



# A STEP-BY-STEP GUIDE FOR MULTIBAGGER SELECTION

*Stock Fundamental Analysis &  
The Secret of Mega Profit*



SAIKAT HALDER, CFA, FRM, MS FINANCE



# TABLE OF CONTENT

## Chapters

## Pages

1. Introduction to Hybrid Investing.....	3
2. Power of Compounding.....	8
3. Introduction to Equity Class.....	13
4. Introduction to Fundamental Analysis.....	17
5. How to Read Balance Sheet.....	22
6. How to Read Income Statement.....	28
7. How to Read Cash Flow Statement.....	36
8. Financial Ratio Analysis.....	40
9. How to Pick Multibagger Stocks.....	50
10. Build Your Risk-Adjusted Multibagger Portfolio.....	55



[ THIS PAGE INTENTIONALLY LEFT BLANK ]

CHAPTER 1

# INTRODUCTION TO HYBRID INVESTING





# Why the stock market is the best investment?

The stock market is one of the best investments one can do. In fact, when it comes to the best investment, I always say any investment done on yourself is the best one. Any investment done to improve your skillset is categorized as the best investment. But when it comes to transforming your wealth from a small portion to a big lot and when any investment option comes into my mind, I can say, it is the investment in stocks.

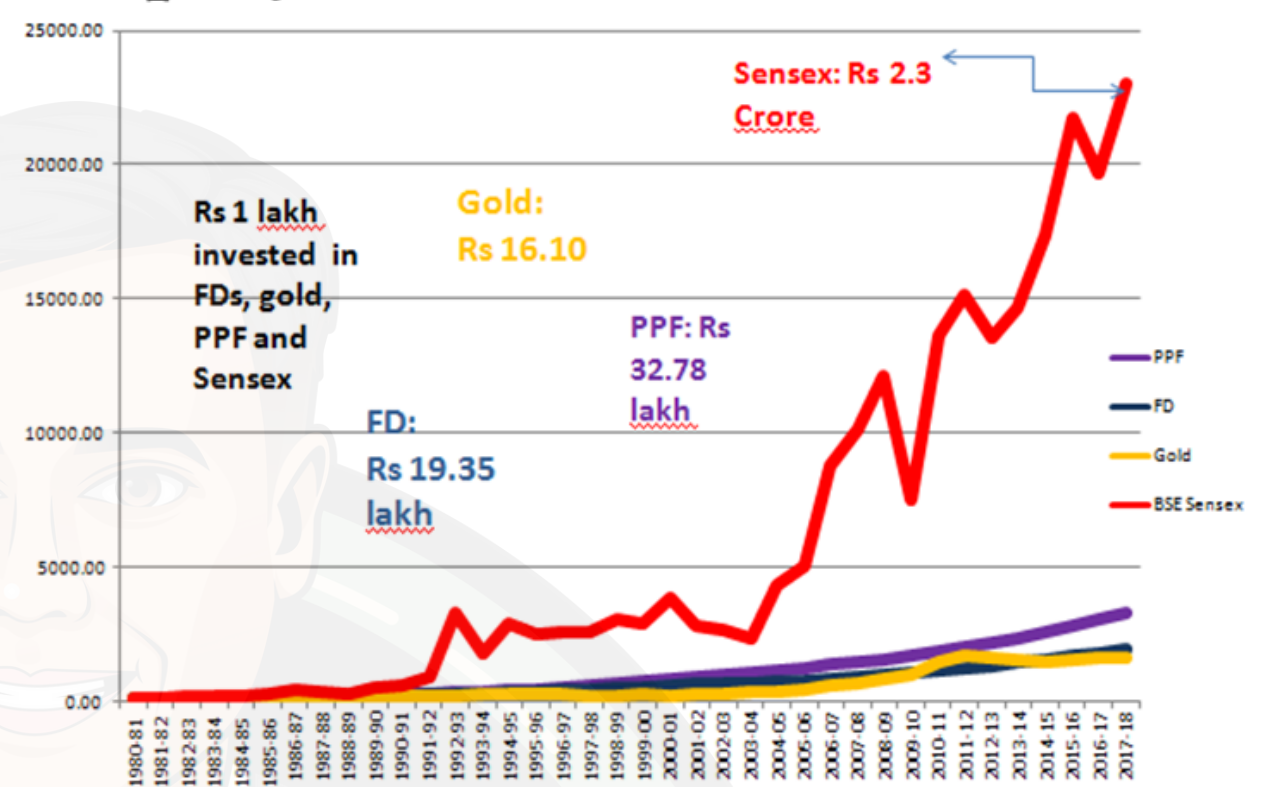
Now, you will be thinking why I am always imposing importance that the stock investment is the best investment. This is because the stock is something that can be analyzed very quickly and efficiently. Also, this analysis helps us to get a return that is not fixed, but variable. So, if our estimates or thought process goes in the wrong direction, we may lose sometimes.

But if our thinking is strong enough and it has good reasons to believe in it and if it has been backed by good analysis, then, of course, we will say that our investment will rise in value in the coming year and eventually will lead to an increase in wealth. So, there is also no binding on the cases like we have a term in fixed deposit. There we are going to lock our money for certain periods and after that only we can get it back.

So, for stock investment, one is not required to be disciplined in terms of making deposits frequently and in a particular amount every month. So, for those people, it is quite evident that they can gather some money over time and when they have accumulated some wealth, they can put it in stocks as they get the right opportunity. They can put it in different stocks from different industries and different sectors and they can get it diversified also. Moreover, they will do the proper analysis for their investment which is backed by reasons. So, they should be prepared for the scenario that the fund may go downward sometimes. So, if they can tackle these instances by investing in gold and silver, they can manage this kind of risk for sure. So, the overall investment in a stock market, including commodity markets, like silver and gold, we can do the best thing is diversification, and this way we can make good money over the period with the application of knowledge of risk management. So, any investment that can give the highest return as I think is by acting passively by investing in the index itself.

We can invest in an index like Nifty 50 or Nifty Next 50, we call it also Junior Nifty or we can invest in Sensex and then we sit passively for next 20-30 years, we will still get better return compared to any bank that can give us as each has been proven in the history, it will be proved again in the future. So, this is what we believe even if we are doing nothing, no analysis, nothing then also a stock market is going to give us the best return. So, this is what we believe even if we are doing nothing, no analysis, nothing then also a stock market is going to give us the best return. So why do we think about anything else? If we think about gold and silver alone, then in gold, we will not get

## Equity Vs Gold Vs PPF Vs FD



## Large Cap Vs Small Cap





that return that we are getting in the equity index also we're hardly getting the fixed rate of interest which is not beyond 7-8%.

We are losing money on all fronts except our investment in the stock market where we are investing in industries, and we are believing that India is growing that it is growing at a faster pace. Indian growth is accelerating actually and that's why we should invest in the stock market in India.

## Here, we have the top myths of Stock Market –

- **Myth 1:** Stock Market is gambling. – Basically, the stock market is a probabilistic game, it is not gambling. If your research is a quality one, you will always win in the long run.
- **Myth 2:** You need to be a qualified financial analyst to take investment decisions – No, even an ordinary person with the training and required knowledge can start investment and even trading.
- **Myth 3:** Bank deposits give assured returns – Nopes, like any industry, may fail, and a private or public sector bank may also get into trouble. Keep your wealth diversified.
- **Myth 4:** Trading is profitable if you have a small sum say 1L rupees. – No, you can still invest 1 Lakh rupees instead of putting that in trading like gambling. It's better to harvest a 10% return in a year than to lose it all in hope of making quick money
- **Myth 5:** Risk Vs. Return, you should always prioritize return – No, protect your capital first, always do the right trade-off between risk and return. Never take a call where you may end up with all your capital, even half of it.

## Investment Vs Speculation

- Investment is a profitable mechanism. And speculation is a betting mechanism.
- Investment requires thoughtful process and speculation requires just enthusiasm.
- Investment will require lots of homework to be done on a plane piece of paper and speculation requires lots of thinking to be done in mind alone without any calculation.
- Investment can be done based on risk appetite and speculations are always done considering that risk is there and still we are going to play best on our mind without doing any homework.
- Investment requires a strategy, and speculation is a strategy-less, it is just a hype.

