCF, Low or No Dividend Payouts

Investment Strategy

- 1 – 2% of Market
- Buy at Reasonable Price



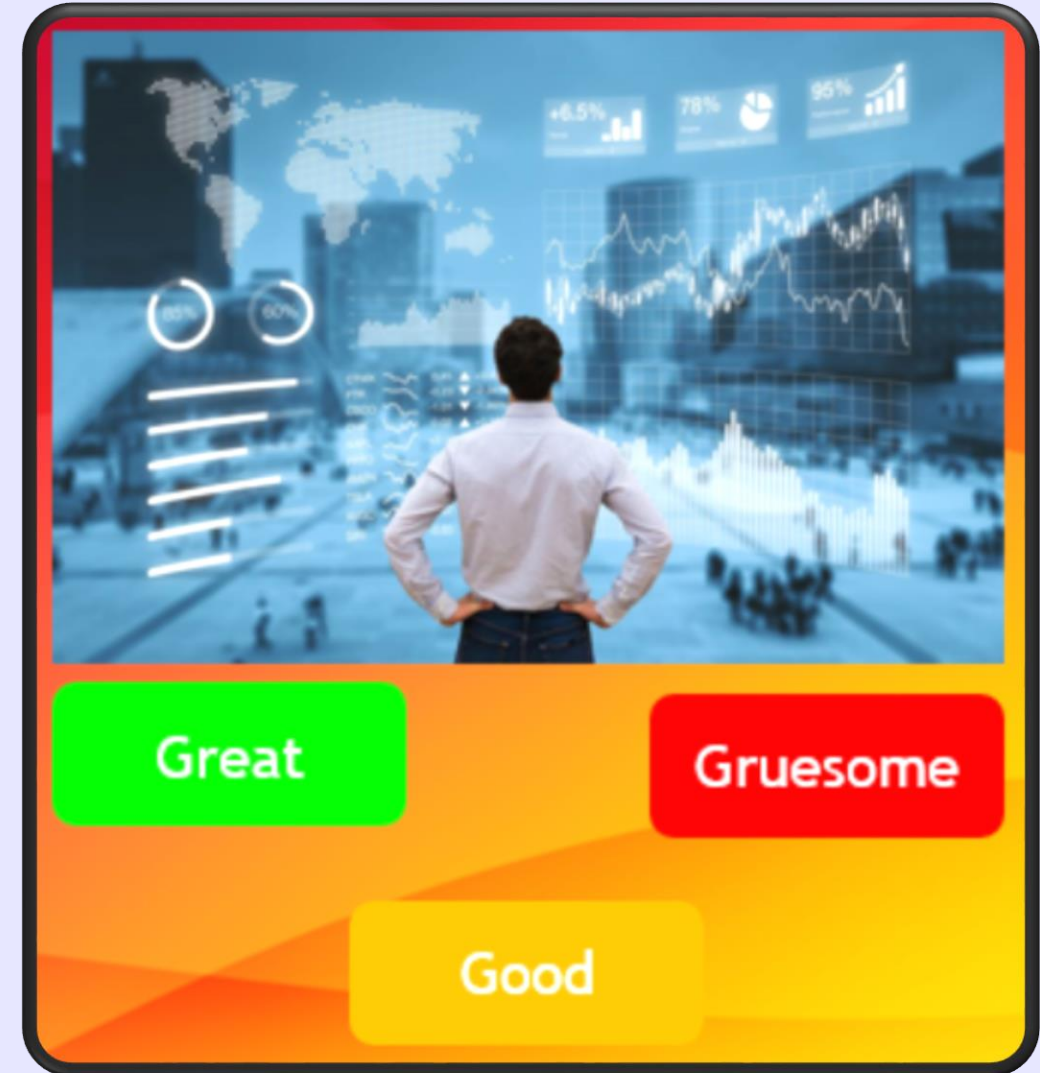
- Remaining share of Market
- Avoid Entering our Portfolio
- Deeply Understand these companies



- 5 – 10% of Market
- Buy at Bargain Prices / Margin of Safety



ACTIONS



- Pick stocks identified in Step 0
- Categorize them as Great, Good and Gruesome
- Nature of Business, Competitive Advantage and Pricing Power
- Screener – RoE value and trend, Growth Rate, Dividend Payout

Step 1: Quality

Quality of Management

YouTube Video:

https://youtu.be/7IbEncmTXho?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

https://youtu.be/PsETCuyabak?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

https://youtu.be/bcNI7AGpCGM?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

Have Open Mind



- Most important thing - Open mind when analysing Managements
- Barrier – Existing opinion for/against the Management from discussions, media, social media etc.



- Existing **Positive** opinion
- Justify findings that are against them
- Specifically look for favourable information about the management



- Existing **Negative** opinion
- Low prospect idea – Due to existing view
- No interest for serious analysis



Have Open Mind, Gather and Analyse all information. Take a decision on Management without emotions!

How Important is Quality of Management

A few real life examples....

- Chit fund investment – Entrust money with a person having a good reputation in the interest of safety of money and return of money at end of tenure
- Buying Gold – Jeweler with impeccable reputation to ensure that you buy gold with highest purity
- Mortgage your Gold Jewelry – Trusted Mortgage company for safe return of the Jewel

Investing in Stocks is no different. Evaluating Management Integrity and other parameters is crucial for successful Investment.

Qualities of Good Management

Are there are some qualities & attributes of a Good Management.

Qualities of a Good Management



Competence

- Minimum skill set required to do the task in hand



Integrity

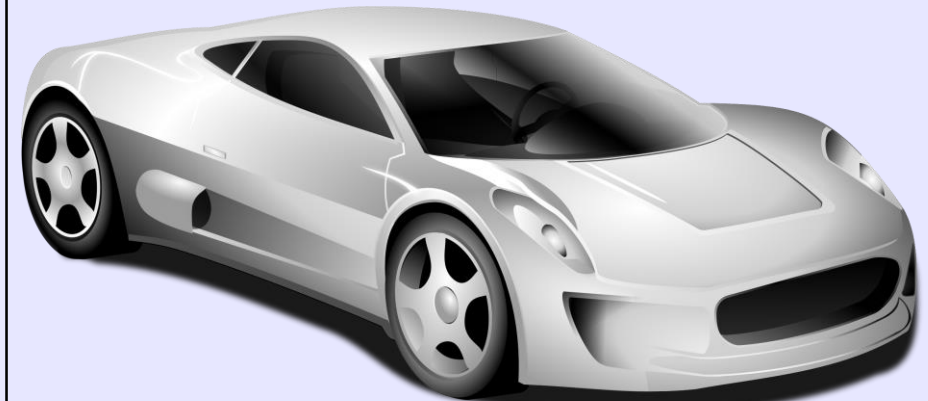
- Executing the task
- Treatment of Minority Shareholders



Passion

- Enthusiasm in doing the task
- Growing business/ Enhancing shareholders wealth

To better explain, assume a situation of you having a driver for your car. Let us see how these 3 qualities stack up in this example.



Qualities of Good Management (Contd.)



- Competent to drive in all conditions i.e. City traffic, high-way, day/night, rainy weather etc. and take you safely to the required destination.
- If your driver sleeps on wheels, then you will loose your sleep!



- You give the driver a 2000 for filling fuel. He fills fuel for 1800 and pockets the rest.
- Would you compromise and have that driver?



- Driving is his passionate & pay cheque comes next. **This is a very rare virtue.**
- Enjoys driving, familiar with alternative routes, never been late to duty and you never missed any appointment

Qualities of Good Management (Contd.)

Now relate these qualities to Business Managements...



The person running the show must be competent enough not only to run the day-to-day business, but also to navigate the business in all conditions i.e. Economy slow down, exploiting economy boom, increasing competition, tightening regulations etc.



- Runs the Business and achieves growth ethically
- The management must treat the minority shareholders in par with promoters/majority share holders.



The key person is passionate about business, very ambitious & loves to see the company grow. Learns from failures, see challenges as opportunity and comes out big after every down turn. Shareholder's wealth creation is accorded priority.

How to Gage Managements?

Analyzing Management Quality is not an easy task like analysing a company's financial performance

Not possible to put a numerical value or have a ratio or specific metrics to gage the quality of management.

Even exact definition of bad or good management is sometimes subjective and not straightforward

What can be bad management: They do all that is possible to benefit themselves at the cost of minority shareholders.

Source of Information

Annual Reports
MGT – 9 Section



Articles &
Interviews

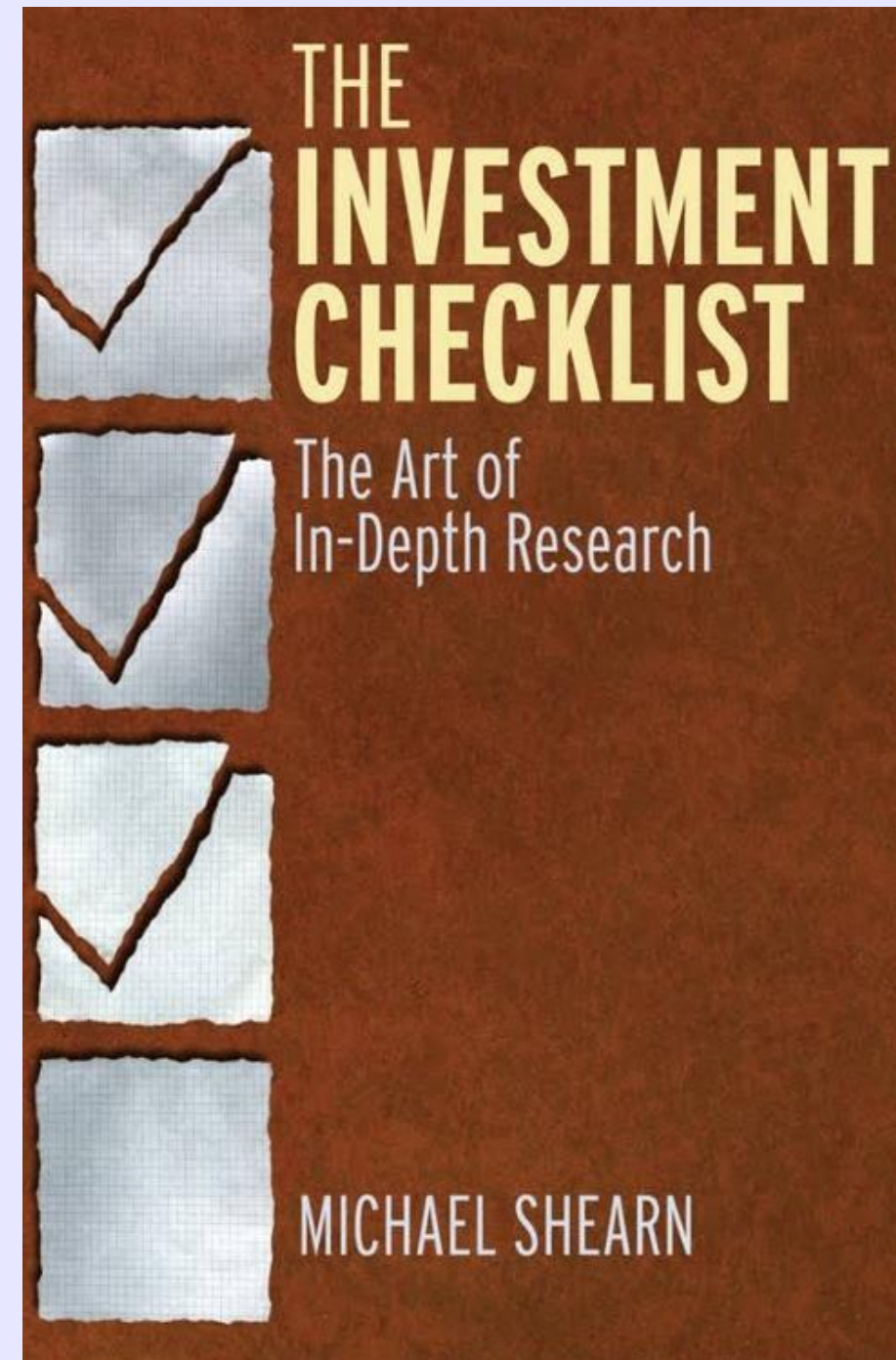
Con call, Investor
Presentations & AGM

How to Gage Managements?

This is a heavy topic to discuss in this video series

If any of you are interested to know or read it immediately kindly refer Chapter 7 to 9 from the book "*The Investment Checklist*" by Michael Shearn

Management Analysis is a In-Depth subject in itself with many pointers to Analyse. However I will discuss a few pointers in this Series. But keep in mind, that there are many more...



Five Pointers



Background



Executive Compensation



Acquisitions



Past Performance



Related Party Transactions

1. Promoter Background



Competence

- Educational qualifications
- Experience details
- The length of tenure, the CEO and the top management has been associated



Integrity

- Are there any pending investigations, fines slapped by SEBI or other regulatory authorities, Fraud, disputes etc. any enquiry pending against the CEO or members of the management layer
- Shareholder friendliness and decisions in the best interest of the minority shareholders



CEO
20Y



40Y





Pointers for Past Performance

- Strong management is the backbone of any successful company
- The past performance is a fair indicator of the management competence and outcome of past decisions

A few pointers...

Growth in the last few years:

| Profit and Loss Account | | | | | | | | | | |
|----------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| 1. Sales (excluding Excise duty) | 12023 | 12792 | 16908 | 22885 | 26005 | 26802 | 26153 | 32653 | 37703 | #39265 |
| 2. Other income | 732 | 872 | 620 | 624 | 803 | 890 | 846 | 690 | 1144 | 1527 |
| 3. Total Income (1+2) | 12755 | 13664 | 17528 | 23509 | 26808 | 27692 | 26999 | 33343 | 38847 | 40792 |

CAGR: 12.5%

Debt Levels in the last few years:


| | | | | | | | | |
|---------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Share Capital + | 234 | 280 | 425 | 425 | 425 | 444 | 444 | 486 |
| Reserves | 4,344 | 6,157 | 8,115 | 10,354 | 11,053 | 12,109 | 9,826 | 14,469 |
| Borrowings | 11,583 | 19,479 | 35,505 | 44,264 | 53,174 | 63,111 | 72,599 | 75,274 |
| Other Liabilities + | 4,565 | 5,725 | 8,044 | 11,992 | 14,816 | 19,819 | 21,412 | 21,314 |

Alarming Levels

Profitability Ratios

Trend of RoE

Constantly rising RoE indicates economic competitiveness.

| Narration | Mar-14 | Mar-15 | Mar-16 | Mar-17 | Mar-18 | Mar-19 |
|------------------------------|--|---------------|---------------|---------------|---------------|---------------|
| Equity Share Capital | | | | | | |
| Reserves | | | | | | |
| Borrowings | - | - | - | - | - | - |
| Other Liabilities | 51.08 | 55.02 | 69.71 | 86.50 | 102.61 | 109.22 |
| Total | 266.45 | 280.76 | 335.70 | 374.49 | 447.63 | 510.49 |
| Net Block | 39.16 | 41.76 | 44.24 | 51.59 | 58.55 | 60.79 |
| Capital Work in Progress | 0.54 | 0.61 | 2.06 | 3.22 | 6.94 | 6.85 |
| Investments | 119.13 | 141.77 | 176.06 | 214.21 | 240.91 | 274.31 |
| Other Assets | 107.62 | 96.62 | 113.34 | 105.47 | 141.23 | 168.54 |
| Total | 266.45 | 280.76 | 335.70 | 374.49 | 447.63 | 510.49 |
| Working Capital | 56.54 | 41.60 | 43.63 | 18.97 | 38.62 | 59.32 |
| Debtors | 59.12 | 63.34 | 60.69 | 66.39 | 93.35 | 103.98 |
| Inventory | 16.99 | 18.05 | 24.92 | 22.42 | 31.27 | 35.34 |
| Debtor Days | 82.68 | 70.54 | 65.95 | 69.02 | 75.32 | 72.26 |
| Inventory Turnover | 15.36 | 18.16 | 13.48 | 15.66 | 14.47 | 14.86 |
| Return on Equity |  9% | 10% | 12% | 11% | 15% | 15% |
| Return on Capital Emp | 12% | 15% | 17% | 17% | 22% | 23% |

Profitability Ratios (Contd.)

Trend of RoE

| Narration | Mar-13 | Mar-14 | Mar-15 | Mar-16 | Mar-17 | Mar-18 | Mar-19 |
|------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Equity Share Capital | | | | | | | |
| Reserves | | | | | | | |
| Borrowings | - | - | - | - | - | - | 83.14 |
| Other Liabilities | 835.31 | 918.37 | 962.54 | 1,007.96 | 1,036.85 | 1,039.25 | 1,096.59 |
| Total | 1,324.90 | 1,518.25 | 1,732.86 | 2,039.00 | 2,310.65 | 2,563.86 | 2,626.48 |
| Net Block | 280.66 | 555.91 | 781.58 | 1,008.14 | 1,108.11 | 1,145.91 | 1,190.85 |
| Capital Work in Progress | 101.96 | 141.51 | 141.18 | 78.37 | 166.59 | 158.58 | 198.70 |
| Investments | 47.12 | 37.13 | 37.13 | 31.16 | 31.16 | 31.16 | 31.15 |
| Other Assets | 895.16 | 783.70 | 772.97 | 921.33 | 1,004.79 | 1,228.21 | 1,205.78 |
| Total | 1,324.90 | 1,518.25 | 1,732.86 | 2,039.00 | 2,310.65 | 2,563.86 | 2,626.48 |
| Working Capital | 59.85 | -134.67 | -189.57 | -86.63 | -32.06 | 188.96 | 109.19 |
| Debtors | 81.21 | 54.73 | 69.64 | 101.54 | 129.90 | 201.03 | 209.79 |
| Inventory | 185.30 | 225.74 | 252.23 | 291.53 | 292.55 | 226.71 | 248.57 |
| Debtor Days | 9.37 | 5.58 | 6.38 | 9.58 | 11.91 | 17.52 | 17.16 |
| Inventory Turnover | 17.07 | 15.85 | 15.79 | 13.27 | 13.61 | 18.47 | 17.95 |
| Return on Equity | 101% | 90% | 73% | 56% | 45% | 44% | 54% |
| Return on Capital Emp | 143% | 134% | 114% | 93% | 74% | 70% | 75% |

Source: Screener.com

Dividend / Retained Earnings

Is Profits shared with the shareholders in the form of dividends.?

- This is one good indicator as there is real money outflow from the company to Investor's pocket
- How much dividend must be distributed as dividends or how much must be retained or reinvested?
 - If no growth or reinvestment opportunities the earnings must be distributed as dividends
 - If there are good growth opportunities then the earnings must be deployed back to business

How to measure the effectiveness of earnings that are re-invested?

RORE

means

Return on Retained Earnings

A few resources...

<https://www.myaccountingcourse.com/financial-ratios/rore>

https://www.readyratios.com/reference/profitability/return_on_retained_earnings_rore.html



3. Executive Compensation

Executive Compensation

- Gives critical insights to Management Intentions
- Management is responsible for increasing shareholders wealth over a period of time.
- But if they pay themselves with huge amounts of money then the gains for shareholders becomes less.
- Such high compensation at the tough times, are not encouraging signs
- The compensation details are available in the Annual reports (Section MGT-9)

Executive Compensation (Contd.)

- But the next question is how much is huge?
- Determining what level of compensation would be too high or low, is no doubt a difficult task, However a few pointers would help:
 - Periodic Comparison & Peer Comparison
 - The ceiling set by Regulations
 - “Salary range for promoter directors/management is about 2-4% of Net Profit After Tax (PAT). The salary generally contains 2% commission on PAT and a fixed monthly component along with other perquisites” - Dr. Vijay Malik

Compensation - Samples

- Comparison of Managerial compensation without reference would be misleading
- The Managerial Compensation (MC) must be referenced to a base value for making a meaningful comparison.
- The base will be Net Profits (Profit After Tax) for the year
- This gives the Managerial Compensation as a %-age of Net profits

Year on Year Comparison

| | Year 1 | Year 2 | Year3 | Year 4 |
|-----------------|--------|--------|-------|--------|
| Net Profit (NP) | | | | |
| MC* | | | | |
| % of (MC/NP) | | | | |

Peer Comparison

| | Target | Comp 1 | Comp 2 | Comp 3 |
|-----------------|--------|--------|--------|--------|
| Net Profit (NP) | | | | |
| MC* | | | | |
| % of (MC/NP) | | | | |



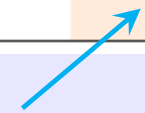
If MC is calculated as a % of Net Profits... then what would be compensation if the company was in loss? 😊



AVOID!