We hear somebody we do that; we think something, and we do that, we do not validate the reason we do not go with logic, that's where speculation fails and logic-based investment wins.





# Introduction to Value Investing

Value investing is an investing style pioneered in the early 1920s at Columbia Business School by Benjamin Graham and David Dodd. Until then, stock market investing was driven mainly by speculation and insider information. Graham, who is known as the father of value investing, sums up the crux of value investing in his classic work *The Intelligent Investor*:

***An investment operation is one that, upon thorough analysis, promises the safety of the principal and an adequate return. Operations not meeting these requirements are speculative.***

Value investing is an investment approach that seeks to profit from identifying undervalued stocks. It is based on the idea that each stock has an intrinsic value, i.e. what it is truly worth.

Through fundamental analysis of a company, we can determine what this intrinsic value is. The idea of value investing is to buy stocks that trade at a significant discount to their intrinsic values (i.e. they are cheaper than their true value). Once we buy an undervalued stock, the stock price eventually rises towards its intrinsic value and makes a profit for us in the process.

Value investing is conceptually simple, though requires effort to implement. The research process focuses on finding out the intrinsic value of a company and the primary tool for researching a company is called fundamental analysis.

Let us understand these bits of value investing more closely...

## Four Pillars of Value Investing by Benjamin Graham

- **Mr. Market:** Imagine you are in a partnership with Mr. Market, where you can buy or sell shares. Each day, Mr. Market offers you prices for shares depending on his mood. If Mr. Market is in a very optimistic mood, he will offer very high prices. In this case, an investor should cash out of shares. If Mr. Market is in a very pessimistic mood, he will offer low prices, and this is the time to buy.
- **Intrinsic Value:** Intrinsic value represents the true value of the company based on fundamentals. In the short term, market prices deviate from their intrinsic values due to changing market sentiments. In the long term, market prices return to intrinsic values. This process allows us to make profits because we can buy stocks when they fall below their intrinsic values. We then hold them until they return to their intrinsic values in the long term.
- **Margin of Safety:** The margin of safety is the essence of valuation. Since the estimates of intrinsic value involve subjective assessments, there is a possibility of being overly optimistic. The margin of safety provides a cushion by adjusting the optimism from the forecast. Say, for example, your estimate of intrinsic value is Rs 100. Taking into consideration a margin of safety of 20%, you can adjust the value to Rs 80. This will ensure that you do not overpay for any asset.
- **Investment Horizon:** Value investing works in the long term because that is when prices return to their intrinsic value. Value investing does not aim to predict what stock prices will do 2 days or 2 months from now. Instead, it aims to pick undervalued businesses that will outperform in the long term. This will eventually reflect in the stock price.



# Warren Buffet's Four Filter Approach to Value Investing

## Step 1: Identifying Circle of Competence

This comprises of identifying all the businesses that you are familiar with and thoroughly understand.

For value investors, it is important to invest only in businesses that they understand. Value investors must focus solely on areas of business where they believe they have an edge over the average investor.

Likewise, staying away from what you don't understand is equally important.

## Step 2: A Moat to Protect Your Castle

If we look at the castles, there is a deep moat all around. This moat was typically filled with water and crocodiles or other predatory reptiles to keep the attackers/enemies away. In value investing too, you should look to protect your castle.

In simple words, you should look for companies with a sustainable competitive advantage. The larger the advantage, the wider the moat. This moat would protect the business from the competition.

And if the company is able to use its competitive advantage to widen the moat over time, then it is the perfect business to be in.

Companies that have a wide moat are able to earn higher returns for its shareholders. They are able to do so consistently year after year, every year. This in turn propels its projected stock value.

## Step 3: Able and Trustworthy Management

Perhaps among the various factors that need to be looked at before investing in a company, management is the most important. Able and trustworthy management means that management consistently demonstrates competence and works in the interest of shareholders.

There are three main factors in assessing management:

- The results of the company
- The treatment of the company's shareholders
- How well it allocates capital

## Step 4: A Sensible Price Tag

Finally, a sensible price tag for stock selection is nothing more than having a margin of safety that we discussed earlier. It consists of valuing the company's true market value per share by various valuation methods.



## CHAPTER 2

# POWER OF COMPOUNDING





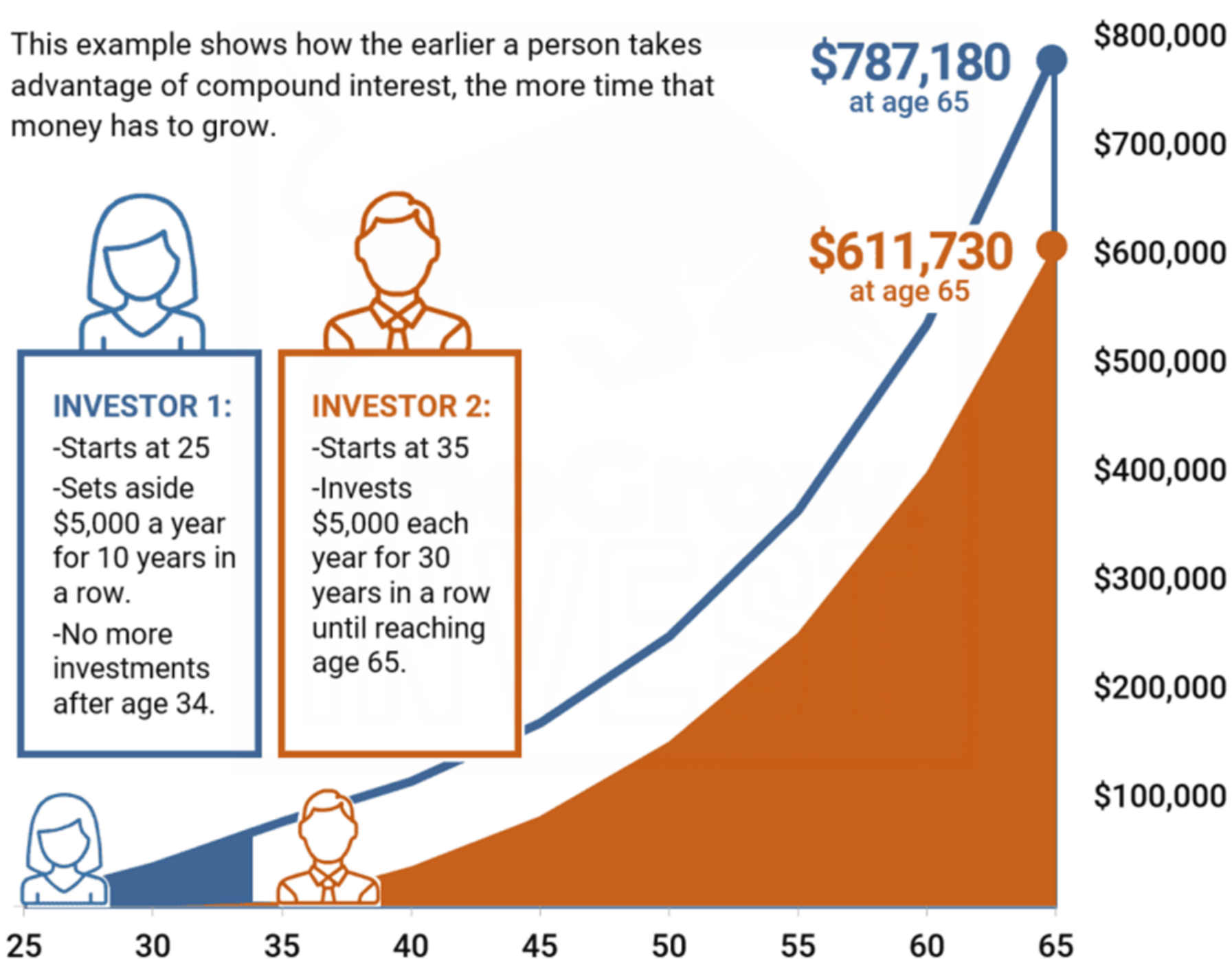
# Understanding the power of compounding

Albert Einstein was the more genius person ever to live on this planet. He was asked about compounding, and he said that compounding actually is the eighth wonder of this world. So according to him the most powerful thing, the strangest thing which people see in their life, but still, they don't know how strange it is and what is the significance of this thing is that the compounding can make even a beggar a millionaire over a period of 20 to 30 years if he keeps investing his savings regularly and he does not touch that amount for the next 30 years. So, this is the power of compounding. We generally ignore this power of compounding, and we do all the expenses in our life as we spend money on luxury things, we spend money on unnecessary things, and we spend it all. We do not save money. Even if we save money, we keep it in a savings bank account.



## COMPOUND INTEREST: WHO WILL EARN MORE?

This example shows how the earlier a person takes advantage of compound interest, the more time that money has to grow.

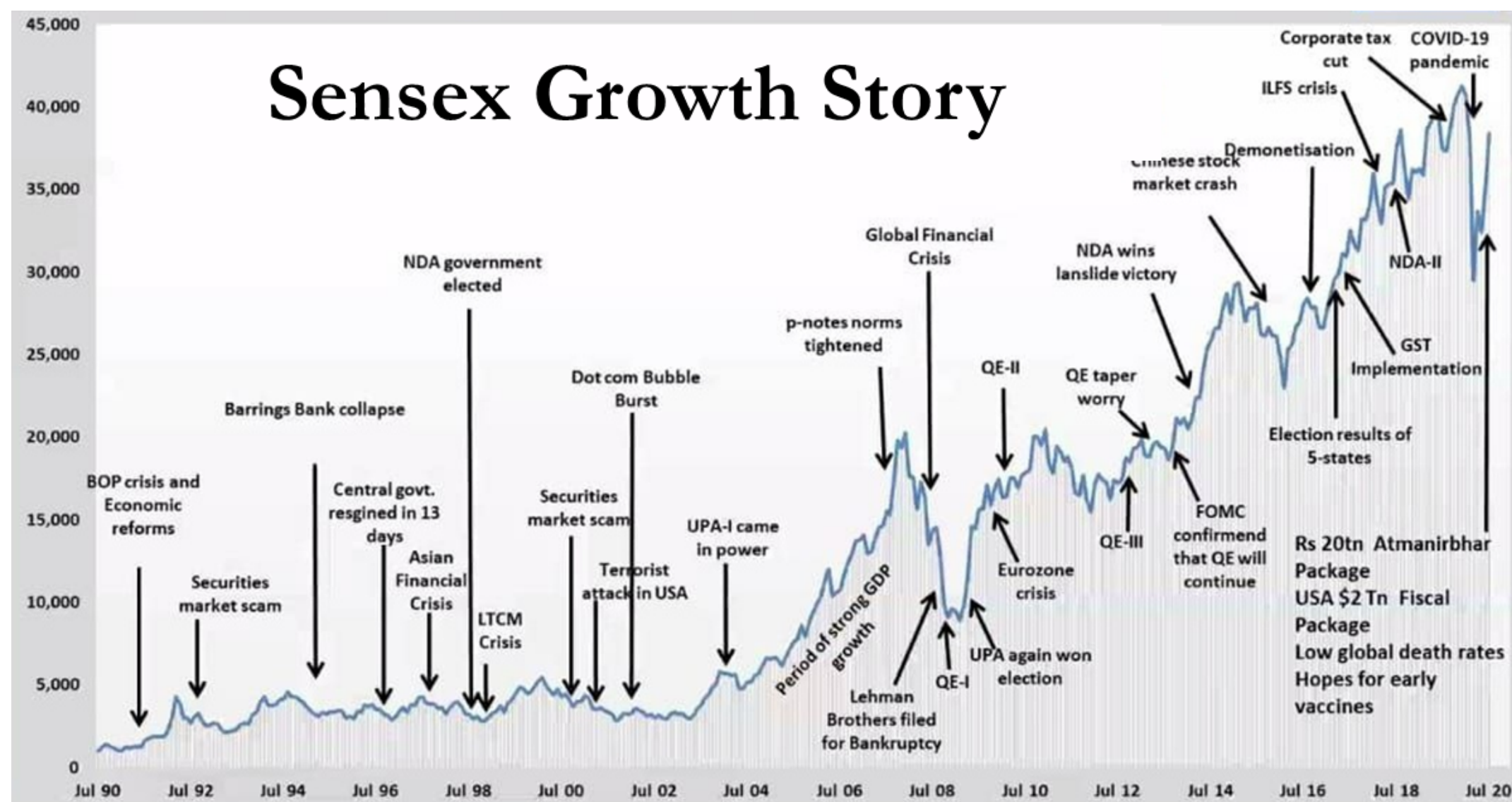


NOTES: Assumes an 8 percent interest rate, compounded annually. Balances shown are approximate.

When the interest rate is low compounding works gradually, but if the interest rate is high, that compounding works like a fire. If you have invested some amount at the higher rate of interest, and the compounding works there, then if you're not withdrawing the amount and you just keep depositing amount every month or every six months like that, and if you're compounding is really at a very high-interest rate the expected rate of return which is maybe 12% or 15% or 20% like that, then then, in that case, you will see that even in 20 years or 25 years, your sum of funds will become a massive one. And you can become a millionaire in a period of 20 years even if you are not doing any extraordinary things but just keeping your savings in a fund where you are getting interest equivalent to 20% or even 15% but that is being compounded year after year.. And sometimes compounding principle allows frequency even on the monthly basis means every month compounding is happening.



So, if the interest rate is high, and compounding is having frequency like every month, or it is exponentially like every second compounding is happening then that fund is going very fast. And in that case, your return will also be very high. And this is the power of compounding. So, as I said earlier, compounding of interest rate in our principal amount may lead to an amount which will become 100 times also if the interest rate is very high and compounding is very frequent like a per month. We need to be careful when we're doing a recurring deposit. You can choose the bank which will give you a fixed rate of interest rate of 8 to 10%. I think and, in that case, you can also choose index funds or some reliable business-related fund where you can trust and that is giving you a higher interest rate like 10-15% like that. And then you can make rapid growth in your income in the following years, and you can become a millionaire by just saving and investing.



*The past 20 years have given a 12–14% CAGR return in Sensex, one may expect a similar return in the next 20 years in the Indian equity market. If you have invested INR1 lakh in the Sensex at the time of inception, your money will grow more than INR4 crore today, this is the power of compounding in the equity market.*





On the last page, we have given you an example of Sensex, if you stayed invested in the indices since inception how much you already have earned. Let's not go to the past 40 years to calculate 17%+ returns compound growth. Let's take a past 10-year horizon, Sensex has given you a CAGR of Sensex has been over 10%. Please stop lessoning market gurus, those who told you to invest in the indices through SIP (Systematic Investment Plan). Yes, I agree your return will be higher as compared to investment in Fixed Deposit (6.5-7%). However, investing in the market you will be exposed to market risk, hence you should expect a return of more than 15%.

When you plan to invest in the indices as SIP, then consider the time horizon should be more than 20 years. For a long period of time (> 20 years), you would negate the volatility of the market, which means within your investment horizon you must go through two to three economic cycles (recession and bull run). In this case, your SIP will give you a significant return.

What if you do not have time to seat on your investment for more than 20 years. If you want to make a 20-30% return annually reduce the time horizon to less than 5-10 years. Then you need to identify the stocks which give you multi-bagger returns and create a multi-bagger portfolio. Let's see some of the multi-bagger stocks in the past.