Compensation - Samples

| | | | |
|---|---|--------------|--------------|
| 1 | Gross salary | | |
| | (a) Salary as per provisions contained in section 17(1) of the Income-tax Act 1961 | 2.40 | 2.40 |
| | (b) Value of perquisites u/s 17(2) Income-tax Act 1961 | | - |
| | (c) Profits in lieu of salary under section 17(3) Income-tax Act 1961 | | - |
| 2 | Stock Option | - | - |
| 3 | Sweat Equity | - | - |
| 4 | Commission | | |
| | - as % of profit | 37.29 | 37.29 |
| | - others specify | - | - |
| 5 | Others Contribution to Provident Fund | 0.00* | 0.00* |
| | Total (A) | 39.69 | 39.69 |
| | Ceiling as per the Act i.e 5% of the net profits calculated under Section 198 of the Companies Act 2013 | | 39.69 |



Compensation - Samples

| | | | |
|---|--|--------------|--------------|
| 1 | Gross salary | | |
| | (a) Salary as per provisions contained in section 17(1) of the Income-tax Act, 1961 | 2.40 | 2.40 |
| | (b) Value of perquisites u/s 17(2) Income-tax Act, 1961 | 0.08 | 0.08 |
| | (c) Profits in lieu of salary under section 17(3) Income-tax Act, 1961 | - | - |
| 2 | Stock Option | - | - |
| 3 | Sweat Equity | - | - |
| 4 | Commission | 36.38 | 36.38 |
| | - as % of profit | | |
| | - others, specify | - | - |
| 5 | Others, Contribution to Provident Fund | 0.00* | 0.00* |
| | Total (A) | 38.86 | 38.86 |
| | Ceiling as per the Act i.e 5% of the net profits calculated under Section 198 of the Companies Act, 2013 | | 38.86 |

Compensation - Samples

| <i>CURRENT YEAR</i> | | | | ₹ crores |
|---|--------------|-----------------------|--------------|----------|
| Particulars of Remuneration | | | | |
| Fees for attending board / committee meetings | Commission | Others please specify | Total Amount | |
| 0.02 | 0.05 ✘ | - | 0.07 | |
| 0.02 | 0.05 ✘ | - | 0.07 | |
| 0.01 | 0.05 ✘ | - | 0.06 | |
| 0.01 | 0.05 ✘ | - | 0.06 | |
| 0.06 | 0.20 | - | 0.26 | |
| - | 23.82 | - | 23.82 | |
| - | - | - | - | |
| - | - | - | - | |
| - | - | - | - | |
| - | 23.82 | - | 23.82 | |
| 0.06 | 24.02 | - | 24.08 | |
| | | | 24.08 | |
| Section 198 of the Companies Act 2013# | | | | 7.30# |

| Fees for attending board / committee meetings | Commission | Others, please specify | Total Amount |
|---|--------------|------------------------|--------------|
| <i>PREVIOUS YEAR</i> | | | |
| 0.02 | 0.05 ✘ | - | 0.07 |
| 0.01 | 0.05 ✘ | - | 0.06 |
| 0.01 | 0.05 ✘ | - | 0.06 |
| 0.01 | 0.05 ✘ | - | 0.06 |
| 0.05 | 0.20 | - | 0.25 |
| - | 23.32 | - | 23.32 |
| - | - | - | - |
| - | - | - | - |
| - | - | - | - |
| - | 23.32 | - | 23.32 |
| 0.05 | 23.52 | - | 23.57 |
| | | | 23.57 |
| | | | 7.15 |

1% of Net Profit

Compensation (Contd.)

| Designation | | Managing Director & CEO | Executive Director & CFO | |
|-------------|---|-------------------------|--------------------------|---------------------|
| 1 | Gross salary | | | |
| | (a) Salary as per provisions contained in section 17(1) of the Income-tax Act, 1961 | 12.00 * | 6000000.00 ** | 60,00,012.00 |
| | (b) Value of perquisites u/s 17(2) Income-tax Act, 1961 | - | - | - |
| | (c) Profits in lieu of salary under section 17(3) Income- tax Act, 1961 | - | - | - |
| 2 | Stock Option | Nil | Nil | - |
| 3 | Sweat Equity | Nil | Nil | - |
| 4 | Commission | | | |
| | - as % of profit | Nil | Nil | - |
| | - others, specify | Nil | Nil | - |
| 5 | Others, please specify | | | |
| | i) Leave Encashment | - | - | - |
| | Total (A) | 12.00 | 6000000.00 | 60,00,012.00 |
| | Ceiling as per the Act | | | |

[REDACTED] Managing Director & CEO has voluntarily opted to receive a token remuneration of ₹1/- (Rupee one only) per month.

Compensation (Contd.)

| Sr. No. | Particulars of Remuneration | | | | Total |
|---------|--|---------------|--------------|-----------------|-----------------|
| 1. | Gross salary | | | | |
| | (a) Salary as per provisions contained in section 17(1) of the Income- tax Act, 1961 | 1* | 1* | 11855400 | 11855402 |
| | (b) Value of perquisites u/s 17(2) Income-tax Act, 1961 | 262800 | 79200 | 371181 | 713181 |
| | (c) Profits in lieu of salary under section 17(3) Income tax Act, 1961 | - | - | - | - |
| 2. | Stock Option | - | - | - | - |
| 3. | Sweat Equity | - | - | - | - |
| 4. | Commission - as % of profit | - | - | - | - |
| 5. | Others, please specify | - | - | - | - |
| | Total (A) | 262801 | 79201 | 12226581 | 12568583 |

Ceiling as per the Act: ₹499.9 Million (10% of Net Profits of the Company calculated as per Section 198 of the Companies Act, 2013)

is ₹1/- each for the financial year 2018-19 and the remaining amount of ₹262800 and ₹79200 respectively pertain to notional value of perquisite as per Income Tax Act.

4. Related Party Transactions



Basics of Related Party Transactions

Who all constitute as Related Party?

Companies Act 2013, gives the definition for Related Party. A few being:

- Director / Relatives to Director
- Key Management Personal / Their relatives
- A Holding Company
- A Subsidiary Company
- An Associate Company and many more

Complete List from Companies Act 2013

<http://www.mca.gov.in/SearchableActs/Section2.htm>

What is a Related Party Transaction (RPT)?

A Related Party Transaction is a transfer of resources, services or obligations between the reporting entity (The company which you are analysing) and a related party, regardless of whether a price is charged.

Importance of Related Party Transactions

- Goldmine of the information for assessment of any management
 - Related party transactions section is one of the essential parts of the annual report that every investor should analyse in detail for every company they invest.
 - This section discloses a summary of all the transaction and dealings that the company made with Related parties i.e. promoters and their personal entities, subsidiaries, holding or associate company etc.
 - By studying each transaction in this section, an investor can get a fair idea of whether the promoters are benefiting from the company at the cost of minority shareholders.
 - Less the number of RPT, the better – This directly related to number of subsidiaries
- Related party transactions are not necessary a mechanism for fraud – But investors need to evaluate in in light of its broader corporate governance.
 - Their presence need not indicate fraudulent financial reporting.

Where all can mistakes happen

Creative areas in RPT

- Subsidiaries Provide Raw materials - Purchase of Raw materials at higher than market cost which gives gains to Subsidiary
- Concessionary Loans: Loans to Subsidiary at low interest rates than market rates
- Purchase of Fixed Assets from Subsidiary at a higher price (or) sale of Fixed assets to Subsidiary at a lower price
- Lease/Rent of facilities from Subsidiary at higher rates (or) Lease/Rent of facilities to Subsidiary at lower rates

Related Party Transactions - Samples

| Purchase of goods | | |
|--------------------------|---------|--------|
| [Redacted] | Limited | 0.53 |
| [Redacted] | ted | 87.17 |
| [Redacted] | | 825.65 |
| Availing of services | | |
| [Redacted] | | 3.21 |
| [Redacted] | Limited | 62.06 |
| Purchase of Fixed Assets | | |
| [Redacted] | | 15.63 |
| [Redacted] | | 0.18 |
| [Redacted] | | 33.07 |
| [Redacted] | | 134.10 |
| [Redacted] | Limited | 0.04 |

Transactions with Subsidiaries

route to siphon off money was by inflating project costs, adds the banker on condition of anonymity. The project cost is generally inflated by 20-30 per cent by conniving with vendors or suppliers of plant and machineries to take the money out from the company.

Mid-sized companies often exploit the working capital route by inflating “stock in trade” bills and “receivables” to take money out from the company. The big boys use sophisticated methods like routing funds to subsidiaries or group companies or companies of relatives as capital or loans and advances. Similarly, there are many instances of companies buying a business at an unreasonable valuation or investing in the equity capital of large unlisted companies. These investments or the returns never come back to the parent company, say experts.

<https://www.businesstoday.in/magazine/cover-story/how-funds-are-siphoned/story/3684.html>

Number of Subsidiaries

More the number of Subsidiaries,
 more the number of
 opportunities for Related Party
 Transactions and more the
 number of options to Siphon
 company money to the Subsidiary

III. PARTICULARS OF HOLDING, SUBSIDIARY AND ASSOCIATE COMPANIES:

| S. No. | Name and Address of the company | CIN/GLN | Holding/Subsidiary/ Associate | % of shares held | Applicable Section |
|--------|---|-----------------------|-------------------------------|------------------|--------------------|
| 1 | Coffee Day Global Ltd. | U85110KA9999PLC010001 | Subsidiary | 89.62% | 2 (87) (ii) |
| 2 | Langhin Developments Ltd. | U85110KA9999PLC019495 | Subsidiary | 100.00% | 2 (87) (ii) |
| 3 | Coffee Day Hotels and Resorts Pvt. Ltd. | U85101KA2004PTC034591 | Subsidiary | 100.00% | 2 (87) (ii) |
| 4 | Coffee Day Trading Ltd. | U84140KA2000PLC026366 | Subsidiary | 88.77% | 2 (87) (ii) |
| 5 | Ray2Wealth Securities Pvt. Ltd. | U22200KA2000PTC027026 | Subsidiary | 85.53% | 2 (87) (ii) |
| 6 | Classic Coffee Curing Works | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 7 | CoffeeLab Ltd. | U85110KA9999PLC019992 | Subsidiary | 100.00% | 2 (87) (ii) |
| 8 | C.N Coffeeday International Ltd. | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 9 | Coffee Day Gastronomie Und Kaffeehandels GmbH | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 10 | Coffee Day C 2 S 2 | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 11 | Sri Vidhyuth (India) Limited | U40101KA2001PLC029886 | Subsidiary | 100.00% | 2 (87) (ii) |
| 12 | Langhin Retail Realty Developments Pvt. Ltd. | U70102KA2007PTC044421 | Subsidiary | 100.00% | 2 (87) (ii) |
| 13 | Stal Logistics Ltd. | LS9807N1999PLC004341 | Subsidiary | 52.83% | 2 (87) (ii) |
| 14 | PNL Logistics Pvt. Ltd. | U84120MH2011PTC233629 | Subsidiary | 60.00% | 2 (87) (ii) |
| 15 | Develcto Mining Limited | U10200TN2018PLC121501 | Subsidiary | 51.00% | 2 (87) (ii) |
| 16 | Archems Pvt. Ltd. | U24110MH1999PLC022943 | Subsidiary | 51.00% | 2 (87) (ii) |
| 17 | Stal Mining Limited | U10300TN2016PLC113461 | Subsidiary | 100.00% | 2 (87) (ii) |
| 18 | Stal Iron Ore Terminal Ltd. | U13100TN2006PLC061023 | Subsidiary | 63.00% | 2 (87) (ii) |
| 19 | Stal Iron Ore Terminal (Mangalore) Ltd. | U63200TN2009PLC073142 | Subsidiary | 100.00% | 2 (87) (ii) |
| 20 | Stal Adams Offshore Ltd. | U63000TN2012PLC087754 | Subsidiary | 100.00% | 2 (87) (ii) |
| 21 | Stal Saumya Mining Limited | U84900TN2015PLC181246 | Subsidiary | 65.00% | 2 (87) (ii) |
| 22 | Vespa Offshore India Ltd. | U84900TN2009PLC011782 | Subsidiary | 100.00% | 2 (87) (ii) |
| 23 | Stal Infra Assets Ltd. | U40001TN2001PLC063432 | Subsidiary | 53.00% | 2 (87) (ii) |

| S. No. | Name and Address of the company | CIN/GLN | Holding/Subsidiary/ Associate | % of shares held | Applicable Section |
|--------|---|-----------------------|-------------------------------|------------------|--------------------|
| 24 | ICM Bangalore Logistics Park Limited | U63000TN2016PLC060674 | Subsidiary | 100.00% | 2 (87) (ii) |
| 25 | Stal Multimodal and Rail Transport Ltd. | U60232TN2007PTC063296 | Subsidiary | 100.00% | 2 (87) (ii) |
| 26 | Bergen Offshore Logistics Pte Ltd. | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 27 | Vespa Global Offshore Pte Limited | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 28 | Wilderness Resorts Pvt. Ltd. | U85101KA2005PTC025587 | Subsidiary | 100.00% | 2 (87) (ii) |
| 29 | Karnataka Wildlife Resorts Pvt. Ltd. | U92199KA2001PTC028981 | Subsidiary | 100.00% | 2 (87) (ii) |
| 30 | Ragnasoft Consulting India Pvt. Ltd. | U75160KA2000PTC026725 | Subsidiary | 77.88% | 2 (87) (ii) |
| 31 | Ragnasoft Europe Ltd. | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 32 | Ragnasoft Spatial Services Inc. | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 33 | Ray2Wealth Distributors Pvt. Ltd. | U70101KA2001PTC029919 | Subsidiary | 100.00% | 2 (87) (ii) |
| 34 | Ray2Wealth Capital Pvt. Ltd. | U65021KA1995PTC018967 | Subsidiary | 99.99% | 2 (87) (ii) |
| 35 | Ray2Wealth Enterprises Pvt. Ltd. | U85999AP2011PTC106318 | Subsidiary | 100.00% | 2 (87) (ii) |
| 36 | Ray2Wealth Insurance Brokers Pvt. Ltd. | U66010KA2003PTC032303 | Subsidiary | 99.99% | 2 (87) (ii) |
| 37 | RandQMarket Traders Pvt. Ltd. | U67190KA2007PTC043494 | Subsidiary | 100.00% | 2 (87) (ii) |
| 38 | Ray2Wealth Brokers Pvt. Ltd. | U67120KA2000PTC027626 | Subsidiary | 99.99% | 2 (87) (ii) |
| 39 | Ray2Wealth Commodities Pvt. Ltd. | U81239KA2008PTC039680 | Subsidiary | 99.99% | 2 (87) (ii) |
| 40 | AlphaGrep Securities Pvt. Ltd. | U66010KA2002PTC029982 | Subsidiary | 51.00% | 2 (87) (ii) |
| 41 | AlphaGrep Commodities Pvt. Ltd. | U65999TC2017PTC117172 | Subsidiary | 100.00% | 2 (87) (ii) |
| 42 | Ray2Wealth Illuminati Pte Ltd. | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 43 | AlphaGrep Holding HK Ltd. | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 44 | AlphaGrep UK Limited | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 45 | Shanghai Dao Ge International Trading Limited | NA | Subsidiary | 100.00% | 2 (87) (ii) |
| 46 | Team Systems Pvt. Ltd. | U72900KA2001PTC026256 | Associate* | 32.51% | 2 (6) |
| 47 | Parabot Resorts and Leisure India Pvt. Ltd. | U85101TN1998PTC040221 | Associate* | 27.69% | 2 (6) |
| 48 | Indtree Ltd. | U22200KA1999PLC035584 | Associate* | 17.11% | 2 (6) |
| 49 | Coffee Day Schweizer Technologies Private Limited | U19048KA2015PTC084523 | Joint Venture# | 49% | 2(6) |
| 50 | SA Stal Terminals Ltd. | U84999TN1998PLC040687 | Joint Venture# | 37.50% | 2 (6) |
| 51 | Stal Satya Rail Terminal Pvt. Ltd. | U63001TN2000PTC045796 | Joint Venture# | 50% | 2 (6) |

Sample – With no significant RPT

PARTICULARS OF CONTRACTS OR ARRANGEMENTS WITH RELATED PARTIES

All related party transactions which were entered during the financial year were in the ordinary course of business and on an arm's-length basis. There were no materially significant related party transactions entered into by the Company with promoters, directors, key managerial personnel or other persons which may have a potential conflict with the interests of the Company.

All related party transactions are placed before the Audit Committee for review and approval. Prior omnibus approval is also obtained from the Audit Committee for related party transactions that are of repetitive nature and can be foreseen, and accordingly the required disclosures are made to the Audit Committee on a quarterly basis in terms of the omnibus approval of the Committee.

The policy on materiality of related party transactions and also on dealing with related party transactions as approved by the Audit Committee and the Board of Directors is uploaded

5. Acquisition

A 3D puzzle with one red piece in the center containing the word 'Acquisition'. The puzzle pieces are white and grey, and the red piece is in the center. The word 'Acquisition' is written in white, bold, sans-serif font on the red piece.

Acquisition

Check the Acquisition Details

Purpose of Acquisition

Growth

Strategic Move

- Raw Materials
- Enhanced Logistics strength or Distribution network
- Enter Foreign Market

- Does the company grow only with frequent acquisitions? – Concern
- During acquisition, does the management stick to core business or their competencies?
- Is the acquisition funded internally or taking high debt affecting the quality of Balance Sheet
- How does the acquisition work out? Is it sold after poor performance? – A bigger concern

Have these in mind...



Annual Reports hide more what they disclose.



Annual Reports disclose more than what it can hide or we can see, but we need to bring in time and skill.



Most of the details that we discussed in these three videos were picked from Annual Report.

<https://economictimes.indiatimes.com/wealth/invest/annual-report-can-reveal-the-secrets-a-company-wants-to-hide-heres-how-to-uncover/articleshow/59190442.cms?from=mdr>

Have these in mind...

- Only few pointers and not an exhaustive or a complete set
- Don't make a decision with only one parameter in isolation.
- Connect the dots and see the bigger picture i.e. Managerial Competence, Compensation, Related Party Transactions etc
- Analysis of Management Quality – Investigation work, Old reports, compare with peers, previous year reports etc.

ACTIONS



Promoter Background

- Who is heading the company?
- What are their educational qualifications
- Their experience and tenure in the company
- Pending Investigations on the CEO



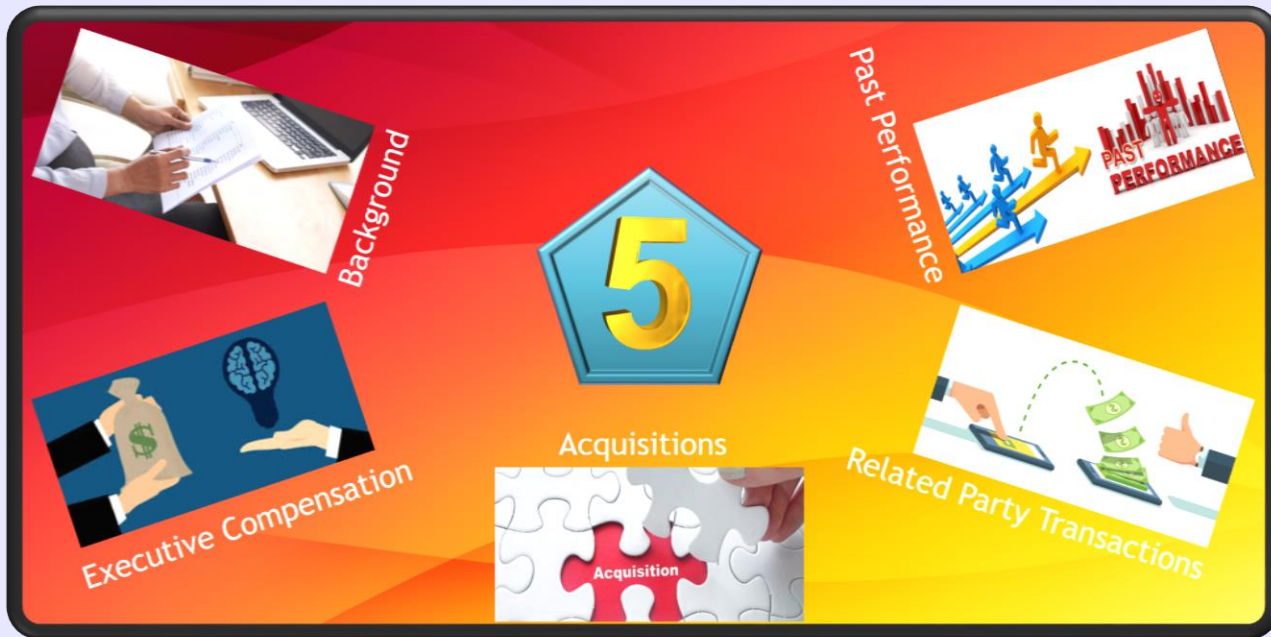
Try to find as much as possible about CEO and Management layer from Annual Reports and Internet

ACTIONS



Past Performance

- Check 5-10 Year Sales and Profit Growth
- Trend of Profitability Ratios
- Check the debt levels (Increased or Decreased)
- Amount of Dividend Distributed & Retained
- Effectiveness Retained Earnings – Return on Retained Earnings



Document the Observations

- 5-10 Year Sales growth _____ CAGR
- 5-10 Year profit growth _____ CAGR
- 5 – 10 Year trend of Profitability Ratios (Not Average!)
- Debt level (Increased / Decreased)
- Effectiveness of Retained Earnings: RORE _____ %

ACTIONS



Executive Compensation

- Calculate the Managerial Compensation (MC) Ratio: (Compensation / Net Profit After Tax)
- 5 – 10 years data of the same company
- Comparison of the same ratio with peers in the industry



Year on Year Comparison

| | Year 1 | Year 2 | Year 3 | Year 4 |
|-----------------|--------|--------|--------|--------|
| Net Profit (NP) | | | | |
| MC* | | | | |
| % of (MC/NP) | | | | |

Peer Comparison

| | Target | Comp 1 | Comp 2 | Comp 3 |
|-----------------|--------|--------|--------|--------|
| Net Profit (NP) | | | | |
| MC* | | | | |
| % of (MC/NP) | | | | |

ACTIONS



Related Party Transaction

- How many subsidiaries does the company have?
- Gather details of Related Party Transactions, (1) The number of such transactions, Amount (Monetary value) of such transactions, Nature of Transaction (Loan, interest back etc)



Document the findings...
What is your general feel
about these transactions

ACTIONS



Acquisition

- Evaluate the nature of recent acquisitions
- How was it acquired? Internal funds or debt?
- Was it into a related or unrelated business?



Sum Up...

- STEP 1 – ANALYZING QUALITY OF BUSINESS AND MANAGEMENT IS THE BIGGEST, TIME CONSUMING ANALYSIS THAT AN INVESTOR MUST DO METICULOUSLY
- COMPLETING THIS ACTIVITY PROPERLY IS LIKE NEARLY HALF JOB DONE
- IF THE QUALITY OF BUSINESS / MANAGEMENT IS **NOT** GOOD, FURTHER ANALYSIS OF THAT COMPANY IS NOT REQUIRED
- IF THIS STEP IS PASSED, ONLY THEN CAN ONE GO FOR ANALYSING GROWTH
- WHAT IS THE USE OF FOCUSING ON A BUSINESS THAT IS NOT A GOOD BUSINESS OR NOT RUN BY A GOOD MANAGEMENT?