#### Bajaj Finance Ltd

₹5,725.05 ↑334.44% +4,407.25 5Y

May 19, 3:59:48 PM UTC+5:30 · INR · NSE · Disclaimer

1D 5D 1M 6M YTD 1Y 5Y MAX



#### Havells India Ltd

₹1,215.00 ↑156.71% +741.70 5Y

May 19, 3:55:42 PM UTC+5:30 · INR · NSE · Disclaimer

1D 5D 1M 6M YTD 1Y 5Y MAX



#### Torrent Pharmaceuticals Ltd

₹2,599.90 ↑112.36% +1,375.60 5Y

May 19, 4:46:37 PM UTC+5:30 · INR · NSE · Disclaimer

1D 5D 1M 6M YTD 1Y 5Y MAX

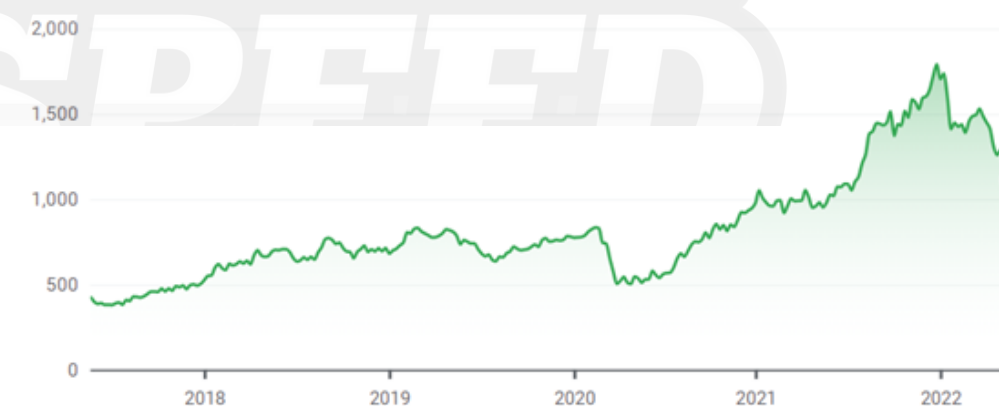


#### Tech Mahindra Ltd

₹1,113.00 ↑159.35% +683.85 5Y

May 19, 3:59:52 PM UTC+5:30 · INR · NSE · Disclaimer

1D 5D 1M 6M YTD 1Y 5Y MAX



#### Berger Paints India Ltd

₹628.90 ↑143.76% +370.90 5Y

May 19, 4:46:35 PM UTC+5:30 · INR · NSE · Disclaimer

1D 5D 1M 6M YTD 1Y 5Y MAX



#### Pidilite Industries Limited

₹2,115.00 ↑176.31% +1,349.55 5Y

May 19, 3:59:47 PM UTC+5:30 · INR · NSE · Disclaimer

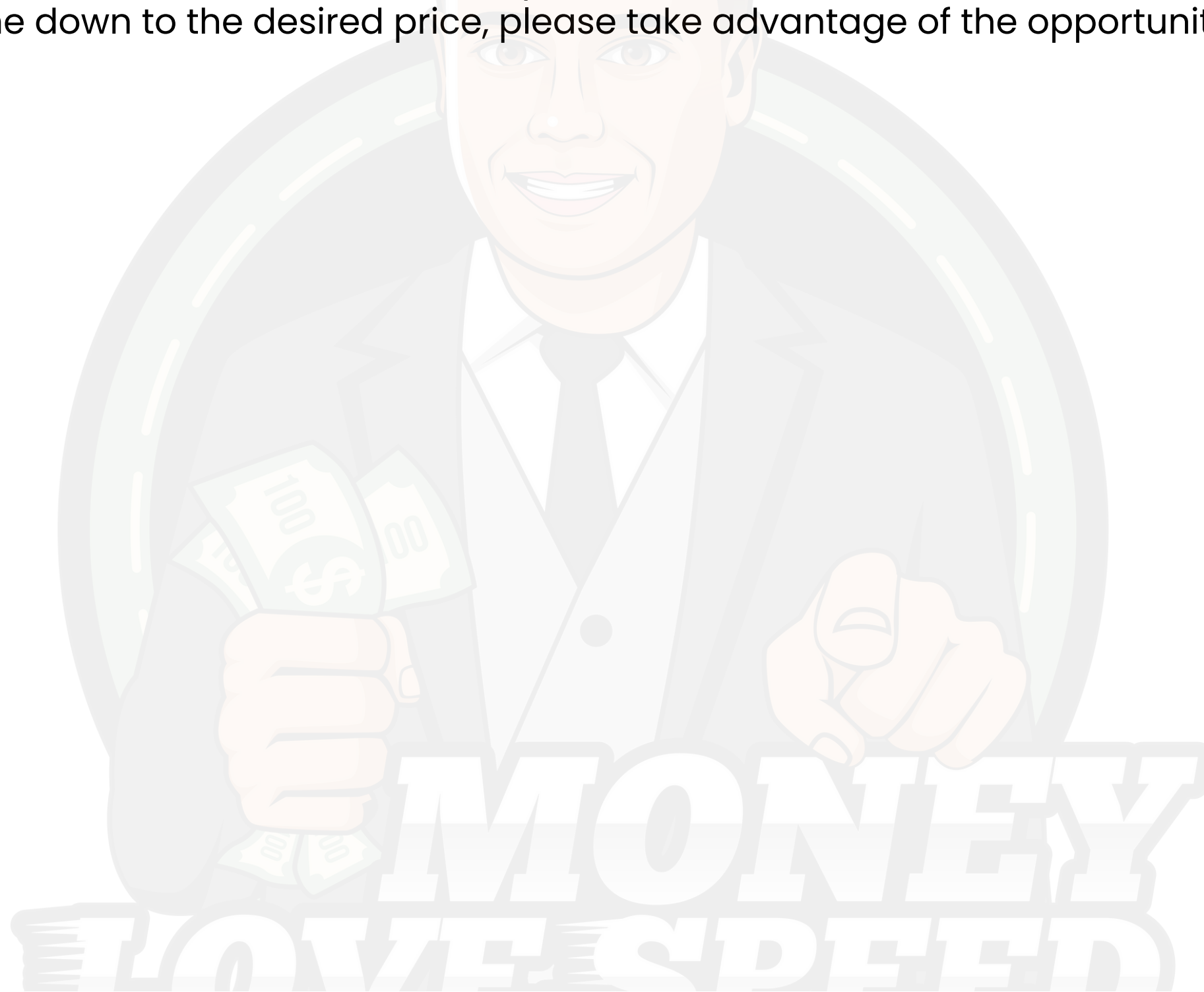
1D 5D 1M 6M YTD 1Y 5Y MAX





On the last page, we have provided you with some of the stocks that had given you multifold returns in the last 5 years. If you had invested in the portfolio with these stocks, you should have booked staggering profit without taking a significant risk (investing in penny stocks) in your portfolio. In the year 2022, you have the same opportunity to identify the next multi-bagger stocks and build your own portfolio. Therefore, I request you to read the entire book and join the workshop, where we will disclose how to identify the next multi-bagger stocks and build your own portfolio based on your risk appetite. Stock market investing is a life skill, learn Value Investing and Growth Investing strategies seriously. If you master these skills, you can make a significant amount of money investing in the Indian Stock Market and lead a lifestyle of Financial Freedom.

If you're ready to invest and don't need the money for at least five years, then yes, jump in. This is a great time to invest with the backdrop of the Russian-Ukraine Crisis, 2022 is off to a rocky start. With the increase in energy prices causing inflation to record high, the ongoing pandemic and interest rate increases have all caused volatility in the market. Some of the stocks' valuations come down to the desired price, please take advantage of the opportunity now.



# DIFFERENT TYPES OF EQUITY CLASS





# What are the Asset Classes to invest in India?

In India, an individual can invest in **Fixed income assets:**

- Bonds
- Fixed income funds
- Bank Fixed deposits
- Recurring deposits in Banks and post office
- National savings certificate
- Kishan Vikas Patras
- Monthly Income scheme (Banks/PO)
- Senior citizen schemes, multiple products for 60+ aged people

**Variable income assets:**

- Equity
- Commodities (nonmetal)
- Real estate
- Gold & Bullion
- Cash & cash equivalent
- Derivatives

## What is Fixed Income Security?

Fixed income is a class of assets and securities that pay out pre-committed funds to the investors, typically in the form of fixed interest or dividends. Like Fixed deposits, Bonds. At maturity, investors are repaid the principal amount they had invested in addition to the interest they have received. Government and corporate bonds are the most common types of fixed-income products. Like Infrastructure bonds. In the event of a company's bankruptcy, fixed-income investors are getting priority over equity investors.