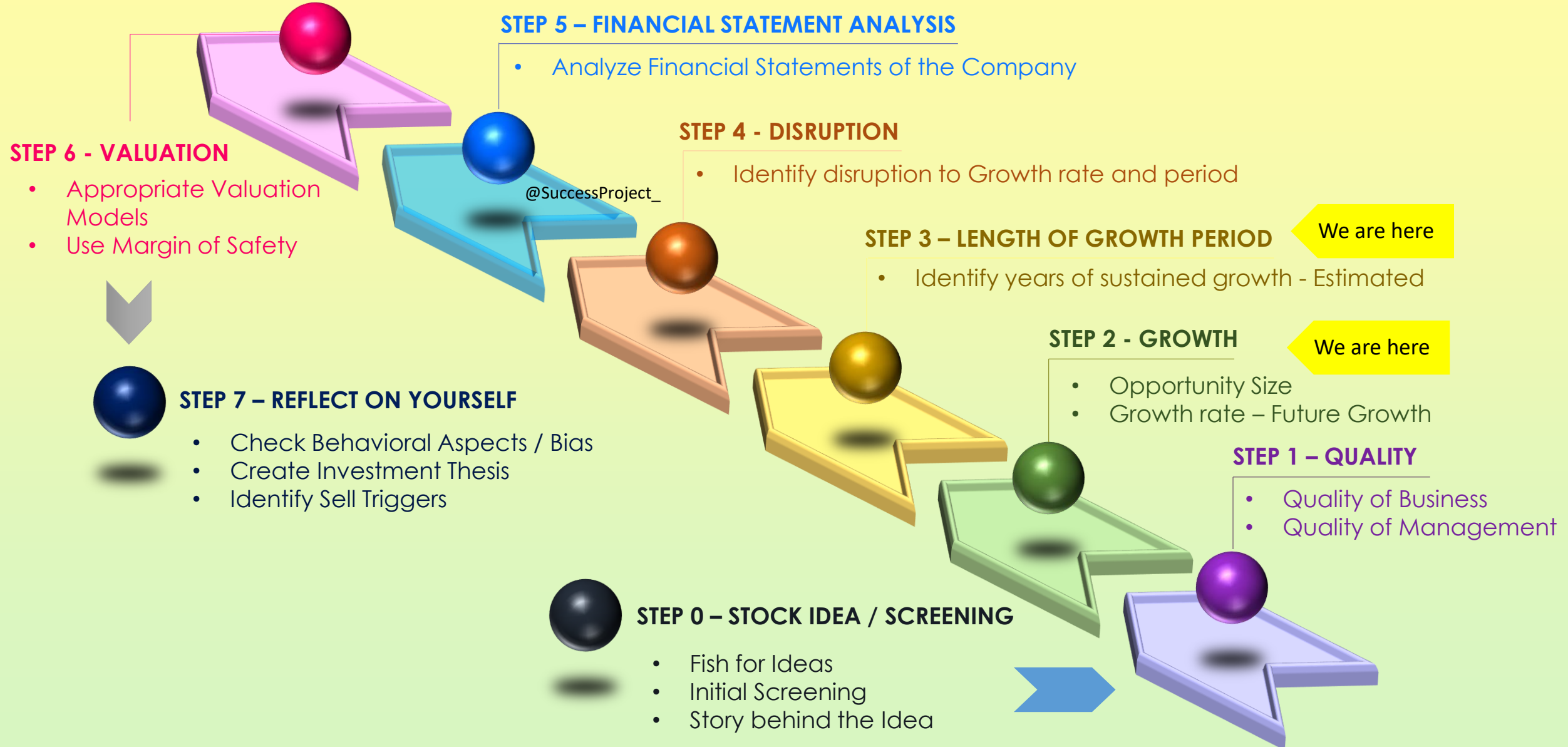
MANY COMPANIES FAIL AT THIS STAGE

Step 2 & 3: Growth & Length of Growth

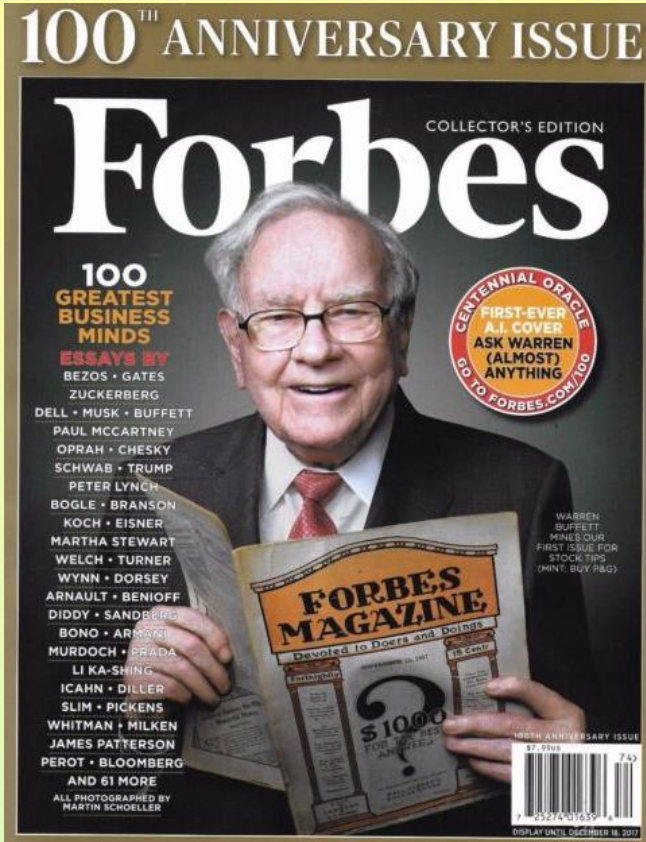
YouTube Video: https://youtu.be/RtRT9OZaDrA?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

Image courtesy: Slidecarnival.com

7-STEPS IN STOCK ANALYSIS



View of the Zen...



"The strategy is to find a good business – and one that I can understand why it's good – with a durable competitive advantage, run by able and honest people, and available at a price that makes sense. Because we are not going to sell the business, we don't need something with earnings that go up the next month or the next quarter; we need something that will earn more money 10 and 20 and 30 years from now."

– Warren Buffett, in Forbes Magazine's 100th Anniversary Issue.

Investor of today will not benefit from the profits of the past but only from the profits of the future - Warren Buffet

Investing is Art or Science?

- Investing is Art or Science? Some say it is art and academicians may say it is Science
- Hard to fit in one of the category - It is a mix of Both
 - **Science** gives consistent results in the same set of conditions. Qualitative analysis and financial models bring in Science flavour in investing.
 - **Art** brings in using one's prudent judgement, intuition, common sense and experience (Unpredictable – Differs from persons and even with the same person!)
- Investing is **Science** to certain extent and **Art** beyond that
- Two great investors or fund managers could come out with two entirely contrary views on the same stock.
- This would be more common when estimating the growth rates. While one investor could say that IT sector would have 10% growth, other would say that there is no growth expected for next 2-3 years.
- When analysing growth, we are in Art portion of investing – No Precision or Accuracy

What is Growth?

- By Growth, we are looking for earnings growth of the company - it increases the value of the company
- Stock prices are correlated with the earning growth and markets richly reward growth
- Earnings growth can come from
 - Margin expansion (Increase in Profit margins for a given level of Revenue)
 - Revenue growth (Increase in Revenue for a given level of Profit margins)
- The earnings growth must come from Revenue growth, as there is limit to Profit margin expansion strategy
- Where does the revenue growth come from?

External
Factors

Opportunity Size

Management Capability

Internal
Factors

Growth – A Numerical Overview

- 100 Crores today and same 100 crores profit in the 10th Year! – No use to Investor
- 100 Crores today and 1000 crores in the 10th Year is what a investor needs (~25% CAGR)
- But to earn 1000 crores in 10 years, two things are vital
 - Opportunity size: The industry or opportunity must be big enough to offer 10 times growth in 10 years
 - Management: Competent enough to exploit this opportunity ethically
- Opportunity size – External factor and more of crystal gazing is involved, depends on our knowledge about the industry and its future prospect
- Management with the three characters needed i.e. Integrity, competency and passion is needed to exploit the opportunity– See in earlier videos

Is Estimating Growth Difficult?

- There is no science or technique that can help investors to figure out the earning growth – complex and multivariate.
- There is no book available which can help to estimate growth.
- Growth is unique to each industry and even different within companies in the same industry. Hence, does not yield itself to any standard frameworks.
- Estimating the growth rate is seeing into the future.
- Your OWN understanding on the industry, trends, competition, management and many more factors come into picture when estimating the growth - Here comes the importance of Circle of Competence (Investing in what you know)

There could be **3** situations...

1. Estimate by Market – This company can grow at 25% for the next few years
2. Self-estimates based on understanding of the business, bring in a differential view, this company can grow at 35%
3. Reality (25% or 35% or contra?) of what happens as time passes

Characteristic of Good Growth

Consistency of Growth

- Cyclical growth is much more difficult to predict compared to secular growth. Stocks with secular or consistent growth commands much higher valuations due to the predictability of it. In short, what can be measured and predicted gets valued.

Sustainability of Growth

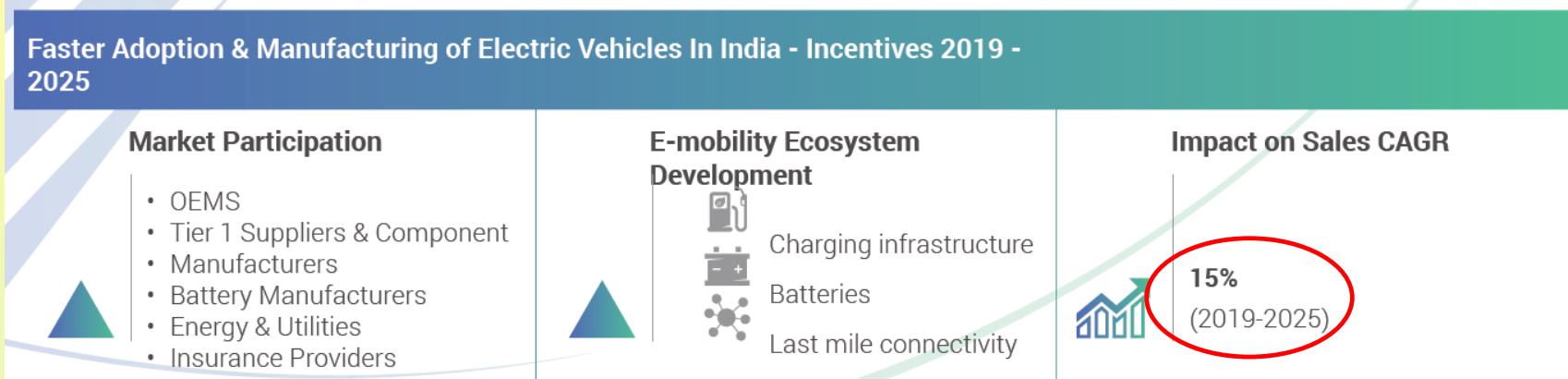
- The current value of companies depends considerably on the perceived longevity of their earnings growth.
- The greater the sustainability of such earnings growth, the better is likely to be the valuation of such growth.

Profitable Growth

- For growth to become self-financing and capable of generating free-cash flows.
- Earnings growth achieved at a significant capital cost is not valuable.
- $RoIC > CoC$ (Great/Good Companies), consistently indicates good growth

Where to get details of Growth?

Another area to look for future growth values is Annual reports of various companies in the whole industry. They bring out their own research/insights or refer to other research which can give a fair idea of expected future growth



The Indian lead-acid battery industry is ~₹300 bn (~US\$4.7 bn) in size and has been growing at a CAGR of 10-12%. In terms of application, it is equally split between the Automotive segment and the non-automotive segment. The industry is divided into three segments: (a) organised segment (₹180 bn market controlled by five manufacturers), (b) SME (₹80 bn-100 bn), and (c) SSI (₹25 bn). Given the high share of replacement demand for segments like automotive, home inverter, UPS, traction, etc, the share of unorganised/semi-organised players is high at ~30% of the total demand.

| Stage | Cum. battery requirements (GWh) | Total market size (INR T) | Imports | Domestic manufacturing |
|-------|---------------------------------|---------------------------|----------------------|---|
| 1 | 120 | 1.3-1.4 | Complete Cells | Battery packs |
| 2 | 970 | 6.1-8.9 | Some Cells, cathodes | Battery packs + Limited cell production |
| 3 | 2,410 | 11.7-17.1 | Cathodes | End-to-end battery manufacturing |

Source: NITI Aayog

Where to get details of Growth?

According to the “Data Center Market in India - Industry Outlook and Forecast 2019-2024” report, the India data center market is expected to reach values of approximately US\$4 bn by 2024, growing at CAGR of around 9% during 2018-2024.

This augurs well for demand in the replacement market, which is driven by factors such as the number of vehicles in use, average battery life, and the average age of vehicles. An automobile battery’s life of 3-3.5 years translates into linear replacement demand from the existing vehicle population. Credible estimates suggest that the auto replacement market could grow at ~7-9% CAGR over FY17-22E; the market share of the unorganised players is expected to dip significantly over the same period due to various factors.

Going forward: Considering the continued pressure on sales and prevailing market uncertainty, the industry lobby group has projected a modest 3-5% rise in passenger vehicle sales in 2019-20.

The passenger vehicle (PV) market in India is likely to reach a sales figure of about 5 million units in FY 2023 from 3.3 million units in FY19 at a CAGR of 7.7%, according to an ASSOCHAM-Roland Berger report.

Stronger preference for SUVs (sports utility vehicles) and crossover models is expected to continue in the future as well leading to a CAGR of 12% in 2018-23.

Size of Opportunity

- Future size of opportunity - Not today (How large can that opportunity become in future)
- This is lot to do with crystal gazing into future to visualize how the business becomes over period of time
- This idea can be equated to the framework of size of fish and size of pond
- The investing world focus on size of fish, but successful investing requires figuring out the size of pond



Small fish in a big pond



Big fish in a big pond



Big fish in a small pond



Small fish in a small pond

Note: The contents of this slide - Fish/Pond Analogy picked from the book *"On Long-Term Value & Wealth Creation from Equity Investing"* by Mr. Bharat Shah. Refer the book for further details and understanding of this concept 'Size of the Opportunity'.

Size of Opportunity (Contd.)



Small fish in a big pond

- If the fish is capable and conditions are favourable, there will be explosive growth
- This option carries certain risk due to the current size of the fish and returns are much higher

These two options only will help in Value creation



Big fish in a big pond

- The fish is already fat and has the needed strength and pond size is also big to accommodate as the fish grows further
- This option carries lesser risk due to the maturity of the fish but gives lesser returns (In comparison with the above option) due to the existing size of fish

A Sample Case

- The overall Size of the opportunity.
 - E.g. Aviation business: How many people travel now by air and how many would travel by 2025?
 - What are enablers? UDAAN - Regional Connectivity Scheme
- Where does the company in analysis stand in relation to the opportunity size?
 - How much market share does your XXX Airline company caters in the current Air travel volumes? It is 10% or 50% or 90%
- The capability of the management to exploit (Ethically!) the available opportunity size.
 - This is the where the quality of Management that we previous discussed becomes important
 - If the current market share is 90%, can it retain the same till 2025 without losing to competition
 - If the current market share is 50%, can the management increase to 80-90% by 2025?

This analysis can be made only, if there is a fair understanding of the industry in which the company operates. To get a right answer, *your own understanding of your company and the industry in which it operates is important*. The question now on you is...

Do you have sufficient understanding of the Industry that you are analyzing to do this Growth analysis?

Longevity of Growth

- Identifying the growth rate for new future (1-2 years) is of little use, Longevity of Growth is more important (Identifying how long a particular growth will sustain, i.e. Growth rate of 15% for 5 years)
- Ideal scenario would be to perpetual growth, but such companies are rare/few
- Longevity in this context is also the duration a company can maintain its competitive advantage and earnings growth.
- Longevity and high growth rates are inversely co-related, Higher the growth, lesser the longevity of the growth
- Hypergrowth sectors/stocks must be carefully approached (Hypergrowth? A stock that had grown over 40-50% in the last 4-5 years)
- While estimating growth is difficult, even much more difficult is determining the longevity of growth as there are many factors (Known and Unknown) that can disrupt this project growth

A Compounding Machine

GOOD GROWTH + LONGEVITY OF THIS GROWTH
=
COMPOUNDING MACHINE

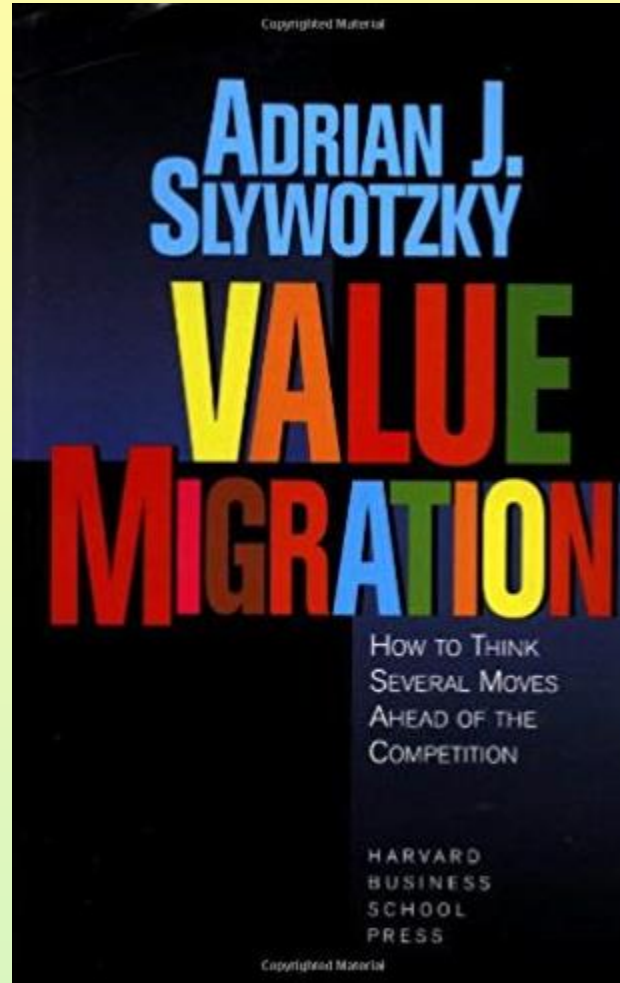
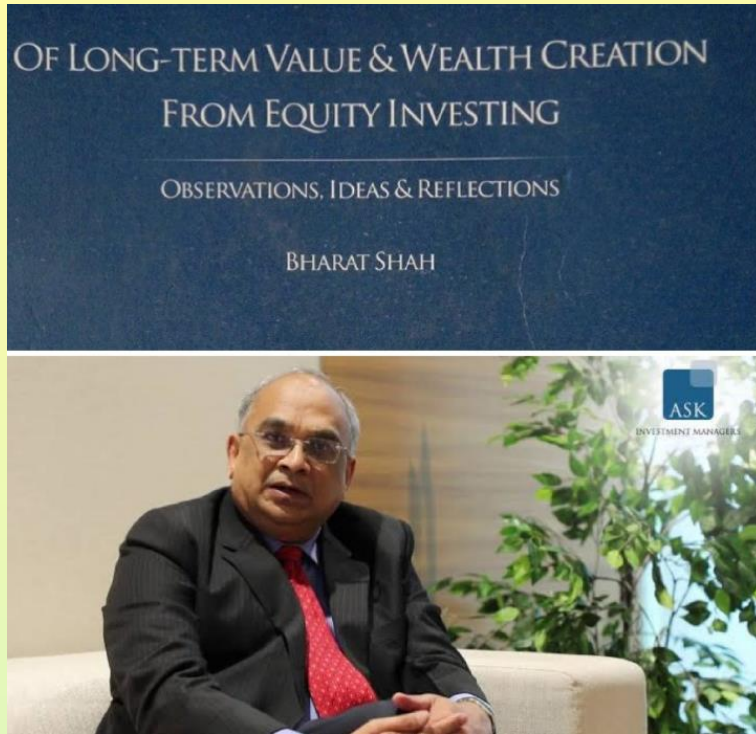
COMPOUNDING MACHINE CREATE OUTSTANDING VALUE OVER
A PERIOD OF TIME

Growth – Key Takeaways

- WE TEMPT TO BUY-IN COMPANIES OR INDUSTRY THAT IS A CURRENT MARKET FAD.
- HOUSING FINANCE COMPANIES (HFC) AND NON-BANKING FINANCIAL CORPORATIONS (NBFC) WAS MUCH DISCUSSED SECTOR A YEAR BACK. HOW MANY REALLY UNDERSTOOD THE INDUSTRY DYNAMICS/RISK BEFORE INVESTING IN THESE COMPANIES?
- THIS STAGE OF ANALYSIS HELPS NOT ONLY TO SEE HOW LONG RUN-WAY OF GROWTH DOES THIS COMPANY HAS... BUT ALSO TO REFLECT ON OURSELF TO SEE, IF WE UNDERSTAND THE INDUSTRY AND COMPANY WELL.
- IF WE CANNOT SATISFACTORILY PERFORM THIS ANALYSIS, REST THE IDEA FOR SOMETIME, TILL YOU GET TO UNDERSTAND THE INDUSTRY. TALK TO PEOPLE IN THE INDUSTRY AND LEARN MORE.