## What is Equity?

Equity typically referred to as shareholders' right over the company's return, represents the amount of money that would be returned to a company's shareholders if all of the company's assets were liquidated and all of the company's debt was paid off in the case of liquidation. In simple terms, the stocks of companies that are traded in the stock market are known as equity which an investor can buy to be the equity holder of the company.

## What is BlueChip Stocks?

Blue-chip stocks are shares of very large and well-recognized companies with a long history of sound financial performance. These stocks are known to have the capabilities to endure tough market conditions and give high returns in good market conditions.

Blue-chip stocks generally cost high, as they have a good reputation and are often market leaders in their respective industries. Oliver Gingold, who worked at Dow Jones, coined the phrase 'Blue Chip' in 1923. Since then, the term has been used to refer to highly-priced stocks, but now it is used more commonly to refer to high-quality stocks. These are stocks that generally deliver superior returns in the long run. Connection with Casino: Some people also relate blue-chip stocks to blue betting disks in the game of poker, where the blue disk has the highest value while the white one has the lowest.



How to select blue-chip stocks: Several parameters can be considered to identify blue-chip companies

- Consistent annual revenue over a long period,
- Stable debt-to-equity ratio,
- Average return on equity (RoE)
- Interest coverage ratio besides market capitalization
- Price-to-earnings ratio (PE) As per Market capitalization,

India's leading blue-chip companies today are State Bank of India (SBI), Bharti Airtel, Tata Consultancy Services (TCS), Coal India, Reliance Industries, HDFC Bank, ONGC, ITC, Sun Pharma, GAIL (India), Infosys, and ICICI Bank.

## What is Growth Stock?

When it comes to stocks, "growth" means that the company has substantial room for capital appreciation. These tend to be newer and smaller-cap companies, and/or those in growth sectors like technology or biotech. Growth stocks may have low or even negative earnings, often making the high P/E stocks.

Investment in growth stocks can be risky. Because they typically do not offer dividends, the only opportunity an investor has to earn money on their investment is when they eventually sell their shares. If the company does not do well, investors take a loss on the stock when it's time to sell. Investors expect growth stocks to earn substantial capital gains as a result of strong growth in the underlying company. This expectation can result in these stocks appearing overvalued because of their generally high price-to-earnings (P/E) ratios.

## What is Dividend Stock?

Dividend stocks distribute a portion of the company's earnings to investors on a regular basis. Most Indian dividend stocks pay investors a set amount either in a year or in half a year, and the top ones increase their payouts over time, so investors can build an annuity-like cash stream. (Investors can also choose to reinvest dividends if they don't need the stream of income).

Companies that pay dividends tend to be well-established, so dividend stocks may also add some stability to your portfolio. so, these dividend-paying stocks are low-risk investments.

## How are Dividends paid?

Usually, dividends are paid out on a company's common stock. There are several types of dividends a company can choose to pay out to its shareholders. Cash dividends. The most common type of dividend. Companies generally pay these in cash directly into the shareholder's brokerage account. Stock dividends. Instead of paying cash, companies can also pay investors with additional shares of stock. Dividend reinvestment programs. Investors can also reinvest any dividends received back into the company's stock, often at a discount. Special dividends. These dividends payout on all shares of a company's common stock, but don't recur like regular dividends.



A company often issues a special dividend to distribute profits that have accumulated over several years and for which it has no immediate need. Preferred dividends. Payouts are issued to owners of preferred stock. Preferred stock is a type of stock that functions less like a stock and more like a bond. Dividends are usually paid quarterly, but unlike dividends on the common stock, dividends on preferred stock are generally fixed.

## What is Growth Stock?

Stocks that give returns that are several times their costs are called multi-baggers. These are essentially stocks that are undervalued and have strong fundamentals, thus presenting themselves as great investment options. Multi-bagger stock companies are strong on corporate governance and have businesses that are scalable within a short span of time. A stock that doubles its price is called a two-bagger while if the price grows 10-times, it would be called a 10-bagger. Thus, multi-baggers are stocks whose prices have risen multiple times their initial investment values.

## How do identify multi-bagger stocks?

1. The company's debt level should be within reasonable limits: There are no defined levels per se for debt, as it will vary from industry to industry. However, as a ballpark measure, debt should not be more than 30 percent of the equity value.
2. Check on previous quarter performance: Keep a check on the company's revenue multiples on a quarter-on-quarter basis. If the multiples are low but the company is performing at the operational level, then that can be a hint that the company has significant upside potential.
3. Sources of earnings: Along with the revenue numbers, check the sources from which the company is making money. Is the primary revenue segment set to grow at the macro level? Are the operations of the company easily scalable? If yes, then the stock may have the potential to be a multi-bagger.
4. Earnings and price multiples: Calculate the trailing 12-month EPS and revenue to arrive at the current PE and price /sales ratios. If the PE level is growing faster than the stock price, then its chances of being a multi-bagger are bright.
5. Check out the business model/capex/ structural/management changes: Be on the lookout for any major changes in the quarterly results/annual reports that could have a significant impact on the company's operations.

Checkout our workshop to learn the art of selecting multibagger stock. Click the link below:



MULTI -BAGGER

## CHAPTER 4

# INTRODUCTION TO FUNDAMENTAL ANALYSIS





# What are Annual/Quarterly Reports?

Annual/Quarterly Reports are statements that present an actual view of the financial performance of a company at the end of each financial year/quarter. It reflects all financial transactions taking place in an organization.

Generally, every public listed company published annual/quarterly reports on its website. Further, each listed company has to produce its annual/quarterly reports to the Stock exchanges if it is not published on the website. You can source annual reports directly from the website or download them from BSE/ NSE websites.



COVID-19 About Ambuja Products and Services Sustainability Investors Media Careers Contact us



About Us Products Markets CSR Investors Media Blogs Careers Contact Us

HOME ABOUT MARKET DATA INVEST LIST TRADE REGULATION LEARN RESOUR

<https://www.nseindia.com/companies-listing/corporate-filings-annual-reports>

Annual Reports

Equity SME

Company:

COMPANY	FROM YEAR	TO YEAR	ATTACHMENT
Tata Steel Bsl Limited	2020	2021	
Tata Steel Bsl Limited	2019	2020	
Tata Steel Bsl Limited	2018	2019	

Note

You can also download the annual/quarterly Ministry of corporate affairs <https://www.mca.gov.in/mcafoportal/viewPublicDocumentsFilter.do>

MCA Services

Home > MCA Services > Document Related Services > View Public Documents

**View Public Documents**

Company  LLP

Company Name :

Company CIN/FCRN :

Company Registration Number :

Country Of Origin :  India  Foreign

State :

# Why Financial Statement Analysis is important?

Financial Statement Analysis is one of the important processes of examining a company's performance in the context of its industry and economic environment in order to arrive at a decision on whether to buy/ sell / or hold your position. Reading Annual Reports is essential since they provide information about a company's informatics.

STAKEHOLDERS

- 01 Equity Investors
- 02 Regulators
- 03 Creditors
- 04 Competitors
- 05 Banks / Lenders
- 06 Credit Agency

One should look at key performance indicators in a company's financial statements before they make the decision to invest in the Company. In addition, financial statements are also scrutinized by creditors, regulators, credit agencies, external stakeholders, etc.



The main aim of the preparation of financial statements is to keep the owners, shareholders, management, government, and other interested parties informed of the actual financial standing of the company. It is, therefore, important that the financial statements are prepared very carefully by collecting all the relevant data.

## What are the Components of Financial Statements?

Financial Statements consist of an Income Statement, Balance Sheet, Cash Flow Statement, and Shareholders' Equity Statement. Each component serves a purpose and helps understand the business's financial affairs in a summarized fashion.



## Devil is in the Details

In addition to the aforementioned statement, the investor should look at the Management Discussion & Analysis section, Notes to Accounts, and Media Announcement section on the website. The Management's Discussion and Analysis (MD&A) is an important disclosure in an annual report because it summarizes the financials and relays management's insights into the company's performance. Notes to the financial statements disclose the detailed assumptions made by accountants when preparing a company's: income statement, balance sheet, statement of changes of financial position, or statement of retained earnings. The notes are essential to fully understanding these documents.

## Read 7 Sections in the Annual Report

Investors should always read the annual report if they're interested in investing in a company. Often, the most essential components of the annual report include:

### 1: Business Profile

Read the annual report to understand what are the products and services they are offering, what is the position of the company against its peers, what is the market position in the industry. We should never invest in a stock without knowing this information. The Company Profile section provides a basic summary of the company. It includes a description of the company, the year it was founded, industry, verticals, the number of employees, and other information.

### 2: Growth Forecast

Our goal is to identify what are the growth prospects of the company not only in the past performance but in upcoming years. Also identify what are the sources of its growth, and how sustainable is that growth likely to be? Looking at the MD&A section you can identify the quality of



the growth. High-quality growth comes from increasing market share either by launching new products, venturing into new geographies, or through acquisitions. The goal is simply to know, how a company is growing.

### **3: Selected Financial Data**

You get information on segment-wise performance in the last two years, key raw materials consumed, etc. Some companies publish financial highlights of 5 to 10 years in annual reports. You will get to analyze the trend of revenue, earnings before interest, tax, depreciation and amortization (EBITDA), profit after tax (PAT/Net income/loss) from the income (profit and loss) statement and also get a glimpse of shareholders equity, assets, debtors, liability and total debt from balance sheet over the years. Important ratios are also presented in charts over a 5 to 7 years timeline. We will discuss more in the next chapter.

### **4: Risks & Mitigants**

Learn about the types of financial risks the company could face, and how they manage the risk. There will always be risks involved with running a company. Risk in business comes in many forms, including, financials, competition, economics, reputational, legal, natural disasters, etc. In the annual report, you may get the risk and mitigants section, where the company provides a write-up on business risk. The goal is simply to know, what type of risk the company is exposed to, and your investment gets affected.

### **5: Notes to Accounts**

Accounts Note of financial statements consists of details related to the information mentioned in the main body of financial statements. These notes (or footnotes) inform of important accounting policies, company's commitments, breakdown of sales, breakdown of purchases, details of assets and liabilities, potential profits and losses, etc. The information provided by notes to accounts is critical for concisely understanding and evaluating the financial statements of the company. Investors who only focus on the main body of financial statements as well as notes to accounts.

### **6: Corporate Governance**

Corporate governance is the structure of rules, practices, and processes used to direct and manage a company. Read the key management personal qualification and experience, company's board of directors, Auditors reports, changes in accounting standards, etc. The basic principles of corporate governance are accountability, transparency, fairness, and responsibility. Investors should invest in companies with a good record of corporate governance in place.

### **7: Corporate Governance**

In the management discussion and analysis (MD&A) section of the annual report, management provides commentary on financial statements, systems and controls, compliance with laws and regulations, and actions it has planned or has taken to address any challenges the company is facing. Management also discusses the upcoming year by outlining future goals and approaches to new projects. The MD&A is an important source of information for analysts and investors who want to review the company's financial fundamentals and management performance.



### 1. Business Profile

- History
- Products or services
- Market position
- Mission Statements
- Numbers of Employees
- Key Shareholders
- Prospects

### 4. Risks & Mitigants

- Market / Liquidity risk
- Competition risk
- Reputation risk
- Leverage risk
- Credit risk
- Supplier risk
- Legal Risk

### 2. Growth Forecast

- Growth Story
- Future Growth Plans
- Inorganic vs Organic
- High-quality vs low-quality growth
- Cost management
- Vision Statements
- Key Geographies

### 5. Notes to Accounts

- Ledgers
- Off-balance sheets items
- One-off expenses/ write-offs
- Contingencies and commitments
- Details items
- Intercompany Transaction
- Management Salaries

### 3. Financial Data

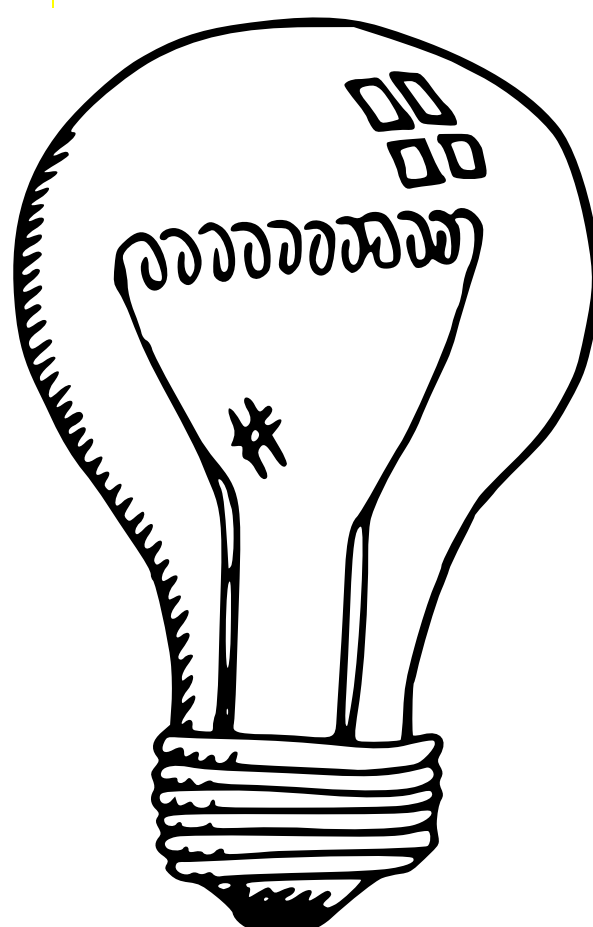
- Revenue Growth
- Operating and net performance
- Cash Flow Statement
- Vertical analysis
- Shareholder Equity
- Balance sheet
- Ratio Analysis

### 6. Corporate Governance

- Independent Auditor
- Top Management Experience
- Audit Report
- Frequency of Audit Committee
- Internal Audit Report
- Parks of top management
- Management qualification

### 7. Management Discussion and Analysis (MD&A)

- YoY Performance Commentary
- Future Growth Prospects
- Expansion Planning
- Mission and Vision Statements
- Objective achievements
- Key points discussed
- Prospects



# HOW TO READ BALANCE SHEET

Monthly Budget

Category	Projected Cost	Actual Cost	Difference
HOUSING			
Mortgage or rent	€ 1,500.00	€ 1,400.00	€ 100.00
Phone	€ 60.00	€ 100.00	€ (40.00)
Electricity	€ 50.00	€ 60.00	€ (10.00)
Gas	€ 200.00	€ 180.00	€ 20.00
Water and sewer	€ 50.00	€ 48.00	€ 2.00
Cable			
Waste removal			
Repairs			