MANY INVESTORS FAIL AT THIS STAGE, DUE TO LACK OF UNDERSTANDING OF THE INDUSTRY

Additional Readings

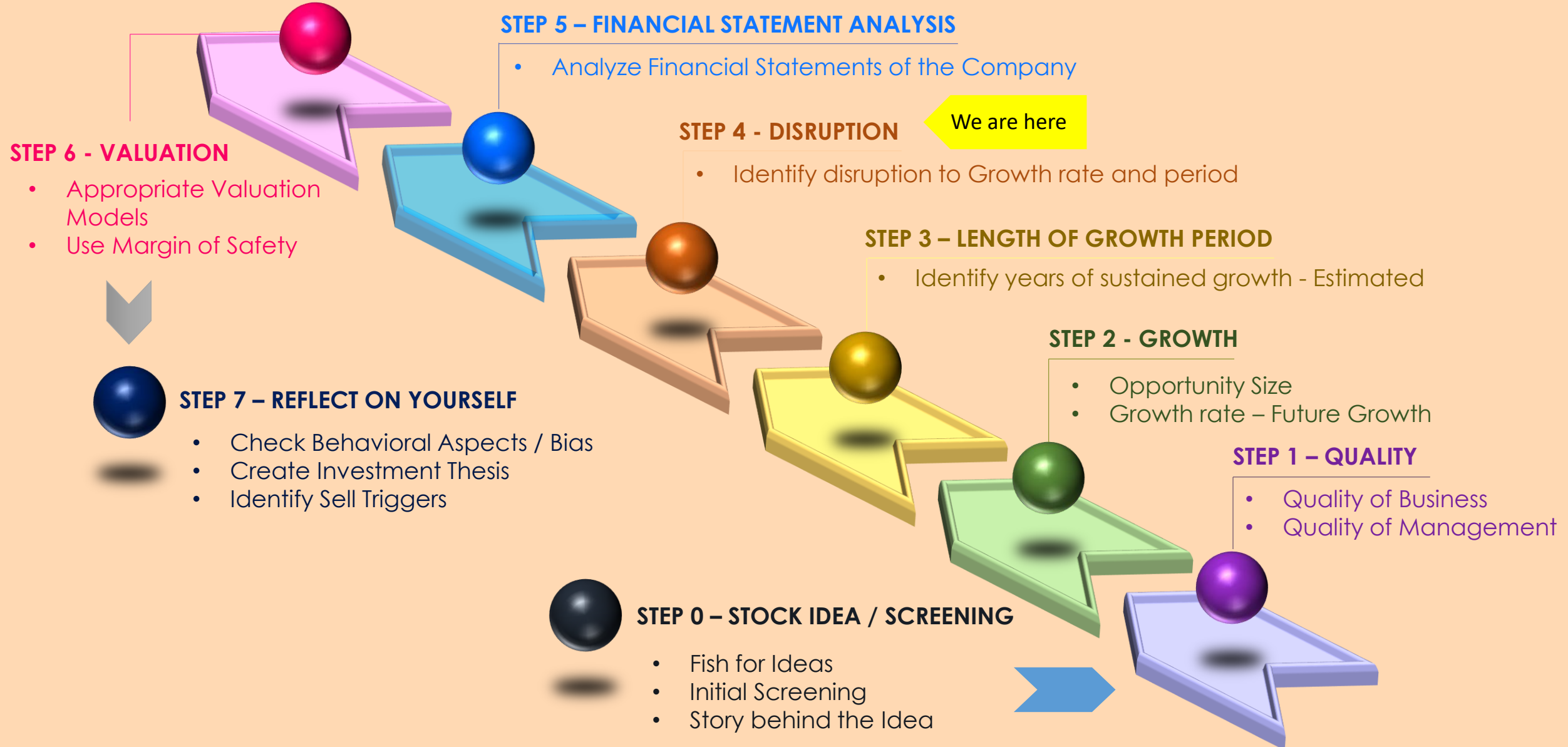


Step 4: Disruption to Growth

YouTube Video: https://youtu.be/O3PQmXBvAS4?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

Image courtesy: Slidecarnival.com

7-STEPS IN STOCK ANALYSIS



Sum Up So far

- STEP 0 – Different ways to get Stock Ideas
- STEP 1 – Analyzing quality of business and management is the biggest, time consuming analysis that a investor must do meticulously. Need not proceed with further analysis, this step is not through.

MANY COMPANIES FAIL AT THIS STEP

- STEP 2 – Estimating Growth
 - STEP 3 – Longevity of Estimated Growth
- More of Crystal Gazing
 - Investment – Both Art and Science
 - Dealing with Growth is more art part
 - Seeing into future / Circle of Competence

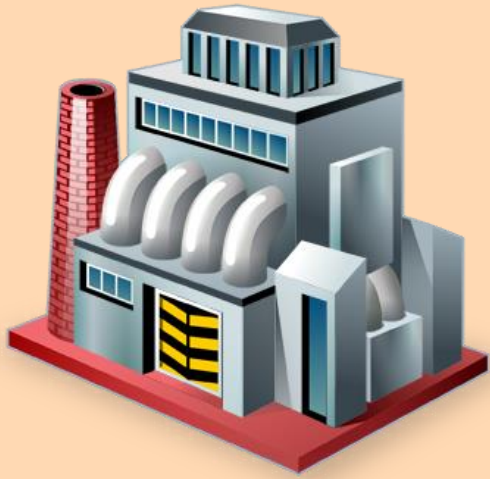
MANY OF US FAIL AT THIS STEP 2 & 3

What do I mean by Disruption to Growth

Not using in the term mean for “Disruptors”

No Technology Disruption – While it is also one of them we discuss

This is about what can affect the growth rate or longevity of growth
that was estimated in Steps 2 and 3



Company Level

Competition, Management competency



Industry Level

Regulations, Technology Changes



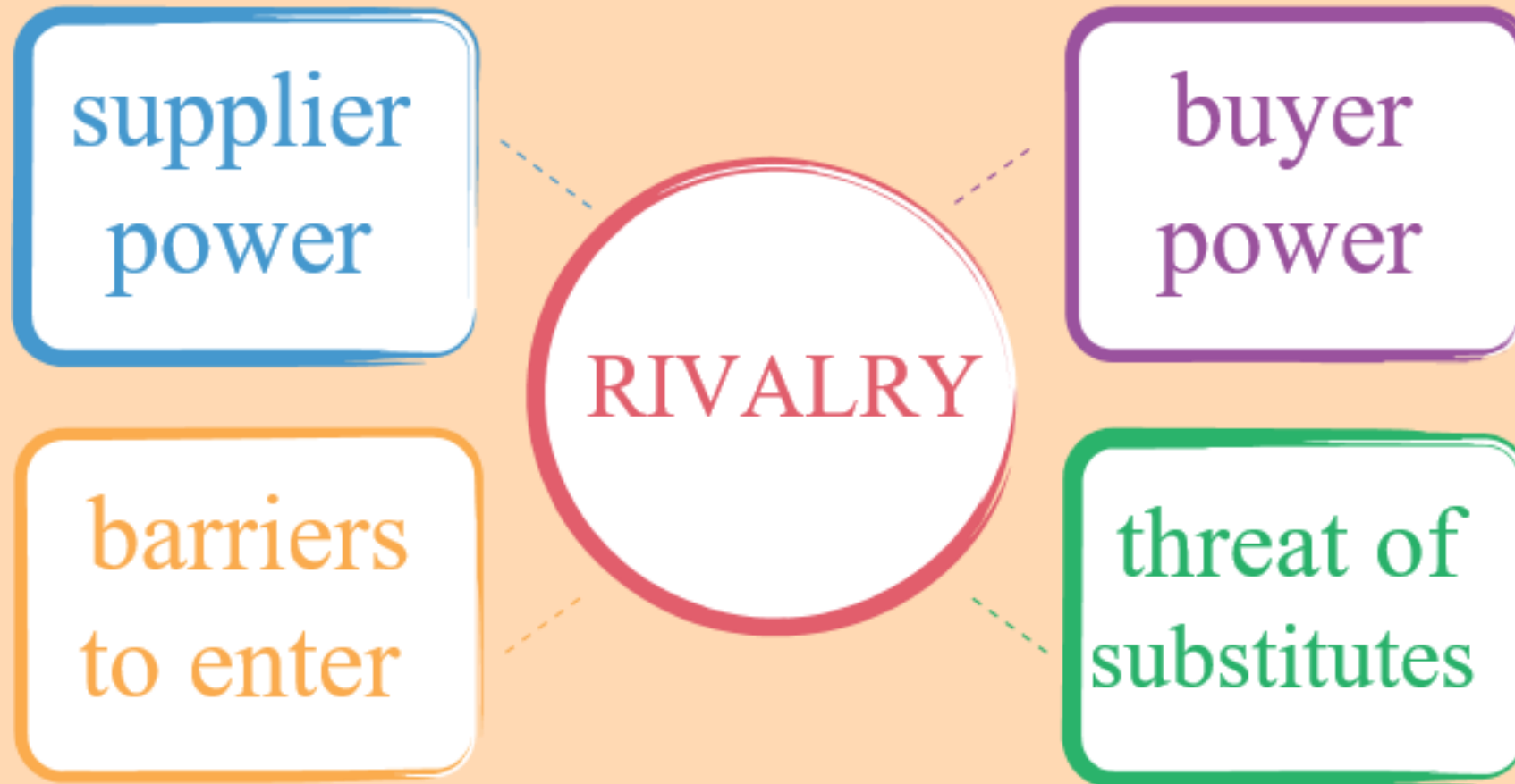
National / Global Level

Economic Conditions, Political Changes etc.

Three Levels...

Competition

Michael Porters Five Forces Framework



Competition (Contd.)

- This looks at the number and strength of your competitors / Core of the analysis
- How many competitors does the company have? and Who are they?
- If there are lot of competitors then the suppliers and buyers can go to any of them where they get a better deal
- How is the quality of their products and services of competitors compared with your company?
- Is the competition intense?
 - If **Yes**, Then there aggressive price cuts become rule of the day to attract customers bringing down the profit levels of the industry
 - If **No**, Then your company does something unique what gives competitive advantage and healthy profits

Competition (Contd.)

- Understanding and practising this framework is demanding
- Needs extensive practise and fair understanding and knowledge on the 5 forces in that industry
- It is time consuming for one industry and doing it for different industries takes significant time
- Google: “Michael Porters 5 forces analysis on XXX Industry
- Thesis, with insights about the industry

Porter's Five Force Model Analysis For Indian Cigarette Industry



- Threats of New Entrants=LOW. ...
- Bargaining Power of Suppliers=LOW. ...
- Bargaining Power of Buyers=LOW. ...
- Low switching costs in terms of price.
- Threat of Substitute Product=LOW. ...
- Nicotine patch is another substitute - but again no comparison with **cigarettes** in.

www.slideshare.net

[More items...](#) • Sep 12, 2013

www.scribd.com > document > Itc-Porter

[Itc Porter | Cigarette | Tobacco Smoking - Scribd](#)

[About Featured Snippets](#) [Feedback](#)

www.slideshare.net > TNMG > porters-five-force-model-analysis-for-i... ▾

[Porter'S Five Force Model Analysis For Indian Cigarette ...](#)

Oct 24, 2009 - [Porter'S Five Force Model Analysis For Indian Cigarette Industry.](#)

[Images for porter five forces for indian cigarette industry](#)

Threats of New Entrants=LOW

- New Product differentiation - Very Tough - already cigarettes at different price points, flavors, brand images.
- Access to distribution channel is tough - Big & established players are present (e.g. ITC)
- Capital requirement is very high for a pan India launching;
- Local launch can not catch up scale - Can't use Economies of scale
- Government policy - High tax, no TV/Radio Ads



Bargaining Power of Suppliers=LOW

- Many inputs are required but in small amount - paper, tobacco, filter
- There are many small scale, unorganized suppliers
- Cigarette companies are big and have direct access to distribution channel and addicted buyers. Suppliers don't have much control over smokers.



Technology

- Look in the future. Which technology change would disrupt your company?
- Internet/Online Platforms/Apps is the **Mother** of all Technology disruptions.
- Ask some basic questions
 - Is there a online way to paint a house? No
 - Is there a online way to consume liquor? No
 - Is there any substitution or threat coming in future to shoes/sandal that we have to wear? No
 - Is there a way that a Automobile engine manufacturing company have a substitute? Yes, Possible with the growth of Electric Vehicle (EV) different kind of engines come up

Yes does not mean, that the company must be skipped. But a indicator to probe more on how long can the estimated growth sustain before being disrupted.

Business that does not change rapidly. Example of Funeral Company by Mohnish Pabrai



This analysis is easier and not required, if your company/industry is immune to Technology changes

Regulation

- Mining Ban – Local provinces not renewing licenses / Environmental Concerns / Public Concerns
- Curbs on Imports / Exports
- License permits – Banks / Cigarette Industry (Players can suddenly enter the markets and trim the market share)
- Restriction on Gold Lease early in 2013 impacted Good Retailers
- More public sentiments or welfare / Interferences of court / Government



Gold prices touched record highs last year, forcing Titan, which owns India's largest jewellery chain Tanishq, and other jewellers to pass on costs to customers. Photo:Pradeep Gaur/Mint (Pradeep Gaur/Mint)

Gold import duty: Titan's shares fall 3% on profit concerns

1 min read . Updated: 14 Mar 2013, 06:16 PM IST

Mihir Dalal

Govt seeks to reduce gold demand to control the widening fiscal deficit

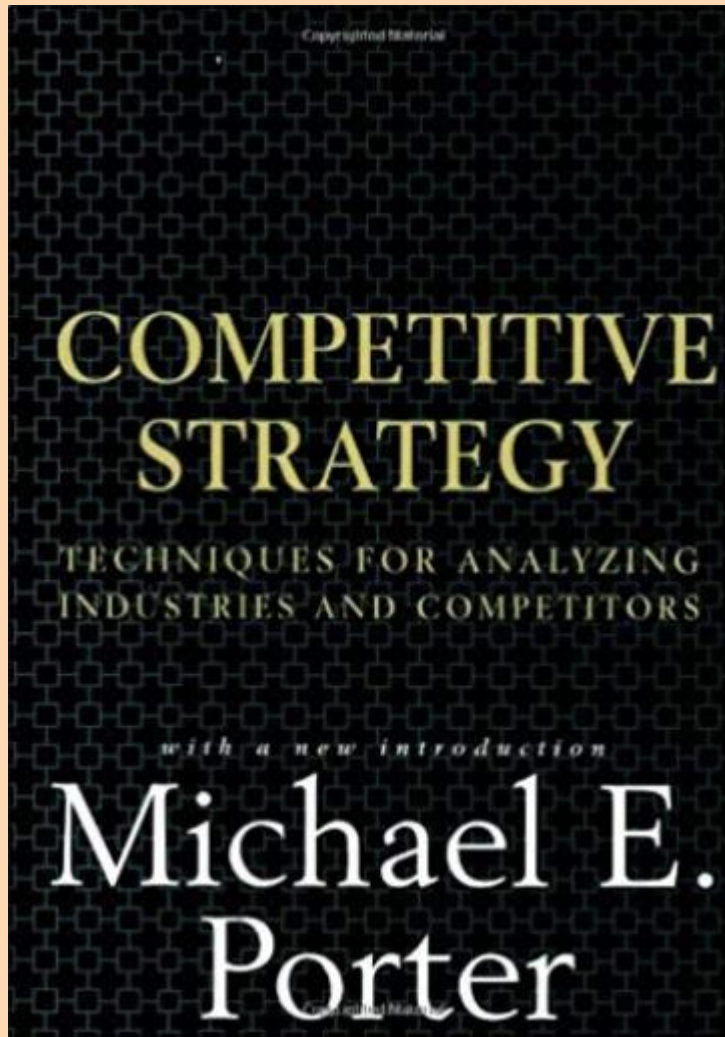
Political

- National / International Level affecting a country or multiple industries in a country
- Trade wars between nations / Anti Dumping duties
- Countries bringing acts and making their outsourcing more stricter to help the job opportunity of locals
- New political party with new policies / Ideologies – May even reverse the earlier approved projects Plans

So what should I do?

- None of this is under investors control
- When there is no control, what is the use of analysing this?
- This are typically kind of risk register, of what can disrupt our estimations on Growth rate and its longevity
- Record these in investment thesis
- Constantly review this with new information
- Remember always something extraordinary can happen, that cannot foresee that might affect the growth in either ways

Additional Readings



Step 5: Financial Statement Analysis

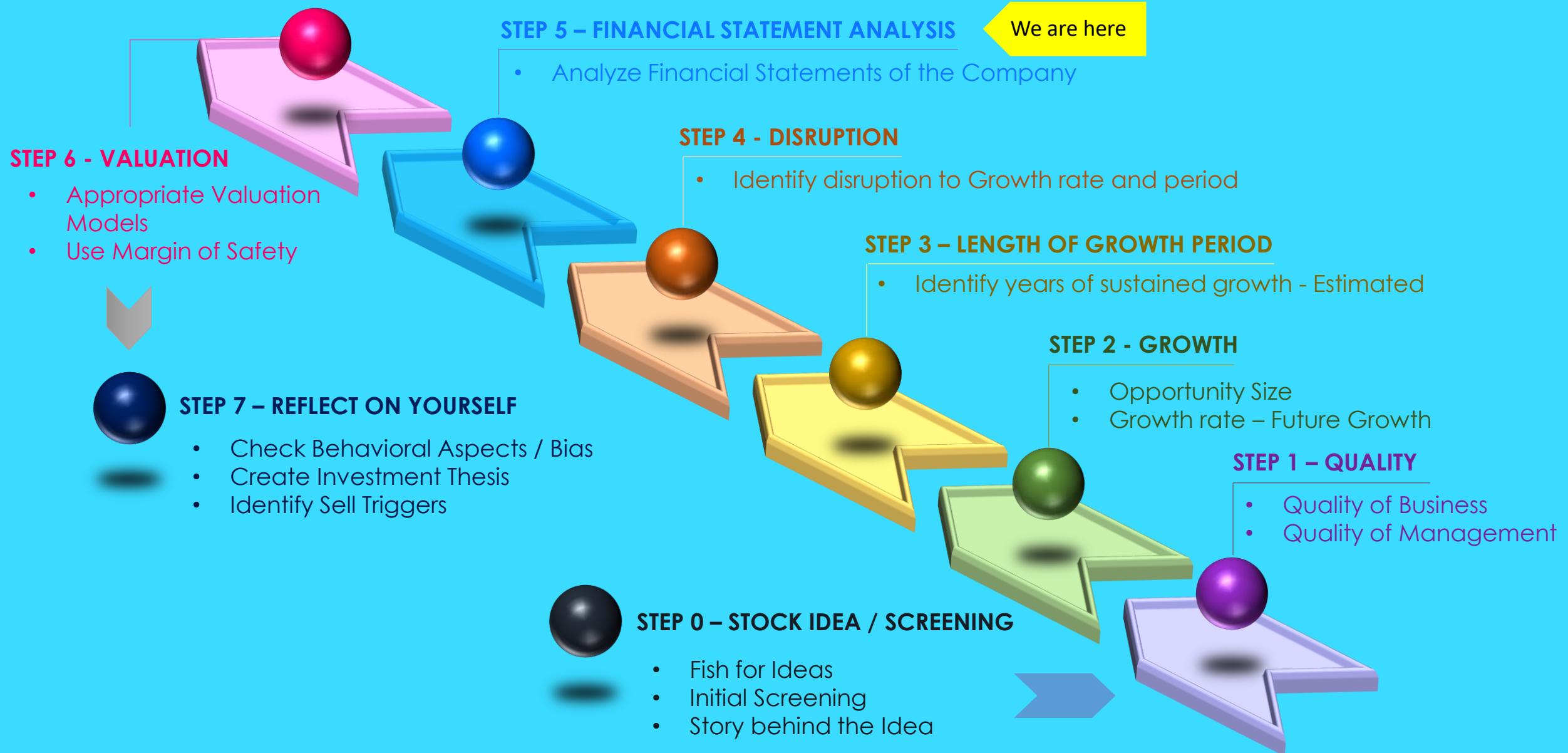
YouTube Video:

https://youtu.be/ksh_4jITQDs?list=PL9QC_19RB6uWQ3lQPSviGI5Pe77aGXson

https://youtu.be/aSyg4R148n4?list=PL9QC_19RB6uWQ3lQPSviGI5Pe77aGXson

Image courtesy: Slidecarnival.com

7-STEPS IN STOCK ANALYSIS



Summing the various Steps...

- STEP 0 – Different ways to get Stock ideas
- STEP 1 – Analyzing quality of business and management is the biggest, time consuming analysis that a investor must do meticulously. Need not proceed with further analysis, this step is not through.

MANY COMPANIES FAIL AT THIS STEP

- STEP 2 – Estimating Growth
 - STEP 3 – Longevity of Estimated Growth
 - STEP 4 – Disruption to Growth
- Art part of Investments' Art/Science debate
 - More of Crystal Gazing & Seeing into future
 - Circle of Competence

MANY INVESTORS FAIL AT THIS STEP 2, 3 & 4

Financial Statements



Balance Sheet

- Assets – Owned by the Company
- Liabilities – Owed by the Company



Income Statement

- Revenue
- Expenses
- Net Profit / Loss



Cash Flow Statement

- Cash flow from Operations
- Cash flow from Investments
- Cash flow from Financing



Financial Ratios

Financial ratio is a relative magnitude of two selected numerical values taken from the three financial statements



- Liquidity Ratios
 - Current Ratio
 - Quick Ratio
- Working Capital
- Debt/Solvency Ratios
 - Debt to Equity Ratio
 - Interest Coverage Ratio



Profitability Ratios
Complete Margin analysis

Cross Ratio: Return on Equity

Investment Valuation Ratio:
P/B, P/E, P/S, Dividend Yield etc.



Cash Flow Indicator Ratios

- Cash flow coverage Ratio
- Cash Return on Capital Invested (CROCI)
- Operating Cash Flow Ratio
- Cash Realization Ratio

What Should an Investor know?