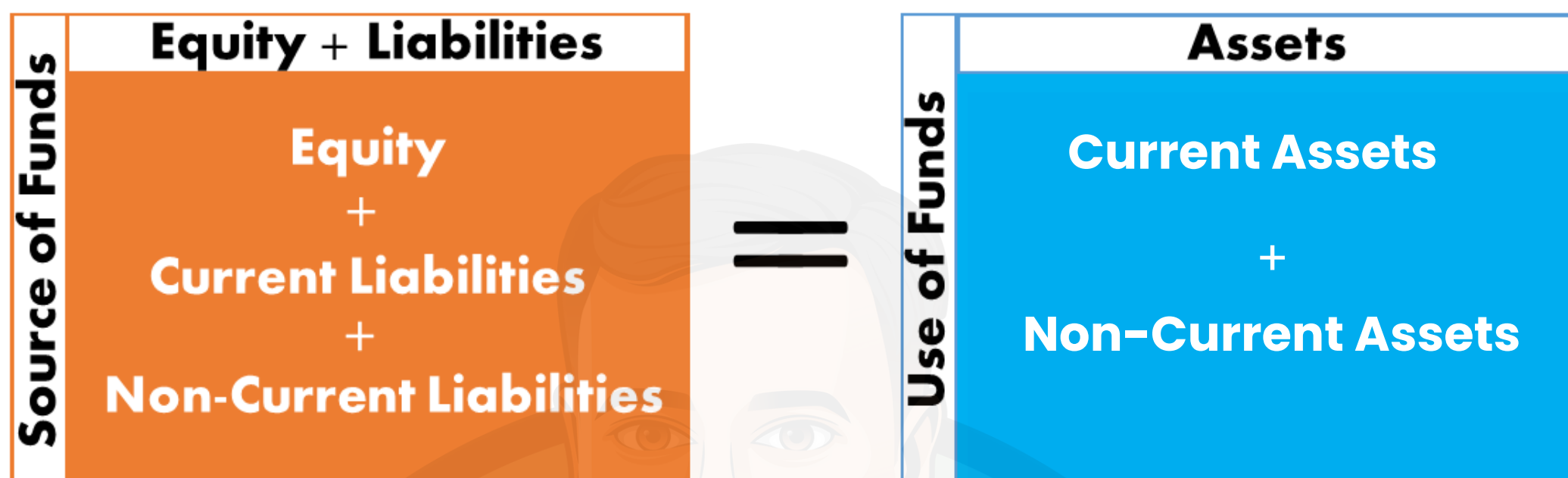
  

Category	Income 1	Extra income	Total monthly income
ED MONTHLY INCOME	€ 2,500.00	€ 500.00	€ 3,000.00
AL MONTHLY INCOME	€ 2,500.00	€ 500.00	€ 3,000.00



# How to read the Balance Sheet Statement?

The balance sheet summarizes a company's financial position at a point in time. It has four major sections – assets, liabilities, shareholder's equity, and notes. To read a balance sheet, you need to understand its different elements and what the reported figures tell you about the health of your business.



The balance sheet becomes a crucial statement to understand and analyze to determine if an organization is in good shape or struggling. Let us understand the component of the balance sheet:

## Understand Current Assets

Current assets are items of value owned by your business that will be converted into cash within one year. Current assets include:

- **Accounts receivable:** these are short-term payments owed to your business, for example, outstanding invoices your clients will pay soon
- **Inventory:** for businesses that sell physical products, inventory includes finished products, in-progress products, and raw materials
- **Cash:** includes checks, hard currency, and unrestricted bank accounts

## Look at Non-Current Assets

Non-current assets are assets that can't be converted to cash easily and won't be converted within the next year. Non-current assets include both tangible and intangible assets.

- **Tangible Assets:** Include items such as property, machinery and equipment like computers and printers
- **Intangible Assets:** Are assets that aren't physical by nature and include goodwill, copyrights and patents.

Most non-current assets reported on a balance sheet are calculated with depreciation, which refers to the cost of the asset over its useful lifespan.

## Scrutinize Liabilities Side

Next in reading a balance sheet, you'll need to understand the business's liabilities. Liabilities are the financial obligations the business owes to someone else. Liabilities are divided into two types:

- **Current Liabilities:** These are short-term liabilities that must be paid within a year, including accounts payable, payroll, and current payments toward long-term debts.
- **Long-Term Liabilities:** These include debts, loans, and other financial obligations due in more than a year from the date reported on the balance sheet.



# Understand Shareholders Equity

Next on the balance sheet, you'll need to understand shareholders' equity. Shareholders equity refers to a business's total net worth. It includes the initial sum of money an owner invests in the company. If a business reinvests its net earnings into the company at the end of the year, those retained earnings are reported on the balance sheet under shareholders' equity.

- **Reserves & Surplus:** Net profit/loss is moved each year from the income statement into the balance sheet under the head 'Reserves & Surplus'. This is also shareholder's money, which they chose to keep in the company and reinvest in the business. While equity may be called contributed capital, reserves and surplus are called retained capital.
- **Share premium reserve:** Shares premium is the excess of the issue price and the par price.
- **Revaluation reserve:** A revaluation reserve is a non-cash reserve created to reflect the true value of the asset when the market value of a certain category of asset is more or less than the value of such asset at which it is recorded in the books of account. This reserve's purpose is to reflect and account for in the books, the real and fair value of an asset.
- **Treasury stock:** Treasury stock, or reacquired stock, is the previously issued, outstanding shares of stock that a company repurchased or bought back from shareholders. The reacquired shares are then held by the company for its own disposition. They can either remain in the company's possession to be sold in the future, or the business can retire the shares and they will be permanently out of market circulation.

Balance Sheet				
As of December 31, 20XX				
<b>Owner's Equity</b>			<b>Fixed Assets</b>	
Retained Earnings	4,009		Property, Plant and Equipment	2,019
Common Stock and paid-up capital	194		Accumulated Deprecation	-664
<b>Total Shareholder's Equity (A)</b>		<b>4,203</b>	Furniture and Fixture	349
<b>Liabilities</b>			<b>Current Asset</b>	
Account Payable	625		Cash	481
Current Portion of Long-term debt	1,021		Marketable Securities	1,346
Tax Payable	36		Account Receivable	1,677
Accrued Expenses	157		Inventories	2,936
<b>Total Current Liabilities (B)</b>		<b>1,839</b>	Prepaid Expenses	172
Long-term Debt (C)		2,332	Other Current Assets	58
			<b>Total Current Asset (B)</b>	<b>6,670</b>
<b>Total Liabilities (A + B + C)</b>		<b>8,374</b>	<b>Total Assets</b>	<b>8,374</b>

$$\text{Liabilities} + \text{Capital} = \text{Assets}$$



# Let's look at the Ambuja Cements Limited Balance sheet

## BALANCE SHEET as at 31st December 2021

Particulars	Notes	As at 31st December 2021 ₹ in crore	As at 31st December 2020 ₹ in crore
<b>ASSETS</b>			
<b>1 Non-current assets</b>			
a) Property, plant and equipment	4	7,128.30	5,382.88
b) Right-of-use assets	5	343.26	373.98
c) Capital work-in-progress (Refer Note 4(g))		951.32	1,873.74
d) Goodwill	6	-	-
e) Other intangible assets	7	174.15	174.64
f) Investments in subsidiaries and joint venture	9	11,787.71	11,787.71
g) Financial assets			
i) Investments	10	9.20	4.50
ii) Loans	11	1.52	0.94
iii) Other financial assets	12	338.79	613.33
h) Non-current tax assets (net) (Refer Note 30)		118.58	152.19
i) Other non-current assets	13	545.94	686.66
<b>Total - Non-current assets</b>		<b>21,398.77</b>	<b>21,050.57</b>
<b>2 Current assets</b>			
a) Inventories	14	1,463.57	746.61
b) Financial assets			
i) Trade receivables	15	293.17	191.51
ii) Cash and cash equivalents	16	3,984.70	2,716.91
iii) Bank balances other than cash and cash equivalents	17	178.37	207.43
iv) Loans	18	4.76	4.43
v) Other financial assets	19	204.89	78.82
c) Other current assets	20	620.46	460.35
		<b>6,749.92</b>	<b>4,406.06</b>
d) Non-current assets classified as held for sale	21	24.75	24.75
<b>Total - Current assets</b>		<b>6,774.67</b>	<b>4,430.81</b>
<b>TOTAL - ASSETS</b>		<b>28,173.44</b>	<b>25,481.38</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity</b>			
a) Equity share capital	22	397.13	397.13
b) Other equity	25	21,810.13	19,918.73
<b>Total Equity</b>		<b>22,207.26</b>	<b>20,315.86</b>
<b>Liabilities</b>			
<b>1 Non-current liabilities</b>			
a) Financial liabilities			
i) Borrowings	26	43.50	43.60
ii) Lease liability	27	261.15	296.64
iii) Other financial liabilities	28	0.13	0.13
b) Provisions	29	65.12	55.62
c) Deferred tax liabilities (net)	30	201.79	185.95
d) Other non-current liabilities	32	36.74	40.05
<b>Total - Non-current liabilities</b>		<b>608.43</b>	<b>621.99</b>
<b>2 Current liabilities</b>			
a) Financial liabilities			
i) Trade payables			
Total outstanding dues of micro and small enterprises	33	7.57	2.46
Total outstanding dues of creditors other than micro and small enterprises		1,136.83	878.44
ii) Lease liability (Refer Note 52)		42.90	27.88
iii) Other financial liabilities	34	879.24	737.77
b) Other current liabilities	35	2,040.12	1,911.97
c) Provisions	36	8.92	3.85
d) Current tax liabilities (net) (Refer Note 30)		1,242.17	981.16
<b>Total - Current liabilities</b>		<b>5,357.75</b>	<b>4,543.53</b>
<b>Total Liabilities</b>		<b>5,966.18</b>	<b>5,165.52</b>
<b>TOTAL - EQUITY AND LIABILITIES</b>		<b>28,173.44</b>	<b>25,481.38</b>

Use of Funds

Source of Funds

Let us analyze the balance of Ambuja Cement, first, we need to start with the source of funds. As we already discussed on the previous page, there are two types of sources of funds on the liability side of the balance sheet; Equity and External obligations (including Debt and liabilities).