- Science part of Investment, involves more number crunching with simple mathematical tools
- Numbers not Static numbers – Convey a story of a company's recent and past performance
- These numbers say many things, Investors must be skilled and experienced to understand/interpret the message from the numbers
- Without the needed skill, this step in the framework cannot be performed
- Acquiring this skill – Invest a few hours to understand Financial Statement Analysis
- Same set of data or information available to everyone
- How much you can flesh out from the numbers, the way you see the numbers matters – Skill and experience comes to play

A Semester worth Contents! Will share many Good Contents. Invest time, acquire knowledge and practise

Techniques for Effective Financial Statement Analysis



Where to Refer Data?

| KEY FINANCIAL RATIOS OF | MAR 19 | MAR 18 | MAR 17 | MAR 16 | MAR 15 |
|---|--------|--------|--------|--------|--------|
| PER SHARE RATIOS | | | | | |
| Basic EPS (Rs.) | 14.70 | 12.03 | 7.22 | 7.64 | 16.20 |
| Diluted EPS (Rs.) | 14.70 | 12.03 | 7.22 | 7.64 | 16.20 |
| Cash EPS (Rs.) | 16.07 | 12.84 | 8.80 | 8.16 | 16.61 |
| Book Value [ExclRevalReserve]/Share (Rs.) | 84.76 | 76.97 | 71.17 | 75.95 | 81.55 |
| Book Value [InclRevalReserve]/Share (Rs.) | 84.76 | 76.97 | 71.17 | 75.95 | 81.55 |
| Dividend / Share (Rs.) | 5.52 | 4.30 | 5.15 | 11.00 | 8.55 |
| Revenue from Operations/Share (Rs.) | 39.69 | 36.71 | 27.90 | 16.28 | 31.17 |
| PBDIT/Share (Rs.) | 24.55 | 20.00 | 14.26 | 12.52 | 25.33 |
| PBIT/Share (Rs.) | 23.64 | 19.19 | 13.64 | 12.00 | 24.92 |
| PBT/Share (Rs.) | 23.51 | 19.53 | 13.57 | 11.37 | 24.64 |
| Net Profit/Share (Rs.) | 15.16 | 12.03 | 8.18 | 7.64 | 16.20 |
| PROFITABILITY RATIOS | | | | | |
| PBDIT Margin (%) | 61.86 | 54.48 | 51.09 | 76.89 | 81.28 |
| PBIT Margin (%) | 59.57 | 52.28 | 48.87 | 73.67 | 79.97 |
| PBT Margin (%) | 59.23 | 53.20 | 48.63 | 69.79 | 79.05 |
| Net Profit Margin (%) | 38.19 | 32.76 | 29.32 | 46.90 | 51.97 |
| Return on Net Worth / Equity (%) | 17.88 | 15.62 | 11.49 | 10.05 | 19.86 |

| Profit & Loss Consolidated Figures in Rs. Crores / View Standalone | | | | | | | | | | | | | Product Segments | | |
|--|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|------------------|--|--|
| | Mar 2008 | Mar 2009 | Mar 2010 | Mar 2011 | Mar 2012 | Mar 2013 | Mar 2014 | Mar 2015 | Mar 2016 | Mar 2017 | Mar 2018 | Mar 2019 | TTM | | |
| Sales + | 575 | 758 | 849 | 895 | 1,143 | 1,232 | 1,113 | 1,042 | 1,258 | 1,279 | 1,308 | 1,376 | 1,467 | | |
| Expenses + | 491 | 643 | 688 | 757 | 930 | 1,013 | 944 | 1,042 | 1,100 | 1,060 | 1,096 | 1,073 | 1,136 | | |
| Operating Profit | 84 | 116 | 162 | 138 | 213 | 219 | 98 | 65 | 159 | 218 | 212 | 303 | 331 | | |
| OPM % | 15% | 15% | 19% | 15% | 19% | 18% | 14% | 6% | 13% | 17% | 16% | 22% | 23% | | |
| Other Income | 49 | 38 | 33 | 9 | 24 | -2 | 6 | 13 | 20 | 26 | 44 | 62 | 52 | | |
| Interest | 28 | 32 | 22 | 21 | 24 | 24 | 22 | 24 | 29 | 27 | 33 | 31 | 33 | | |
| Depreciation | 38 | 39 | 40 | 45 | 48 | 51 | 54 | 42 | 56 | 51 | 55 | 55 | 59 | | |
| Profit before tax | 68 | 83 | 132 | 80 | 165 | 142 | 83 | 12 | 93 | 167 | 168 | 278 | 292 | | |
| Tax % | 24% | 34% | 33% | 30% | 31% | 36% | 32% | 92% | 39% | 25% | 29% | 31% | | | |
| Net Profit | 56 | 55 | 77 | 58 | 109 | 84 | 52 | -5 | 48 | 121 | 117 | 190 | 199 | | |
| EPS in Rs | 19.67 | 19.24 | 27.57 | 20.44 | 39.13 | 29.79 | 18.22 | 0.00 | 17.75 | 44.79 | 42.99 | 70.26 | 73.46 | | |
| Dividend Payout % | 27% | 33% | 21% | 29% | 20% | 23% | 26% | -167% | 28% | 22% | 23% | 14% | | | |

| Balance Sheet | Profit & Loss | Cash Flow | Ratios | Quarterly | Half-Yearly |
|--------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Yearly | | | | | |
| Parameters | MAR'18 (₹ Cr.) | MAR'17 (₹ Cr.) | MAR'16 (₹ Cr.) | MAR'15 (₹ Cr.) | MAR'14 (₹ Cr.) |
| EQUITY AND LIABILITIES | | | | | |
| Share Capital | 316.39 | 316.39 | 396.47 | 396.47 | 396.47 |
| Share Warrants Outstanding | | | | | |
| Reserves & Surplus | | | | | |
| Shareholder's Funds | 24,353.83 | 22,518.94 | 29,117.59 | 32,331.74 | 29,988.30 |
| Long-Term Borrowings | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Secured Loans | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Unsecured Loans | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Deferred Tax Assets / Liabilities | -385.71 | -453.36 | -263.17 | 98.40 | 107.25 |
| Other Long Term Liabilities | 0.00 | 0.00 | 0.00 | 40.10 | 29.11 |
| Long Term Trade Payables | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Long Term Provisions | 714.12 | 611.20 | 353.45 | 10.60 | 11.44 |
| Total Non-Current Liabilities | 328.41 | 157.84 | 90.28 | 149.10 | 147.80 |
| Trade Payables | 159.54 | 198.78 | 324.42 | 226.28 | 185.67 |
| Current Liabilities | | | | | |
| Other Current Liabilities | 2,854.14 | 2,067.11 | 1,309.67 | 1,140.84 | 1,153.20 |
| Short Term Borrowings | 500.09 | 0.00 | 1,496.95 | 0.00 | 0.00 |
| Short Term Provisions | 5,813.40 | 7,169.04 | 8,332.44 | 10,491.37 | 10,017.91 |
| Total Current Liabilities | 9,327.17 | 9,434.93 | 11,463.48 | 11,858.49 | 11,356.78 |
| Total Liabilities | 34,009.41 | 32,111.71 | 40,671.35 | 44,339.33 | 41,492.88 |

Have your own data

- Online platforms – Treatment of various numbers / assumptions
- Create your own Excel for various ratios applicable / needed for a company or industry that you are analysing
- Flesh out the source numbers from the Financial Statements in Annual Reports (Not any portal) over the last 5-10 years
- Read through the notes against various numbers i.e. Investments
- This approach gives a feel of how the Numerator and Denominator in various ratios have behaved over a period of time
- Worth going the extra mile, 5 days for a 5 year investment

Horizontal Analysis

- This method of analysis is also known as **Trend Analysis**
- Involves comparison of a financial line item or a ratio over a number of accounting periods – (Minimum three period is needed)
- Different methods i.e. absolute comparison or percentage comparison
- Revenues, Profit, Expenses, Cash, Liabilities etc.
- This method is useful when comparing performance of two companies of different scale and size

| Sales Analysis | <i>2013</i> | <i>2014</i> | <i>2015</i> | <i>2016</i> | <i>2017</i> | <i>Trend</i> |
|-----------------------|-------------|-------------|-------------|-------------|-------------|---|
| Sales | 931 | 1,208 | 1,485 | 1,749 | 2,002 |  |
| Sales growth (Abs.) | | 277.50 | 276.87 | 264.16 | 252.27 |  |
| Sales growth (%) | | 29.81 | 22.91 | 17.79 | 14.42 |  |

Vertical Analysis

- This method of analysis is also known as Common Sized Financial Statements
- Calculated by using various components/subcomponents in a statement to a common denominator.
 - Balance sheet the common denominator could be Total Assets/Liabilities
 - Profit & Loss statement it is the revenue

Inferences

- What % of Inventory or Current assets or Accounts Receivable is against the Total Assets
- Observe changes over time
- How does the value of a component or sub component stack against peer/competitor companies

| Common Balance Sheet | 2013 | 2014 | 2015 | 2016 | 2017 | Trend |
|---------------------------|-------|-------|-------|-------|-------|-------|
| LIABILITIES | | | | | | |
| Shareholder's fund | 54.74 | 62.49 | 79.10 | 80.03 | 86.01 | |
| Non Current Liabilities | 14.32 | 8.52 | 4.75 | 2.50 | 1.73 | |
| Current Liabilities | 30.94 | 28.99 | 16.15 | 17.47 | 12.26 | |
| ASSETS | | | | | | |
| Fixed assets | 39.69 | 39.28 | 39.99 | 46.41 | 50.94 | |
| Non-current investments | 1.18 | 0.89 | 3.97 | 0.00 | 0.00 | |
| Long term loans & advance | 0.00 | 0.00 | 0.81 | 0.62 | 0.51 | |
| Current investments | 0.00 | 5.79 | 1.74 | 5.16 | 9.96 | |
| Inventory | 20.55 | 16.37 | 13.91 | 13.75 | 11.58 | |
| Trade receivables | 20.95 | 21.30 | 22.63 | 25.02 | 17.66 | |
| Cash and bank balance | 6.44 | 6.36 | 10.84 | 2.91 | 3.07 | |
| Short term loans and adv. | 0.00 | 0.00 | 0.80 | 0.05 | 0.07 | |

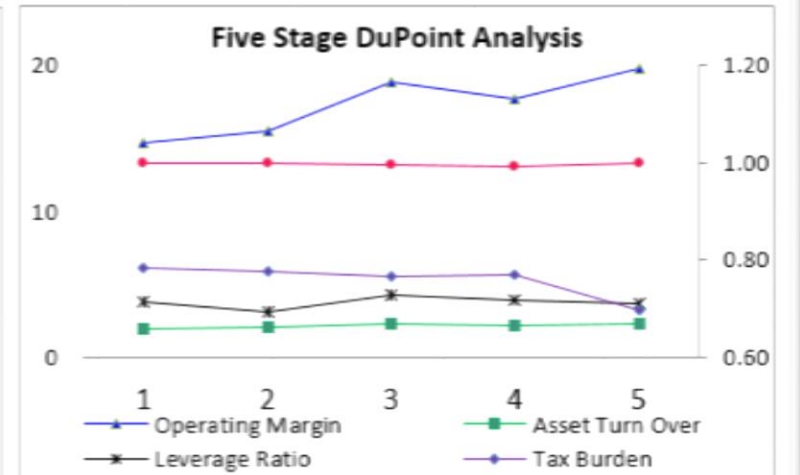
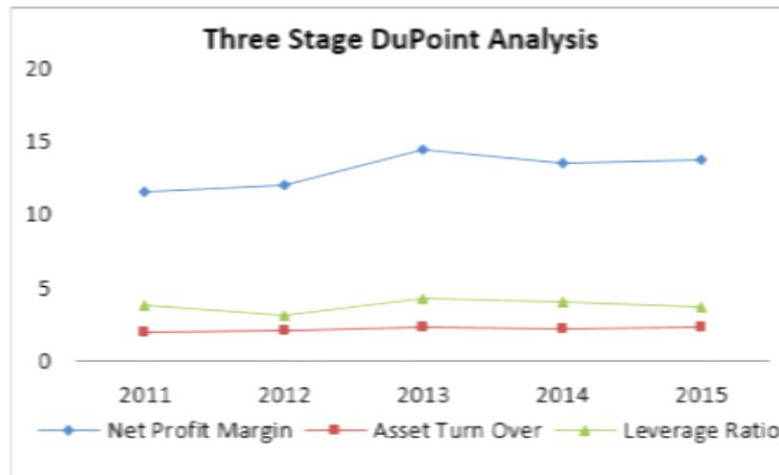
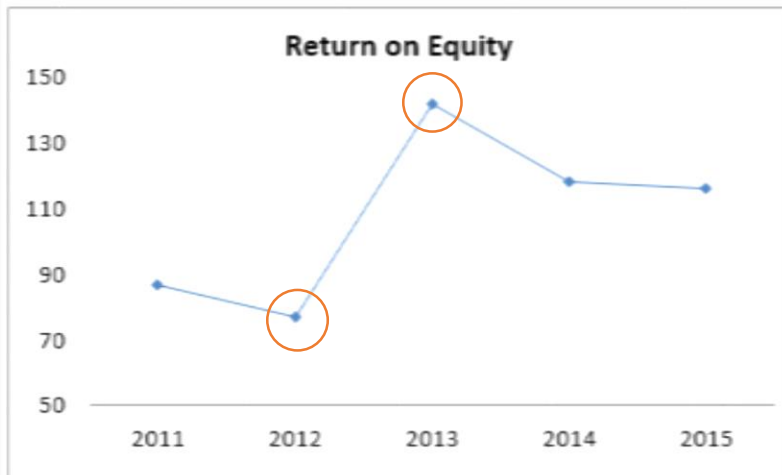
Other Aspects

Multiple Year

- Don't limit the analysis for one financial year – Get trend
- Minimum of 5 years and 10 years (to get effect on cycles)

Create Charts

- Charts help better interpretation than stand alone numbers
- Create charts with multiple year data and see the trend
- Get insights by deep-diving at anomalies



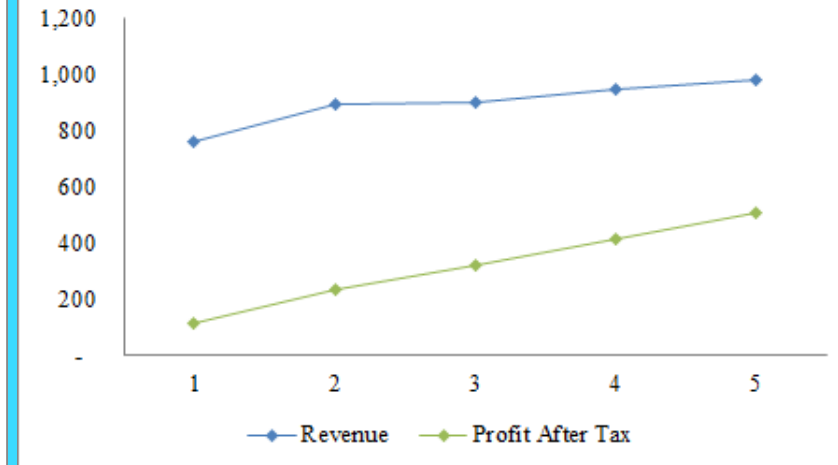
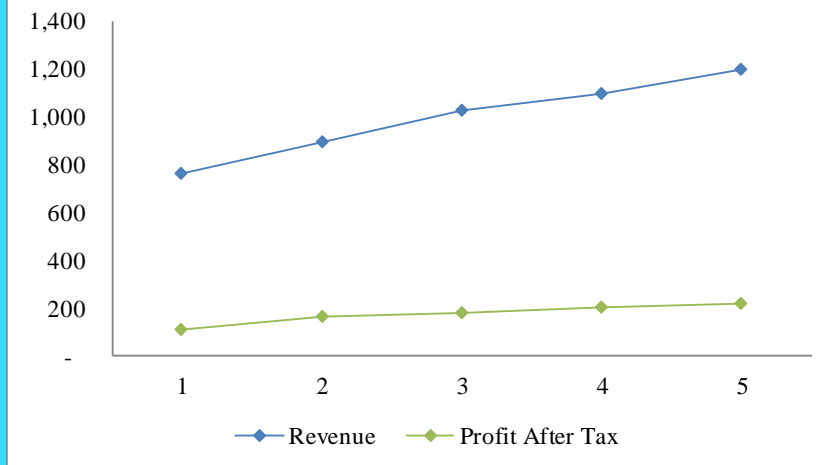
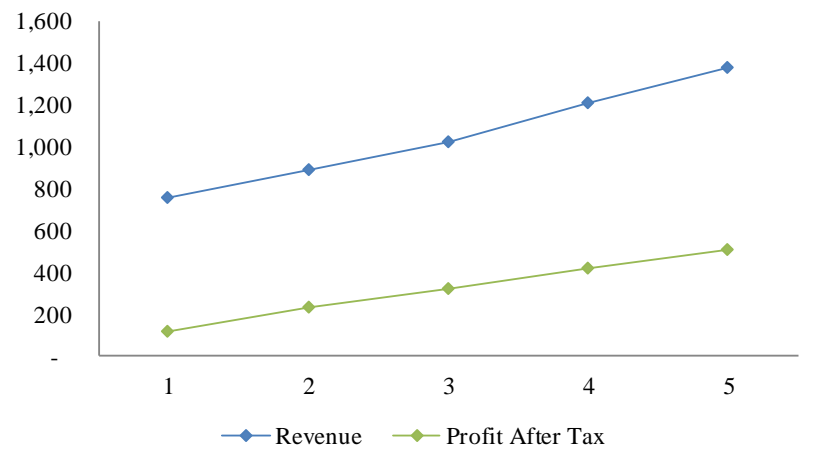
Other Aspects (Contd.)

Consolidated

- Focus on Consolidated Financial Statements
- In case of company with multiple subsidiaries, this is crucial
- Standalone may be profitable, but consolidated may show a different picture

Evaluate related Parameters

- Check how two related parameters behave over time
- What insights does it reflect?
- Revenue/Net Profits, Revenue/Inventory, Revenue/Receivables



Recap of what we saw in last part...



- Financial Statements
- Financial Ratios
- Importance of a Investors skill in Analysing Financial Statements



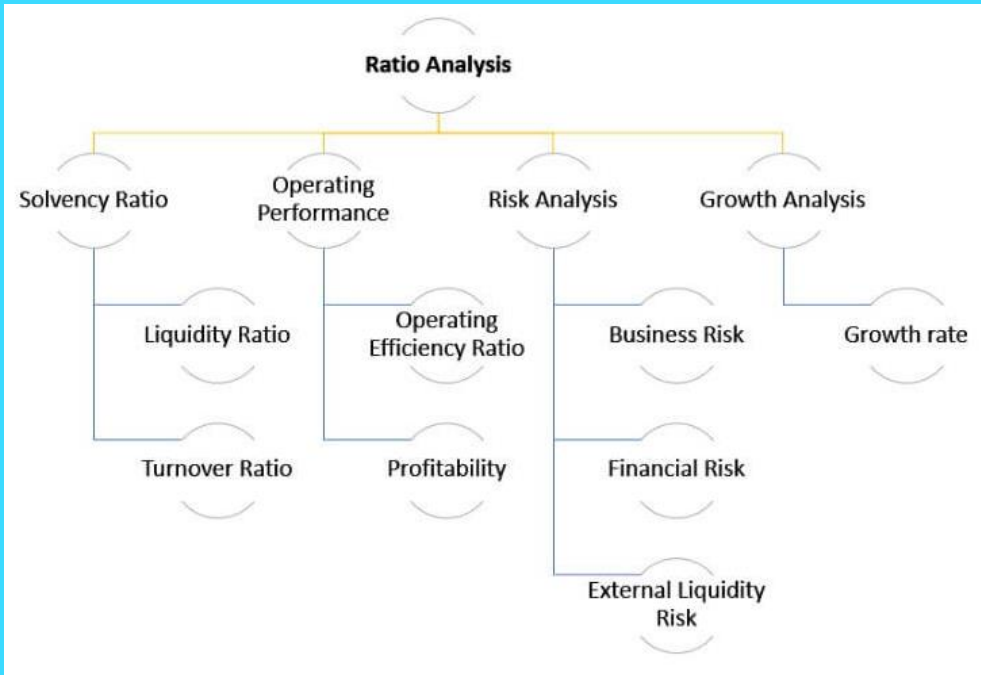
- Source data for Financial Statements / Creating your own excel / Read the notes as you refer the source data
- Horizontal Analysis – Different time periods
- Vertical Analysis – Common Sizing of Financial Statements
- Others – Reading consolidated statements, Creating charts, deep diving at anomalies and evaluating related parameters together

CAN YOU PLEASE ADD WHAT RATIOS WE SHOULD STUDY? WHILE PREPARING THE XL SHEETS, PLEASE MENTION WHAT PARAMETERS TO BE STUDIED. THIS WILL HELP US BUILD THE SPREADSHEET.

- A technician or mechanic has every tool in his tool box, needed for his work – But may not use every tool for his work!
- The huge bunch of ratios are neatly categorized under various heads i.e. Profitability Ratios, Solvency Ratios, Efficiency Ratios etc
- These ratios are neatly covered in all available existing literature on financial statements – Which will be shared
- Alternatively, go by the entries in each financial statement:
 - Current Assets, Current Liabilities, Inventory can give **Current and Quick Ratio**
 - Debt entries give various **Solvency ratios**
 - Entries in P&L statement helps in **Profitability analysis**

CAN YOU PLEASE ADD WHAT RATIOS WE SHOULD STUDY? WHILE PREPARING THE XL SHEETS, PLEASE MENTION WHAT PARAMETERS TO BE STUDIED. THIS WILL HELP US BUILD THE SPREADSHEET.

Ratio Categorization



• Solvency Ratio

- #1 – Current Ratio
- #2 – Quick Ratio
- #3 – Cash Ratio

• Turnover Ratios

- #4 – Receivables Turnover
- #5 – Days Receivables
- #6 – Inventory Turnover
- #7 – Days Inventory
- #8 – Accounts Payable Turnover
- #9 – Days Payable
- #10 – Cash Conversion Cycle

• Operating Performance

• Operating Efficiency

- #11 – Asset Turnover
- #12 – Net Fixed Asset Turnover
- #13 – Equity Turnover

• Operating Profitability

- #14 – Gross Profit Margin
- #15 – Operating Profit Margin
- #16 – Net Margin
- #17 – Return on Total Assets
- #18 – Return on total equity
- #19 – Return on Equity or Return on Owner's Equity
- #20 – Dupont ROE

• Risk Analysis

• Business Risk

- # 21. Operating Leverage
- # 22. Financial Risk – Financial Leverage
- # 23. Total Leverage

• Financial Risk

- # 24. Leverage Ratio or Debt to Equity Ratio
- # 25. Interest Coverage Ratio
- # 26. Debt Service Coverage Ratio (DSCR)

You Cant
Trust the
Numbers..





Flags in Annual Reports

1) Read Auditors Report


In our opinion and to the best of our information and according to the explanations given to us, due to the significance of the matters described in the Basis for Adverse Opinion section below, the aforesaid standalone financial statements do not give the information required by the Companies Act, 2013 ("the Act") in the manner so required and also does not give a true and fair view in conformity with the Indian Accounting Standards prescribed under section 133 of the Act read with the Companies (Indian Accounting Standards) Rules, 2015, as amended, ("Ind AS") and other accounting principles generally accepted in India, of the state of affairs of the Company as at 31 March, 2019, and its loss, total comprehensive loss, its cash flows and the changes in equity for the year ended on that date.

Independent Auditor's Report

REPORT ON THE AUDIT OF THE STANDALONE FINANCIAL STATEMENTS

ADVERSE OPINION

We have audited the accompanying standalone financial statements of Mcleod Russel India Limited ("the Company"), which comprise the Balance Sheet as at 31 March, 2019, and the Statement of Profit and Loss (including Other Comprehensive Income), the Statement of Cash Flows and the Statement of Changes in Equity for the year then ended, and a summary of significant accounting policies and other explanatory information.



In our opinion and to the best of our information and according to the explanations given to us, due to the significance of the matters described in the Basis for Adverse Opinion section below, the aforesaid standalone financial statements do not give the information required by the Companies Act, 2013 ("the Act") in the manner so required and also does not give a true and fair view in conformity with the Indian Accounting Standards prescribed under section 133 of the Act read with the Companies (Indian Accounting Standards) Rules, 2015, as amended, ("Ind AS") and other accounting principles generally accepted in India, of the state of affairs of the Company as at 31 March, 2019, and its loss, total comprehensive loss, its cash flows and the changes in equity for the year ended on that date.

2) Read how Revenue is recognized, compare the policy with competitor companies

3) Monitor for change in Accounting policies, frequent change in Management or resignation of Auditors

Focus on Cash Flow Statements

- Most neglected, when compared to the importance that Balance sheet and P&L Statement
- Most of the wrong doings in BS and P&L Statement may be evident from CFS
- Infact the CFO is the real **Cash** profit, while Net Profit is **Accounting** Profit
- A simple test would be to compare both, for a few recent (5-10 years) years – Importance of analysing multiple year financial statements

| | | | | |
|----|--|---------|-----------------|----------------|
| | (ii) Income tax relating to items that will be reclassified to Profit or Loss | | -3 | -6 |
| | | | -5824 | -15091 |
| XV | Total Comprehensive Income for the period (XIII+XIV) (Comprising Profit (Loss) and Other Comprehensive Income for the period) | | 222420 | 183651 |
| | Trade Payables | 96337 | | -9847 |
| | Financial Liabilities, Provisions and Other Liabilities | -444771 | | -255053 |
| | Sub-total | | -1273239 | -456410 |
| | Cash generated from Operations | | -635959 | 77625 |
| | Direct Taxes Paid | | -110001 | -150992 |
| | Net Cash from / (used in) Operating Activities (a) | | -745960 | -73367 |

Notes to Financial Statements

- Place for unpleasant and unexpected surprises
- Each component of Balance Sheet and P & L statement has a Note with detailed schedule in subsequent section “Notes to Financial Statements”

| S.No. | Particulars | Note No. | 31 st March 2019 | 31 st March 2018 |
|-------|-----------------------------------|----------|-----------------------------|-----------------------------|
| | EQUITY AND LIABILITIES | | | |
| (1) | A. Equity | | | |
| | (a) Equity Share capital | 22 | 33439 | 33439 |
| | (b) Other Equity | 23 | 1051413 | 915126 |
| | Sub Total - A | | 1084852 | 948565 |
| | LIABILITIES | | | |
| (1) | B. Non-current liabilities | | | |
| | (a) Financial Liabilities | | | |
| | (i) Borrowings | 24 | 10000 | |
| | (ii) Trade payables | 25 | | |

Note 24 - Borrowings

| Particulars | (₹ in Lakhs) | |
|---|-----------------------------------|-----------------------------------|
| | As at 31 st March 2019 | As at 31 st March 2018 |
| A. Secured Long Term Borrowings: | | |
| a) Term Loans | | |
| (i) From Banks* | 10000 | 10000 |
| Sub-total (A) | 10000 | 10000 |
| B. Unsecured Long Term Borrowings: | | |
| Sub-total (B) | - | - |
| TOTAL (A + B) | 10000 | 10000 |

*Ref Note No. 49 Clause 35A



Notes to Financial Statements (Contd.)

Note 24 - Borrowings

| Particulars | (₹ in Lakhs) | |
|---|--------------------------------------|--------------------------------------|
| | As at 31 st March 2019 | As at 31 st March 2018 |
| A. Secured Long Term Borrowings: | | |
| a) Term Loans | | |
| (i) From Banks* | | |
| Sub-total (A) | | |
| B. Unsecured Long Term Borrowings: | | |
| Sub-total (B) | | |
| TOTAL (A + B) | | |

*Ref Note No. 49 Clause 35A

TOTAL (A + B)

*Ref Note No. 49 Clause 35A

Note 49 - Notes to Accounts

| Clause No. | Particulars |
|--------------------|---|
| | (₹ in Lakhs) |
| | Borrowing Term Loan (Note - 24) |
| Name of the lender | State Bank of India |
| Facilities | Term loan of ₹ 100000 lakhs may be availed as Rupee facility or capex LC subject to maximum of ₹ 40000 lakhs. |
| Purpose | The proceeds of the Term Loan will be utilized specifically for building capacity for executing order of 162 LCH. The expenses will include, Civil works, Plant and Machinery and Deferred Revenue Expenditure. |
| Security | Primary: First charge on the Project assets present and future excluding Civil works and intangible. Collateral: Second charge on the Current Assets (stock and receivables) |
| Interest Rate | Interest at the rate of 0.10% above 1 year MCLR which is presently 7.95% p.a. calculated on daily products at monthly rests. The Bank shall at any time and from time to time be entitled to vary the margin based on the Credit Risk Assessment of the borrower at its discretion and MCLR will be reset on an annual basis on the anniversary of reset. The interest will be serviced by the Company during the moratorium. |
| Disbursement | The term loan of ₹ 100000 lakhs will be disbursed in tranches beginning from the fourth quarter of Financial Year 2017-18 to first quarter of Financial Year 2024-25. |
| Repayment | The repayment will be in quarterly installments amounting to ₹ 6250 lakhs after moratorium of 4 years i.e. Repayment will be from the Fourth Quarter of the Financial Year 2021-22 to Third quarter of the Financial Year 2025-26 |

35A

Notes to Financial Statements (Contd.)

| B. Current assets | | |
|---|-----|---------|
| (a) Inventories | 13 | 1976451 |
| (b) Financial Assets | | |
| (i) Investments | 14 | - |
| (ii) Trade receivables | 15 | 1393897 |
| (iii) Contract Assets | 15A | 302005 |
| (iv) Cash and Cash Equivalents | 16 | 1150 |
| (v) Bank Balances other than (iv) above | 17 | 10071 |
| (vi) Loans | 18 | 4490 |
| (vii) Other Financial Assets | 19 | 118490 |

| Particulars | As at 31 st March 2019 |
|------------------------|--------------------------------------|
| Contract Assets | |
| Unbilled Revenue | 302005 |
| TOTAL | 302005 |

Note 16 - Financial Asset- Cash & Cash Equivalents

| Particulars | As at 31 st March 2019 |
|--|--------------------------------------|
| A) Balances with Bank | |
| - Current Account | 1118 |
| B) Cash on Hand | 6 |
| C) Cheques, Drafts on Hand | 6 |
| Sub Total (A+B+C) | 1130 |
| D) Other Bank Balances | |
| Others | |
| - Short Term Deposits * | 20 |
| Sub Total-D | 20 |
| TOTAL (A)+(B)+(C)+(D) | 1150 |
| *Balance with Banks to the extent held as Margin Money or Security against Borrowings, Guarantees, Other Commitments | - |

Note 17 - Financial Asset - Bank Balances other than (iv) above

| Particulars | As at 31 st March 2019 |
|--|--------------------------------------|
| Bank Deposit* | 3426 |
| Earmarked balances with banks-Unpaid Dividend | 6645 |
| TOTAL | 10071 |
| *Balance with Banks to the extent held as Margin Money or Security against Borrowings, Guarantees, Other Commitments | - |

Compare with Competitors and Peers

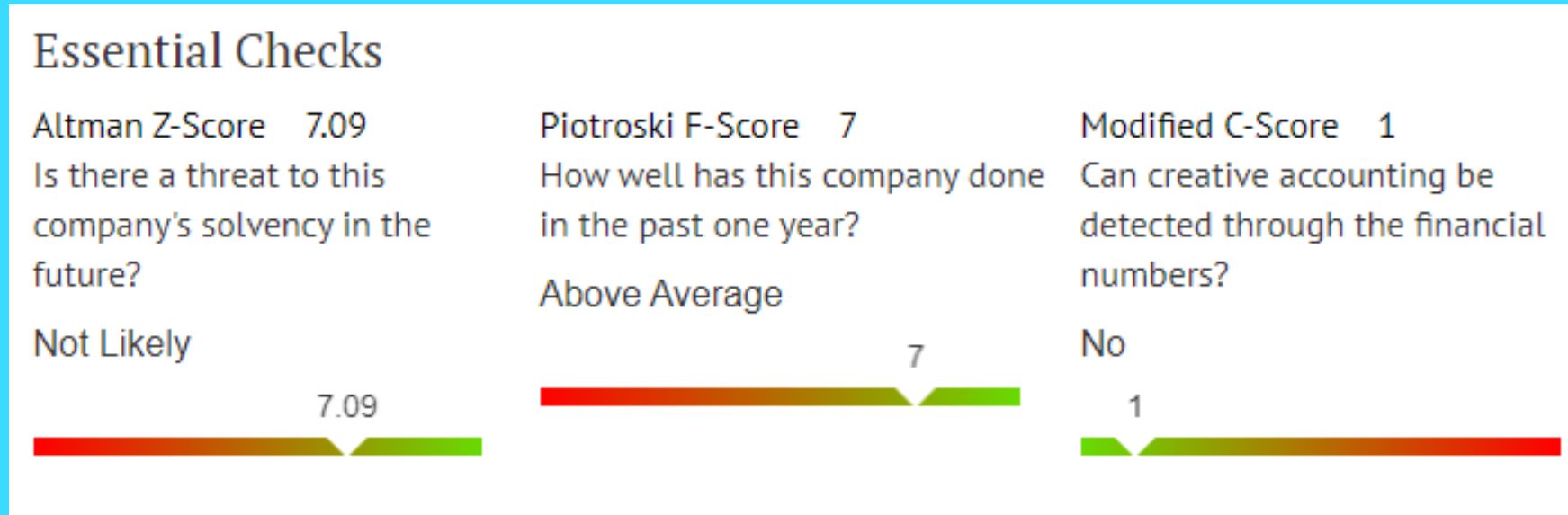


| | Company 1 | Company 2 | Company 3 | Company 4 |
|-------------------|-----------|-----------|-----------|-----------|
| Net Profit Margin | 12% | 10% | 11% | 20% |
| RoE | 18% | 17% | 19% | 30% |
| Past Growth | 10% | 12% | 8% | 20% |
| Receivable days | ? | ? | ? | ? |
| Payable days | ? | ? | ? | ? |
| XX | | | | |

- What causes the difference? What way does the company you analyse has substantially difference in parameters against the Sector leader or against its peers
- Check Revenue Recognition and Depreciation Policy

Statistical Models

- Altman Z-Score
- Piotroski F-Score
- Modified C-Score
- Benish M Model
- James Montier C-Score
- Decho-Dichev Accrual Quality
- Sloan's Accruals
- Lev Thiagarajan Model



Create your own excel with trend

A person is shown from the chest up, reading a book. The image is heavily blurred and has a uniform light blue color overlay. The person's head is tilted down towards the book, and their hands are visible holding the pages. The text 'Additional Readings' is centered in the lower half of the image.

Additional Readings

Financial Statement Analysis



| Title | Author |
|---------------------------------------|-------------------|
| Financial Intelligence | Kerman Berman |
| Financial Statement Analysis Workbook | Martin S. Fridson |
| Financial Ratios for Executives | Michael Rist |
| How to Read a Balance Sheet | John A Tracy |
| Quality of Earnings | Hewitt Heiserman |

Investopedia - <https://www.investopedia.com/>

This is a one stop solution for learnings about financial ratios. One can search a ratio or financial parameter of interest here. The explanation is well illustrated with videos and examples in many cases. Read one ratio a day, and in less than two months, one will be able to read the financial statements comfortably.

Financial Statement Analysis (Contd.)




Financial Statement Analysis And Reporting – By Prof. Anil K. Sharma

Financial Statement Analysis And Reporting
Management - 1 / 60

↺ ↻ ⋮

- ▶ **Lecture 01- Introduction**
Financial Statement Analysis and Reporti...
35:16
- 2 **Lecture 02- Accounting Process**
Financial Statement Analysis and Reporti...
31:15
- 3 **Lecture 03- Accounting Concepts**
Financial Statement Analysis and Reporti...
33:43
- 4 **Lecture 04- Trial Balance & its Relevance**
Financial Statement Analysis and Reporti...
32:24

Analyzing Financial Statements by “The Finance Story Teller”


The Finance Storyteller
6,902 subscribers • 90 videos
Would you like to learn how to read an annual report, how to analyze an income...

Balance Sheet Analysis
Alphabet Google
The Finance Storyteller • 1.3K views • 6 months ago
How to read and analyze a balance sheet of a company? This balance sheet tutorial video to "How to read an ..."
Subtitles

TOP 10 ESSENTIAL Financial Acronyms
The Finance Storyteller • 828 views • 1 year ago
Business life is full of acronyms. Here's the top 10 financial acronyms that you are able to join the ...
Subtitles

Accounts Receivable and Accounts Payable
The Finance Storyteller • 692 views • 2 months ago
What do the financial terms accounts receivable and accounts payable mean? The definitions of accounts ...
Subtitles

How to analyze an income statement - Walmart example (case study)
The Finance Storyteller • 1.1K views • 6 months ago
How to analyze an income statement - Walmart example (case study) video to "How to analyze an income statement - Walmart example (case study) ..."
Subtitles

Financial Statement Analysis (Contd.)

A screenshot of the WallStreetMojo website. The browser address bar shows 'wallstreetmojo.com'. A yellow banner at the top reads 'Special Offer - All in One Financial Analyst Bundle (250+ Courses, 40+ Projects)'. Below the banner is a navigation bar with a search bar and a 'Resources' dropdown menu highlighted with a red circle. The main content area is divided into four columns: 'Investment Banking Guides', 'Accounting', 'Financial Statement Analysis', and 'Others'. Each column lists various topics and includes an illustrative image. At the bottom, there are four icons with labels: 'ALL IN ONE BUNDLE', 'REVIEWS', 'VIEW ALL COURSES', and 'FREE COURSES'.

| Investment Banking Guides | Accounting | Financial Statement Analysis | Others |
|----------------------------|-----------------------------|------------------------------|------------------------|
| Investment Banking Basics | Accounting Basics | Ratio Analysis | Resources (A to Z) |
| Investment Banking Careers | Balance Sheet in Accounting | Profitability Ratios | Finance Certifications |
| Mergers and Acquisitions | Cash Flow Statement | Turnover Ratios | Top Books |
| | | | Asset Management |
| | | | Risk Management Basics |
| | | | Learn Economics |
| | | | VBA |
| | | | Power BI |
| | | | Full Form |
| | | | Calculator |
| | | | Templates |

Click on the link "Resources" to get the free courses on Financial Statements, Accounting and Valuation

Accounting Forensics



Accounting Forensics is a specialty practice area of **accounting** that focuses on uncovering **financial** fraud.

| Title | Author |
|--|---------------------|
| The Financial Numbers Game | Charles W. Mulford |
| Creative Cash Flow Accounting | Charles W. Mulford |
| Financial Shenanigans | Howard Schilit |
| Using Analytics to Detect Possible Fraud | Pamela S. Mantone |
| Quality of Earnings | Thornton L. O'glove |

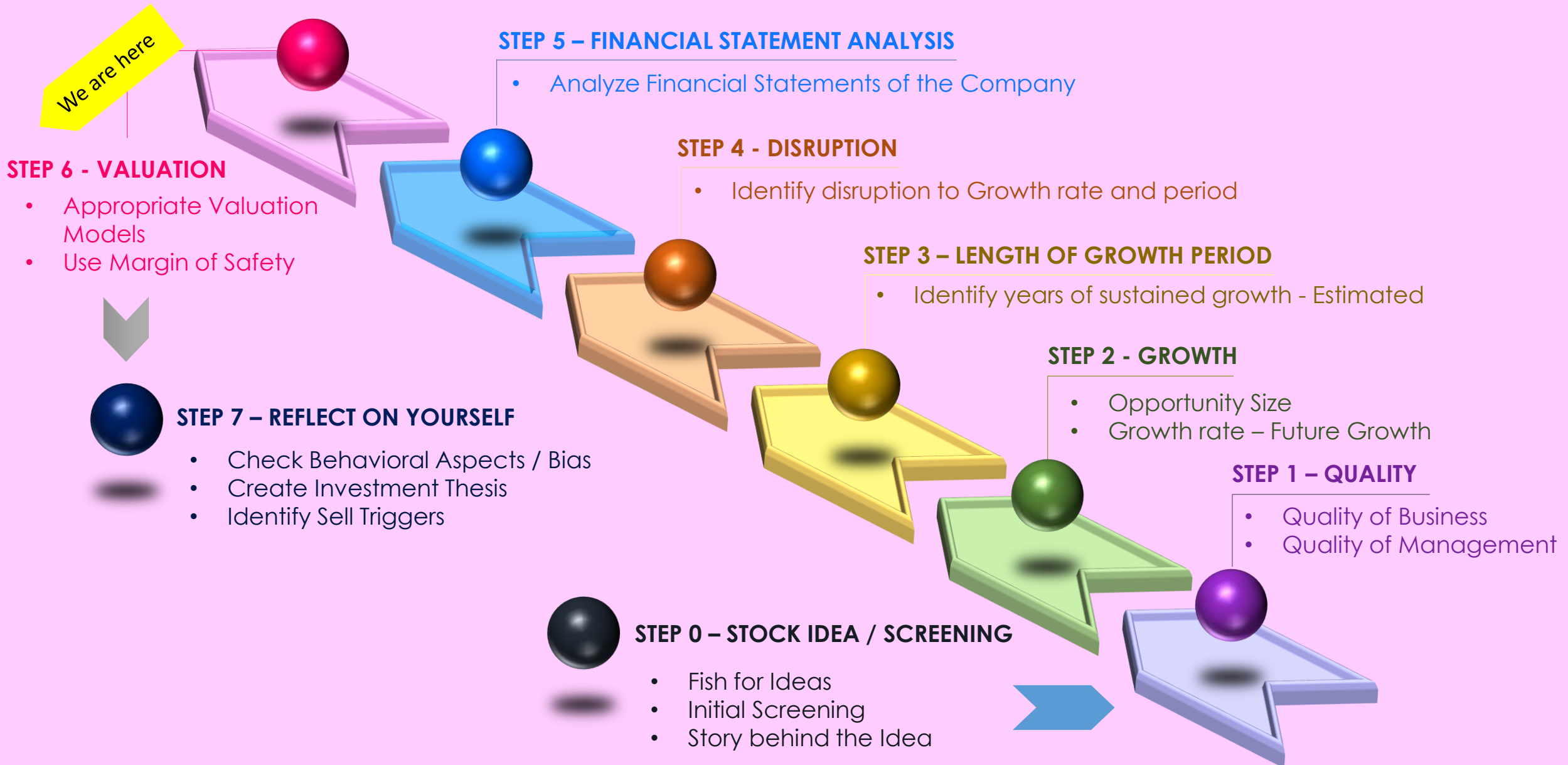
Understanding Financial Statements (Books in the previous section) is a pre-requisite to understand the topics in this book

Step 6: Valuation

YouTube Video: https://youtu.be/NVdl0nnzhI0?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

Image courtesy: Slidecarnival.com

7-STEPS IN STOCK ANALYSIS



Practical Approach



Buying a House...

Check with neighbour about owner / Encumbrance from Municipality

Quality of Management

If letting out – What rent can be expected

Would there be a demand, if let out? Is the location is such that there is good demand?

What is the value of the land in the locality – You enquire the Sq. Ft prices

What is the condition of the building? Needs repair / How many years can that sustain?

Was any similar property sold/brought in the locality near by? – Reference to gauge over/under value of the property you are looking to buy

Relative Valuation

Practical Approach (Contd.)



Buying a Commercial Property / Business

Very similar as before, but a few more pointers

Are there many more restaurants near by? –

Competitor Analysis

Does your restaurant command a good will from customers and provide some kind of a clear value differentiator to the customers

Moat Analysis

Commercials: Land value, building worth, cost of other assets, expected earnings and the duration of such earnings

- Assets Analysis, Earnings Analysis (Both current and Future)
- Duration of earnings – Longevity of Growth
- Future Earnings – Earnings Growth

What is Valuation?

Every investor wants to beat the market knows that it is essential to master the skill of stock valuation.

MOSTLY ASKED QUESTION...

- What is the value of a stock XYZ?
- How to value a stock?
- What are the different valuation tools/models?
- Which model or ratio to use for valuation?

WHAT IS VALUATION?

Valuation essentially is a fundamental assessment of intrinsic value of a stock

HOW INVESTORS USE VALUATION?

- The valuation is compared with the current market price
- This helps to determine, if a stock is overvalued or undervalued
 - ❖ Overvalued: Intrinsic Value << Current Market Price
 - ❖ Undervalued: Intrinsic Value >> Current Market Price

DIFFERENT VALUATION APPROACHES...

- Relative Valuation
- Absolute Valuation
- Buffettology based Valuation Methods

HOW TO VALUE A STOCK

- Complicated process, combination of both art and science part of investing
- Need certain data to decide on the valuation model to use
- Use suitable stock valuation model/method based on available data
- These data come from analyzing the previous 5 steps that we did in stock analysis
- Use possible multiple models – Best case

How Previous Steps Help

- Why so many steps prior to valuation?

- Most of the inputs for valuations comes from the previous stages

- DCF needs future expected growth rates and duration of the growth

- Both these values can be reasonably arrived from previous steps rather than pure assumption

- What purpose does valuation serve for a company that has a poor business dynamics or management or stagnant growth?

STEP 5 – FINANCIAL STATEMENT ANALYSIS

- Business insights: Loans, Assets, Profitability and turn over ratios. Cash flows (CFO, FCF) and CAPEX

STEP 4 - DISRUPTION

- What can cut short the predicted growth

STEP 3 – LENGTH OF GROWTH PERIOD

- How long can the predicted growth sustain

STEP 2 - GROWTH

- Predicable Growth

STEP 1 – QUALITY

- Poor Business Dynamics, Competition no pricing power
- Fraud management

Valuation without a due diligence about the company is a recipe for disaster !!!!!

You are Set to Go

You Are Ready to Start Valuation, If Your Stock Has Successfully Passed All The Previous Steps

By Now, Even Without Any Excel Or Valuation Models, You Will Have A Fair Idea Of Value Of The Company 😊

Valuation Is The Last Step to calculate After completing all the Previous Steps...

P/E Ratio!

- Traditionally used ratio / Every new investor starts from this
- Interesting Numerator & Denominator, where one is dynamically varies
- PE ratio swings with the mood of market, one day showing high and other day low with CMP
- A commonly used thumb rule: But a company selling below a particular PE levels as cheap and above a particular value as expensive / No Bench mark
- Misconception, that people buying low PE are Value investors
- High PE ratio could come down with increasing earnings
- A low or high PE value does not give a conclusive evidence - Can be a rough barometer
- Not valuable, if earnings fluctuate i.e. Cyclical

P/E Ratio! (Contd.)

- This valuation does not capture :
 - Growth (Past / Future growth)
 - High / Less ROE
 - Cash flow, Free cash flow
 - CAPEX spend/requirements

Factoring Earnings Growth

Purchase price: 100, Growth: 10% and longevity of this growth: 8 years

| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|----------|-------|-------|-------|-------|-------|-------|-------|-------|
| Earnings | 10.00 | 11.00 | 12.10 | 13.31 | 14.64 | 16.11 | 17.72 | 19.49 |
| P/E | 10.00 | 9.09 | 8.26 | 7.51 | 6.83 | 6.21 | 5.64 | 5.13 |

Never in the past, did Investors have Challenging Time. It is high time to look beyond P/E for other valuation metrics

Relative Valuation Models

- In this method, Price is the primary variable
- These models value companies by comparing them to other companies on metrics such as EV/Revenue, EV/EBITDA, and P/E ratios.
 - ❖ Competitors companies
 - ❖ Companies with similar business dynamic
 - ❖ Industrial Average
- The logic for determination of valuation or overvaluation
 - ❖ Your company has 10x in one of the variable
 - ❖ Your company is overvalued, if comparable company/average is <10x
 - ❖ Your company is undervalued, if comparable company/average is >10x

Various Tools

- Price Books Multiple
 - Price Earnings Multiple
 - Price FCF Multiple
 - Price Sales Multiple
 - Price Cash Multiple
 - Dividend Yield
- many more...

Disadvantage

- Subjective, depends on entity being compared i.e. Industry average / similar company
- Company being compared becomes benchmark without analysing it!
- Does not answer the intend of what your company is worth

Remedy

- Perform Absolute valuation
- Analyse compared companies / Competitive Analysis

Absolute Valuation Models

- These valuation models attempt to determine the intrinsic value of a company in absolute terms
- This method relies on the company's fundamental information, i.e. various financial information published or derived from a company's financial statements
- Supported by these details are your own insights and assumptions i.e. Expectations on Growth, dividends etc.
- There is no comparison with the Competitor company or Industry averages

Various Tools

- Discounted Cash Flow (DCF)
- Reverse DCF
- Discounted Dividend Model
- Discounted Asset Model
- Discounted FCF Model

many more...

Disadvantage

- Heavily dependant on published numbers – Possible of numbers being fraud
- Your estimates and assumptions have a greater impact on this valuation

Remedy

- Analyse compared companies
- Accounting Forensics
- Circle of Competence

Which one to use?

- There are many tools and methodologies available
- Not a single model or approach is suitable for every company, sector or situation
- Finance stocks: Price Book Multiple suitable

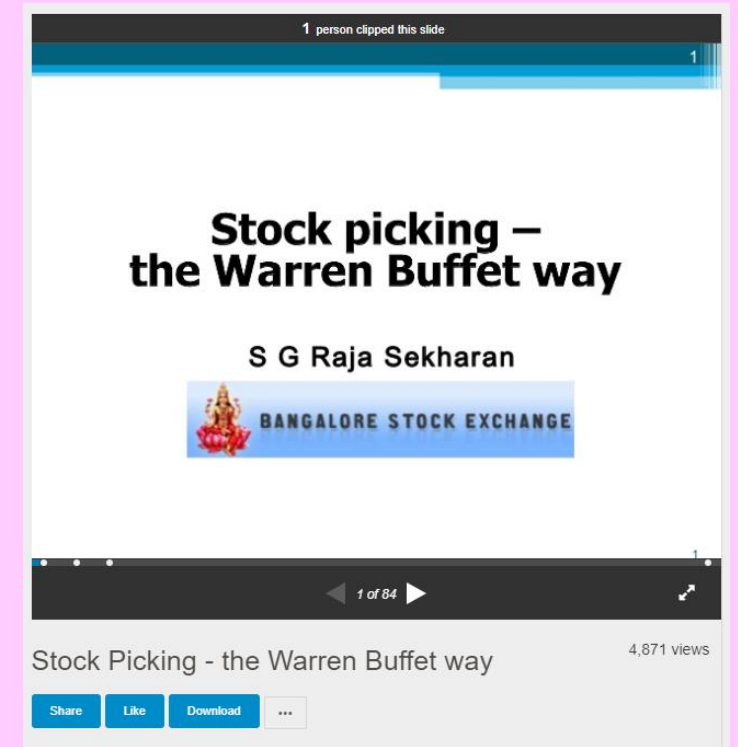
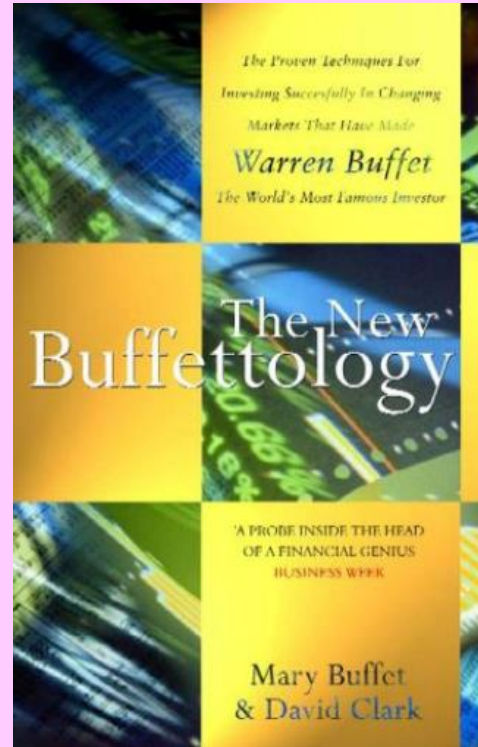
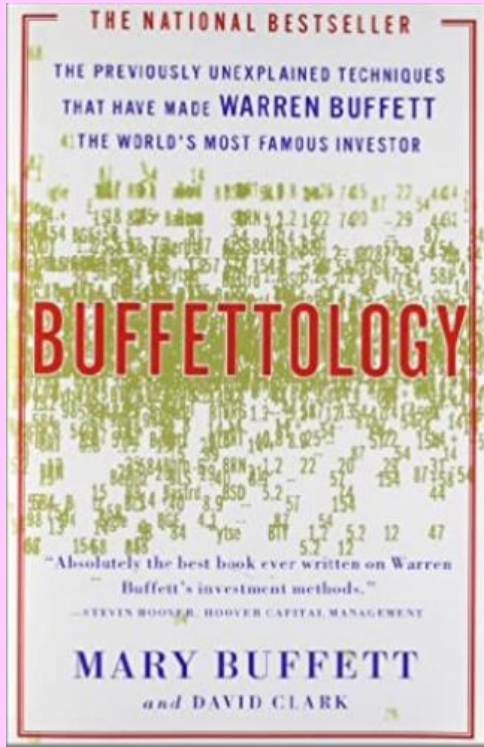
Absolute Valuation Models

- Discounted Cash Flow (DCF)
- Reverse DCF
- Discounted Dividend Model
- Discounted Asset Model
- Discounted FCF Model and many more

Relative Valuation Models

- Price Books Multiple
- Price Earnings Multiple
- Price Sales Multiple
- Price Cash Multiple
- Dividend Yield and many more

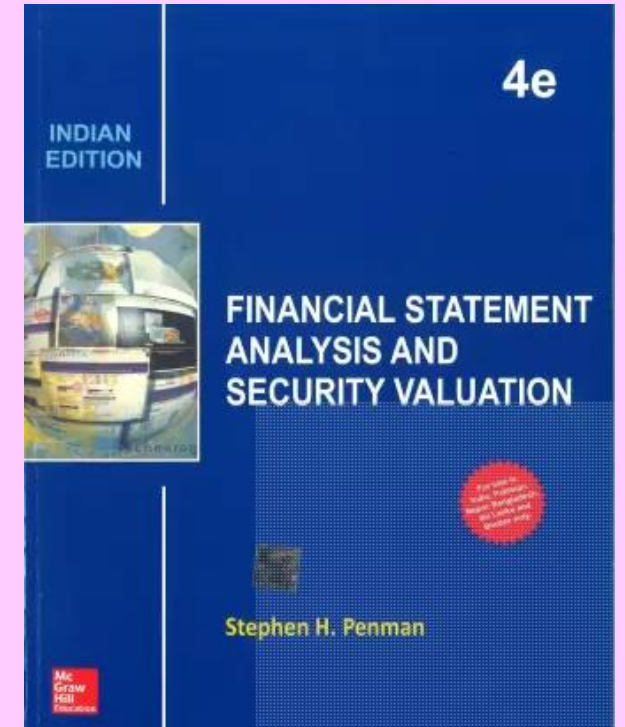
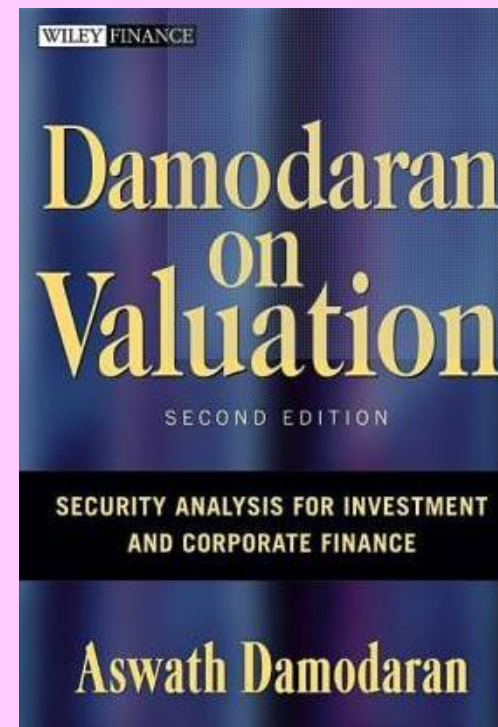
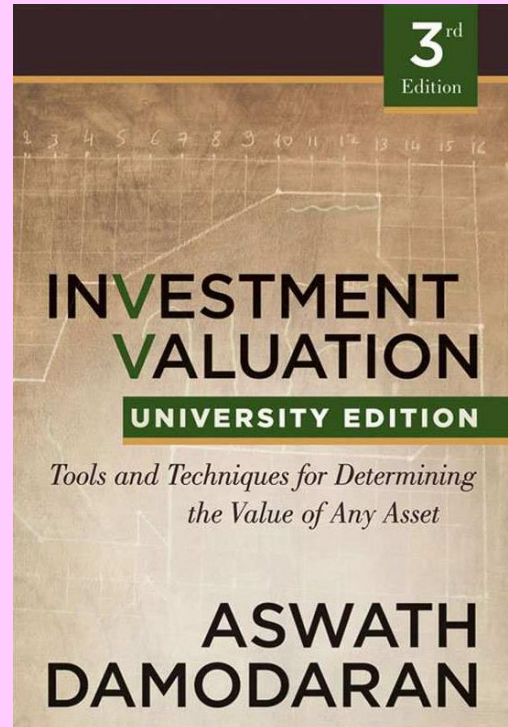
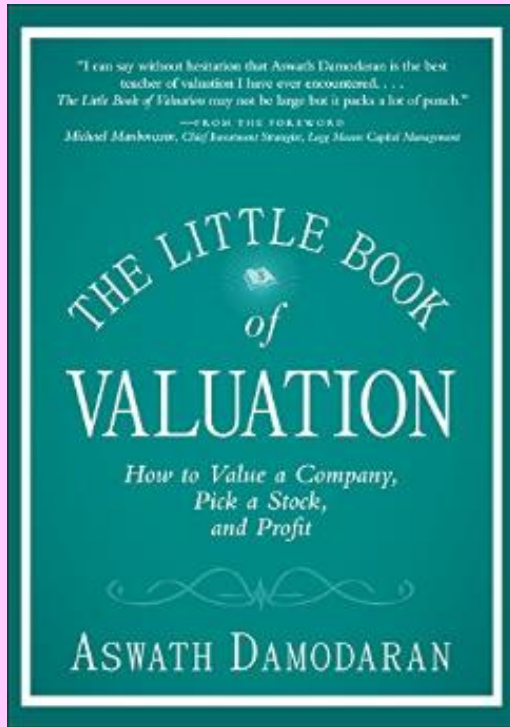
Buffettology Based Valuation



- Three models on how Buffett Approaches Valuation
- Two of them very effective
- Estimation of future book value

- Estimation of future Earnings / Share
- Checklist kind of approach with some 10-15 questions mostly covering what we discussed in the previous steps

Additional Reading



There are huge resources (Books, Videos and Lessons) available in the open domain on valuation and all the models.

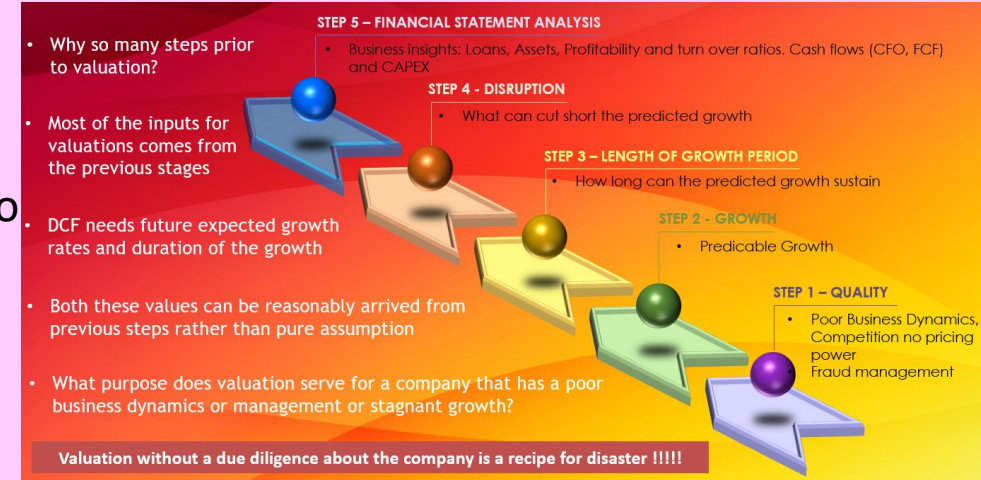
A Quick Recap



Practical Approach...

IMPORTANCE OF PREVIOUS STEPS...

- Outcome of each step contributes to valuation
- Weed out companies that do not worth to valued!



WHAT IS VALUATION?

HOW TO VALUE A STOCK

GOOD READS

DIFFERENT VALUATION APPROACHES...

- Relative Valuation
- Absolute Valuation
- Buffettology based Valuation Methods

Margin of Safety

Simple concept: Protects investors from big mistakes

If a stock price is significantly below the actual fair value of a company, that percentage difference is known as the Margin of Safety.

Margin of Safety is the percentage difference between a company's Fair Value per share (Investors estimate) and its actual stock price.

The percentage that a company is undervalued by the stock market.

$$\text{Margin of Safety} = (\text{Intrinsic Value Per Share} - \text{Stock Price}) / \text{Intrinsic Value Per Share}$$

Margin of Safety...Views from the Father of Investing



The Idea of concept first came from Benjamin Graham

Central Concept of Investment, dedicated Chapter 20:“Margin of Safety” in his book *Intelligent Investor*

Past earnings are used to project into future – Do conservative projection of future earnings

This margin of safety is always dependent on the price paid. Thus for any stock, it will be large at one price, small at some higher price, non existent at some still higher price.

Graham really was a pioneer in behavioural finance before behavioural finance was even a thing, and the margin of safety concept was one of the first tools that allowed investors to overcome their own biases, creating a protection against the “unknown unknowns” of an investment.

Margin of Safety...View from the Zen



When you build a bridge, you insist it can carry 30,000 pounds, but you only drive 10,000 pounds truck across it. And that same principle works in Investing.

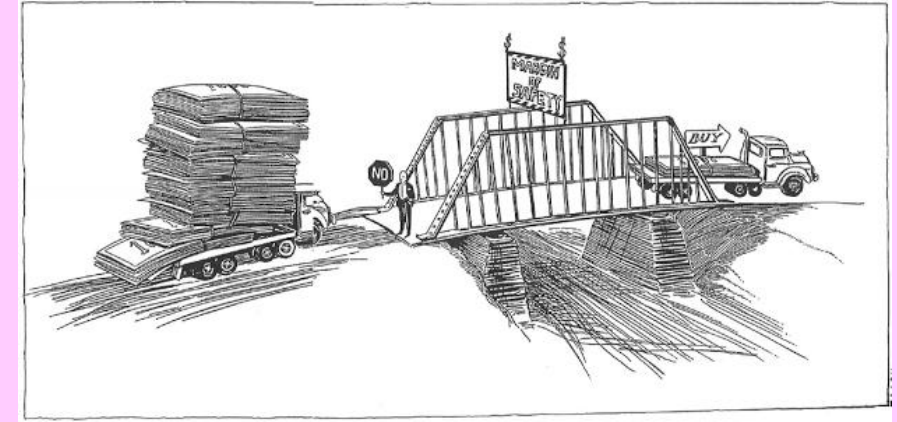


Image source of the bridge art: <https://www.vintagevalueinvesting.com/what-is-margin-of-safety/>

“You also have to have the knowledge to enable you to make a very general estimate about the value of the underlying businesses. But you do not cut it close. That is what Ben Graham meant by having a margin of safety. You don’t try and buy businesses worth \$83 million for \$80 million. You leave yourself an enormous margin.”

Buying a dollar for 50 Cents



Image source: ValueWalk Blog
<https://www.valuewalk.com/2018/04/best-warren-buffett-speech/>

Margin of Safety...More Views



...most investors think quality, as opposed to price, is the determinant of whether something's risky. But high quality assets can be risky, and low quality assets can be safe. It's just a matter of the price paid for them...



One of “The Six Commandments of Value Investing”

Margin of safety – leave room in your buy price for being wrong

Margin of Safety...More Views



Because investing is as much an art as a science, investors need a margin of safety. A margin of safety is achieved when securities are purchased at prices sufficiently below underlying value to allow for human error, bad luck, or extreme volatility in a complex, unpredictable, and rapidly changing world.

Is it required? How much...?

Is this required in the first place?

- Good Quality Business (with moats, pricing power, less or no competition)
- Good Quality Management
- Predictive Growth

It is a humble way of accepting to yourself, that you...

- Might not have all the available information
- Not connected the dots/picked insights from available information
- You would have been biased to the industry
- We ourselves could make errors (Over and under estimation of Growth or Pricing power, competition, remember many in the art part of investing are estimates)

How Much MOS?

No Bench mark or recommended values

Again a Art – Science debate

Level of risk one is comfortable

Risk averse: More MOS

Risk taker: Less MOS

Now what next?

Now you have used the applicable models and arrived at the valuation with MOS. There could be **three** scenarios as below. What to do in the three scenarios?



1. Add this to your investible universe of stocks and watchlist
2. Monitor the price regularly to check if it comes down to your valuation
3. Particularly check at times of panic sell offs



What is the big fun in paying 100 rupees for a 100 rupee bill? Not a buy

- All three actions as above



- Congratulations - You have identified a value stock.
- So what next? Should you place a bulk tomorrow at 9 AM?

What Next?... Cooling Period

Give a cooling period (2 weeks) after this research.

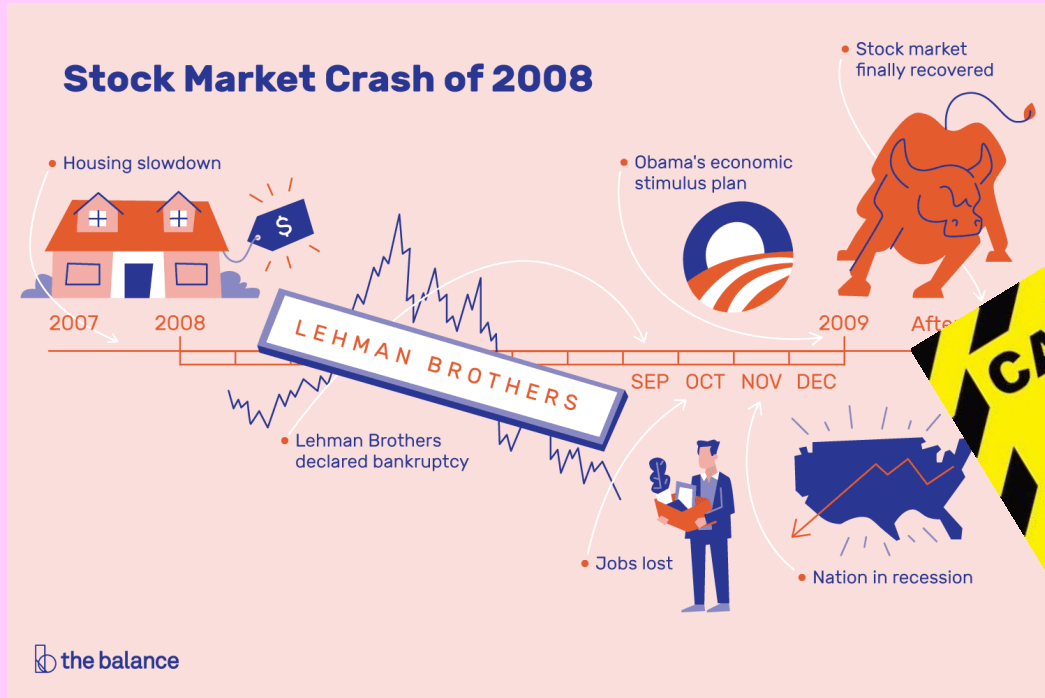
- Revisit the Investment thesis
 - Revisit the estimates and assumptions. Have all the assumptions considered conservatively for valuation?
 - One last MOST IMPORTANT STEP, that you can do as you buy... 😊 SELL DECISION TRIGGERS!
- Make sure that all available positive/negative information and risks has been factored in valuation.
- It is quite possible, that you had spend a good time analyzing the stock for weeks/months and got emotionally attached.
- This could have led to UNCONSCIOUSLY lowering the Margin of Safety or having a higher growth rate or any other assumptions to tilt your valuation plate higher than price



Go ahead and buy the stock. NOT IN BULK. But in a staggered manner to have sufficient "Dry Gun Powder" to EXPLOIT the situation in case of panic selling in the markets.

Caution

Even with all that this accurate estimation, the market prices can go below estimated values + MOS in the event of a financial melt down or any other unforeseen circumstances like how see in 2020

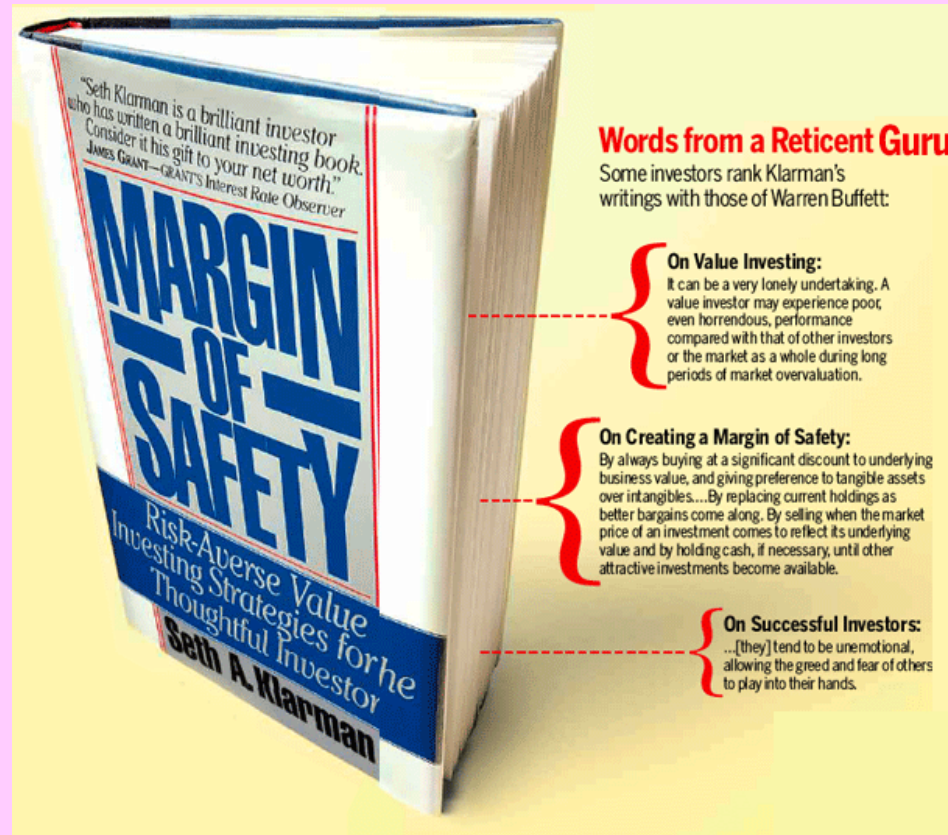


2008



2020

Positive aspect is such a rigorous analysis gives investor the confidence to navigate the crisis and also...once the crisis is resolved the stock will get back and much stronger business fundamentals/managements due to lesson from crisis



Additional Readings

Additional Readings (Contd.)

<https://www.liberatedstocktrader.com/margin-of-safety/>

Home » Latest Articles » Margin of Safety – The Key To Warren Buffett's Wealth

Margin of Safety – The Key To Warren Buffett's Wealth

Our Simple & Powerful Guide Helps You Transform Your Investments By Truly Understanding Buffett's "Margin of Safety", The Core of Value Investing.

By Barry D. Moore - CFTe Certified Financial Technician - IFTA - October 16, 2019

COMPANY FAIR VALUE
\$1 Billion
10 Year Earnings - Assets = \$1B
10,000 shares outstanding
Fair Value \$1B / 100,000 Shares = \$1,000 per share

Vs.

STOCK MARKET CAPITALIZATION
\$500 Million
Margin of Safety = 50%
Stock Market Undervalues Company by 50%
10,000 shares outstanding
Stock Market Share Price = \$500 per share

One of the wealthiest people in the world and the undisputed heavyweight champion of successful investors has actually told us everything we need to know for long-term profitable investing.

With multiple books and countless letters to investors, the co-founder of Berkshire Hathaway has communicated over and over his investing philosophy.

His core investing principle is the **Margin of Safety**

What Is The Margin of Safety?

If the stock price of a company is below the actual value of the cash flow (income) and assets of a company the percentage difference is the Margin of Safety. This is the discounted price at which you are buying a share in the company.

If a company is worth \$5 per share on the stock market exchange, but the value of its earnings, property, and brand is worth \$10 then you have a discount of 50%.

If you buy the stock at \$5 then eventually the stock price should rise 100% to get to \$10 per share.


Simple really! Or is it, how about an infographic to help explain.

<https://www.johnenglander.net/margin-of-safety-applies-to-investing-and-flooding/>

'Margin of Safety' Applies to Investing and Flooding

Oct 8, 2017 | 0 comments

"Margin of Safety"
The 3 Most Important Words for investing



Benjamin Graham | Warren Buffett

"Margin Of Safety" are the 3 key words of investing wisdom from Benjamin Graham

The late Benjamin Graham is one of the all-time investing icons, even in the eyes of Warren Buffett, his famously successful student (both pictured above). Graham said his *secret to sound investing* was three words: **"Margin of Safety."** The words could also well apply to designing for flooding.

Step 7: Reflect On Yourself

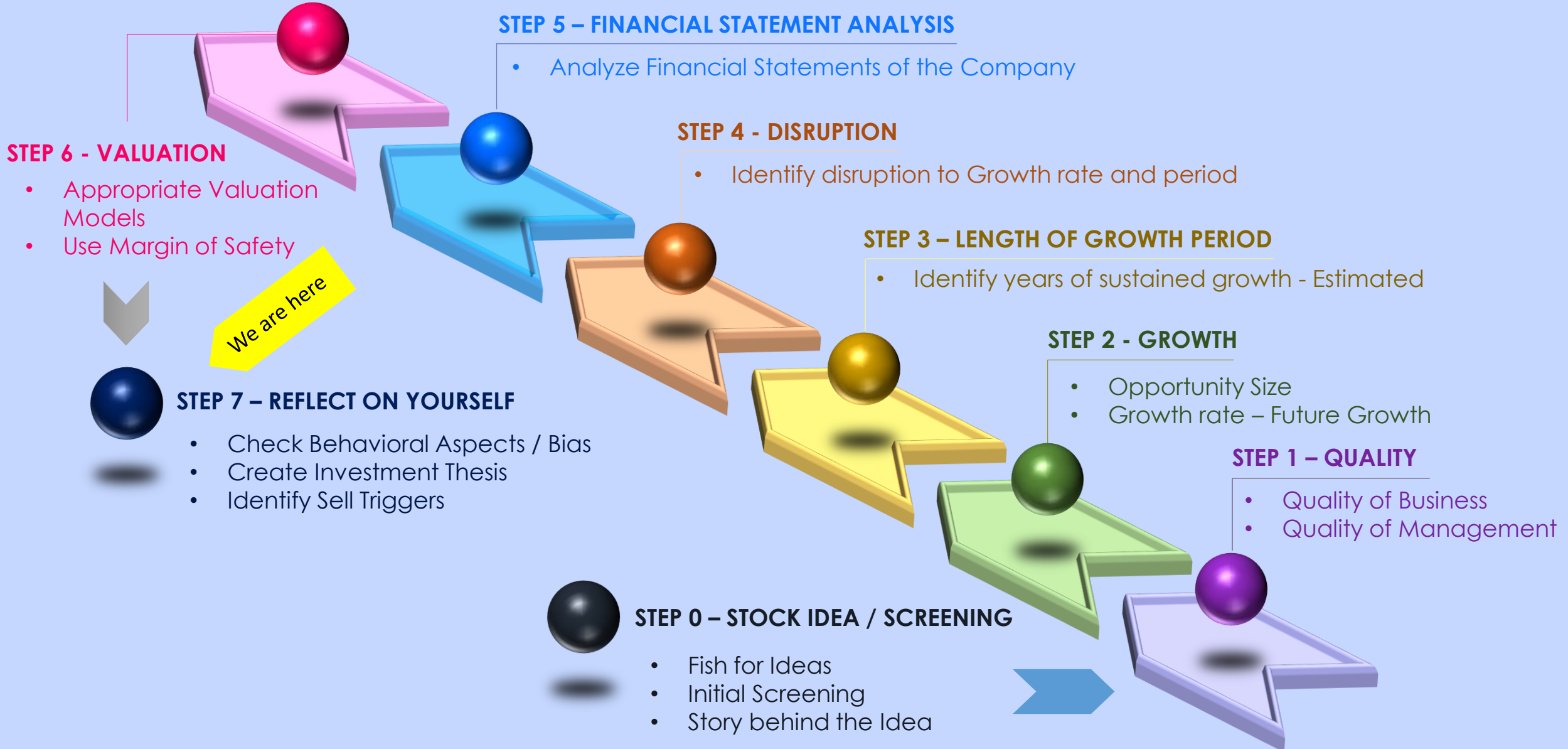
YouTube Video:

https://youtu.be/NGeix4iP5Oc?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

https://youtu.be/pirTK9WR1ec?list=PL9QC_19RB6uWQ3IQPSviGI5Pe77aGXson

Image courtesy: Slidecarnival.com

7-STEPS IN STOCK ANALYSIS



INVESTMENT
THESIS

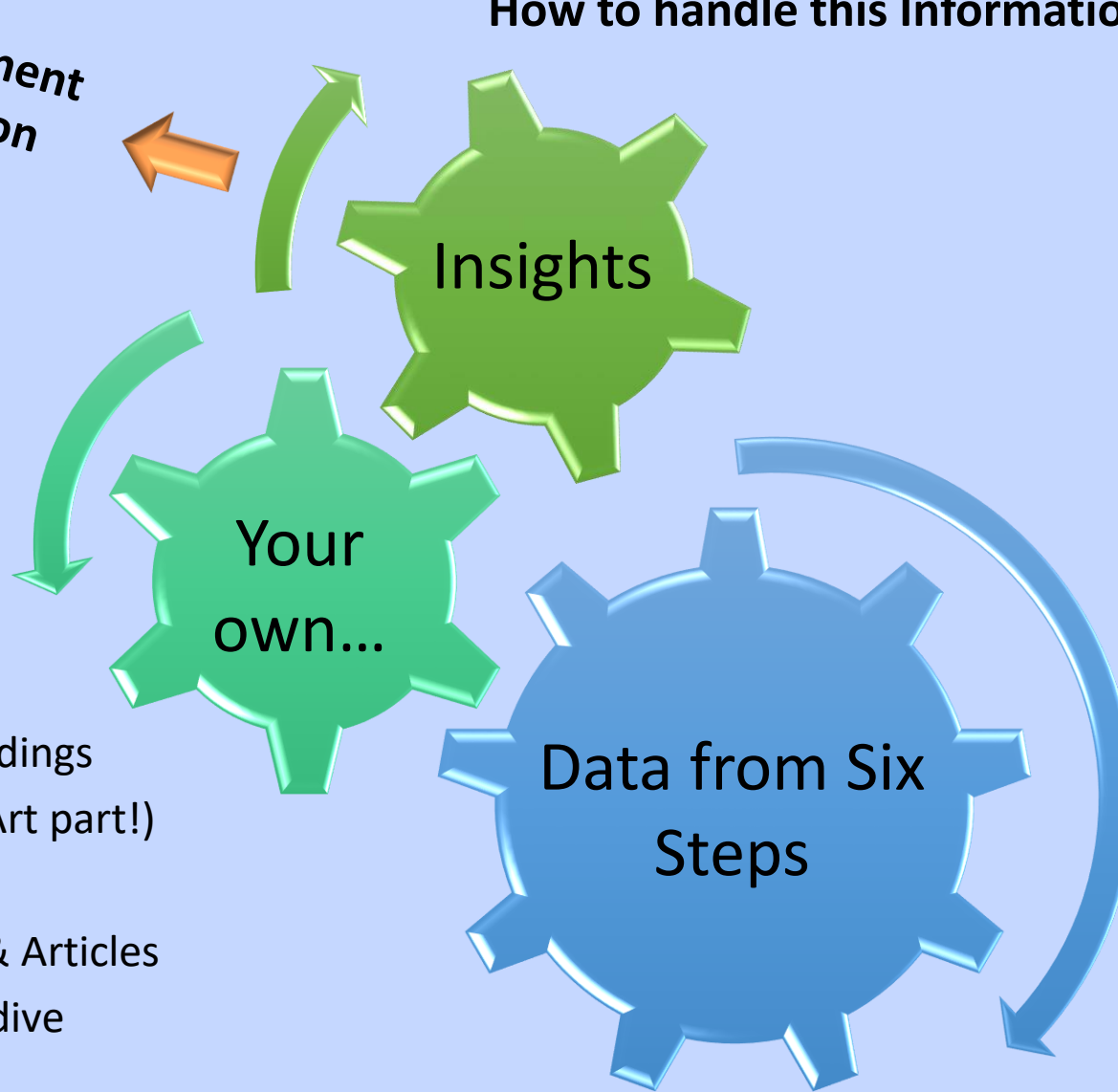


Investment Thesis

How to handle this Information overload?

INVESTMENT THESIS

- Observations
- Queries
- Remarks on findings
- Assumptions (Art part!)
- Risks / Flags
- Various News & Articles
- Areas to deep dive
- Unknowns



- Quality of Business: Moat, Pricing power, efficiency ratios etc
- Management Actions: Acquisitions / Buybacks
- Management Quality: Experience, RPT, Compensation
- Inferences from Financial Statement and Ratio Analysis / Forensics
- Growth of Industry / Company
- Longevity of Growth
- Disruptors to Growth
- Competition analysis
- Valuation insights with Margin of Safety

Investment Thesis (Contd.)

- This document is written and dynamic/running document and shall be updated on a ongoing basis as new information is available and during the course of this 6 step analysis
- Remember! Investment Thesis is not a analyst report
- An investment Thesis format - No universal standards for the contents, but you can align to the 6 steps and the analysis from the six steps
- Since lot of data is evaluated over a long period of time which spans for weeks, a Investment Thesis helps to record the findings and revisit when needed
- It helps to look back and analyze why a particular decision was made in the first place—and whether it was the right one.

This document will be helpful in analysis, buying decision...

1. Quality

2. Growth

3. Longevity



4. Disruption

5. Valuation

6. Sell Trigger

...and also guide you when there is Panic in Market or a situation to sell arises.

Investment Thesis (Contd.)

- The summary of a Investment thesis should ultimately have at least 5 – 10 points as to why that stock is a Buy idea or why the idea should be rejected
- Rationale for the Buy Price / Holding period
- Should you exit the holdings...What should be the reason – Sell Triggers

When to Sell a Stock

- The decision and point to **Sell** a stock is much difficult to identify and execute than the decision to **Buy** a stock.
- Much has been discussed on this by various Investment Gurus.

One General rule is you could have gone wrong in your analysis about the stock. Once it becomes clear that

- The analysis you did is wrong or
- The initial Investment Thesis has changed and no longer valid

In this circumstance, without further hesitation (or ego) sell the stock irrespective of whether the stock shows a gain or a deep loss. Just get out of it.

This is like a situation where you go to a city and stay in a Hotel. You realize that something illegal happening and all is not well in that lodge. You are not in the right place. Will you stay because you have paid the money or just get out of it to save yourself from any further trouble?

How to approach Sell?



What else can guide a investor to make a rationale sell decision



Let us quickly look at a Aircraft Pilot and come back to Investor!



A Pilot Takes Off and Lands...



- Imagine how would it be, if a pilot takes-off and flies a aircraft. But does not know **when, where and how to land**.
 - The very thought is absurd 😊
 - So a Pilot does not get trained to “Land” not in the air, just before arriving at the destination...
 - His training for landing is done even before he takes-off
 - When we started to learn driving a bike or car, were we not first thought how to use the brakes?
- The pilot is allowed to fly only when they are confident to land safely.
 - Infact it is much more...The training includes not only regular landing, but special situation landings like:
 - Landing in complete darkness (No Runway lights),
 - Landing in Bad weather and
 - Emergency landing procedures (Lighting strike, Shortage of fuel, landing in sea/ocean, if needed)

Think over this and try to relate with Investing **Buy** and **Sell** Aspect

Sell Triggers in Investment Thesis

- The same analogy can be replicated for Selling a Investment
- As a Investor gets ready to buy a stock after analysis they MUST also identify the triggers/conditions/risks in the Industry or the company that should make the stock a “SELL” candidate. A few sample pointers:
 - Competitor gaining ground – Loss of market share
 - Structural changes in the sector/company leading to declined growth rates / Different business dynamics
 - Changes in management which is not in the best interest of Shareholders
- These triggers must be captured well in their investment thesis made before purchase
- This list of triggers must also be updated regularly in light of the new facts and changing reality in the industry or the stock – Running document
- Should any (or multiple) of the triggers become a reality, a investor must make a judgement/call and sell the stocks WITHOUT EMOTIONS!

Sell Triggers in Investment Thesis

- Ideally for a “Quality Business/Management”, it may take years for the triggers to become a reality (or) it may never happen at all, making it a perfect long term investment candidate.
- BUT...not all factors are in our control. The triggers could happen very soon due to change in Technology or regulation or any thing else forcing us to make a SELL decision.
- Also note, that Price levels targets (i.e. 200% gains or 50% loss) are NOT “Sell Triggers”

Sum Up...



1. Quality



2. Growth



3. Longevity

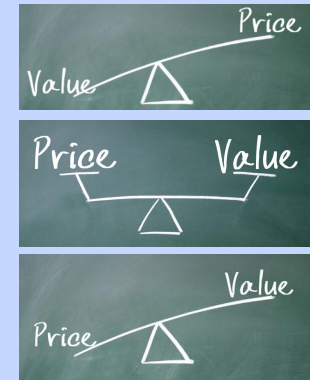


Investment Thesis

4. Disruption



5. Valuation



6. Sell



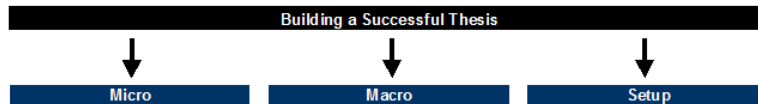
Additional Readings

Update: Find a job you love at [Vetterly](#)

BUILDING AN INVESTMENT THESIS

of [Hedge Fund Training](#)

Now that you understand what characteristics make up attractive long and short ideas, it is time to explain how to formulate an investment thesis. Being able to construct a real and actionable investment idea is in the heart and soul of an analyst's work in the hedge fund industry. Building a successful thesis begins with (1) rigorous due diligence at the Micro level, (2) aligning that view with the Macro environment, and (3) understanding the overall trade setup.



MICRO

GOOD COMPANY QUALITIES

- High return on capital
- Barriers to entry
- Growing industry
- High margins relative to competition

GOOD MANAGEMENT

- High insider ownership
- Well respected
- Clean accounting
- Infrequent restating of earnings
- Not overly promotional

<http://www.streetofwalls.com/finance-training-courses/hedge-fund-training/building-an-investment-thesis/>

**Thanks for watching
the Video &
Presentation**

**Follow me in Twitter
@SuccessProject_**

**Links to my
YouTube Channel**

**If you have not downloaded this file from the <https://mysuccessproject.in/presentations/>, please
check the link for the latest version**

Image courtesy: Slidescarnival.com