1st Step: Compared two years' balance sheet, look at any change in the source of funds (total equity + Liabilities sides). Check whether it is increased or decreased as compared to previous year.

**In the Ambuja Cement case, the total liability side had increased by INR2.69cr as compared to last year.**

Total Liabilities	5,966.18	5,165.52
<b>TOTAL - EQUITY AND LIABILITIES</b>	<b>28,173.44</b>	<b>25,481.38</b>

2nd Step: Identify how the total liabilities side had increased, is it from an internal source or external source. If it is the internal source, then the company must generate a good net profit. If it is an external source, check what is the external source, is it debt or increase in creditors, or current liabilities.

**Now look at the example of Ambuja Cement, total equity had increased, which means the company had either issued new shares or increased retained earnings. In this case, retained earnings had increased (check the previous page), which is a good sign. Non-current liabilities had decreased due to repayment of lease liability a form of external debt (note 27).**



<b>Total Equity</b>	<b>22,207.26</b>	<b>20,315.86</b>
<b>Total - Non-current liabilities</b>	<b>608.43</b>	<b>621.99</b>
<b>Total - Current liabilities</b>	<b>5,357.75</b>	<b>4,543.53</b>

**Total current liabilities had increased by INR0.8cr, we need to look at each component. Check the notes to accounts if you find any unnatural movement in numbers. In the Ambuja cement case the movement is negligible.**

<b>2 Current liabilities</b>		
a) Financial liabilities		
i) Trade payables		
Total outstanding dues of micro and small enterprises	33	7.57
Total outstanding dues of creditors other than micro and small enterprises		1,136.83
ii) Lease liability (Refer Note 52)		42.90
ii) Other financial liabilities	34	879.24
b) Other current liabilities	35	2,040.12
		1,911.97

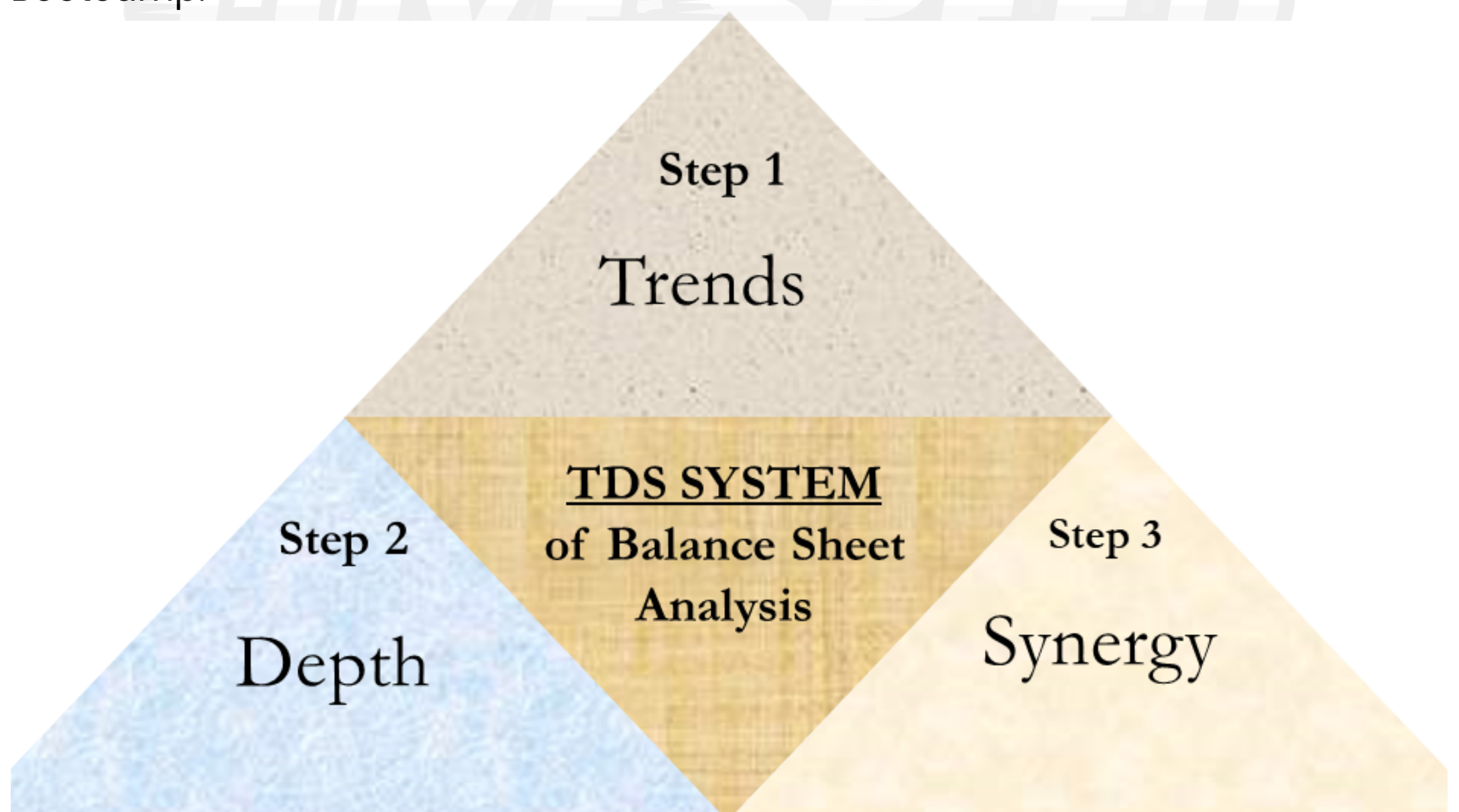
We have already analyzed what is the source of the fund on the liabilities side, we need to check at what is the use of the fund. Since the balance sheet is always balanced, we need to check how the company deployed the funds.

Step 3: If there is a change in the total liabilities side, there should be a change in the asset side also. Start with Non-current assets and then-current assets. Let's look at our example of Ambuja Cement:

*There is a marginal increase in non-current assets in the case of Ambuja cement, however current assets had increased significantly. Let's check in detail why current assets had increased. You need to go to the notes to accounts if you need to analyze it further. In this case, cash balance had increased which is also good sign of a company.*

<b>Total - Non-current assets</b>		<b>21,398.77</b>	<b>21,050.57</b>
<b>Total - Current assets</b>		<b>6,774.67</b>	<b>4,430.81</b>
<b>TOTAL - ASSETS</b>		<b>28,173.44</b>	<b>25,481.38</b>
a) Inventories	14	1,463.57	746.61
b) Financial assets			
i) Trade receivables	15	293.17	191.51
ii) Cash and cash equivalents	16	3,984.70	2,716.91
iii) Bank balances other than cash and cash equivalents	17	178.37	207.43
iv) Loans	18	4.76	4.43
v) Other financial assets	19	204.89	78.82
c) Other current assets	20	620.46	460.35
		<b>6,749.92</b>	<b>4,406.06</b>

We have created 3 Simple Steps to analyze the balance sheet, which we call the TDS System of Balance Sheet Analysis. We will, however, discuss two steps in this book. The third step we will discuss in our 5-day Live workshop. The third step is very critical and very dynamic in nature because you must correlate with Economic Industry Company (EIC) Framework; therefore, we'll discuss it in the Bootcamp.





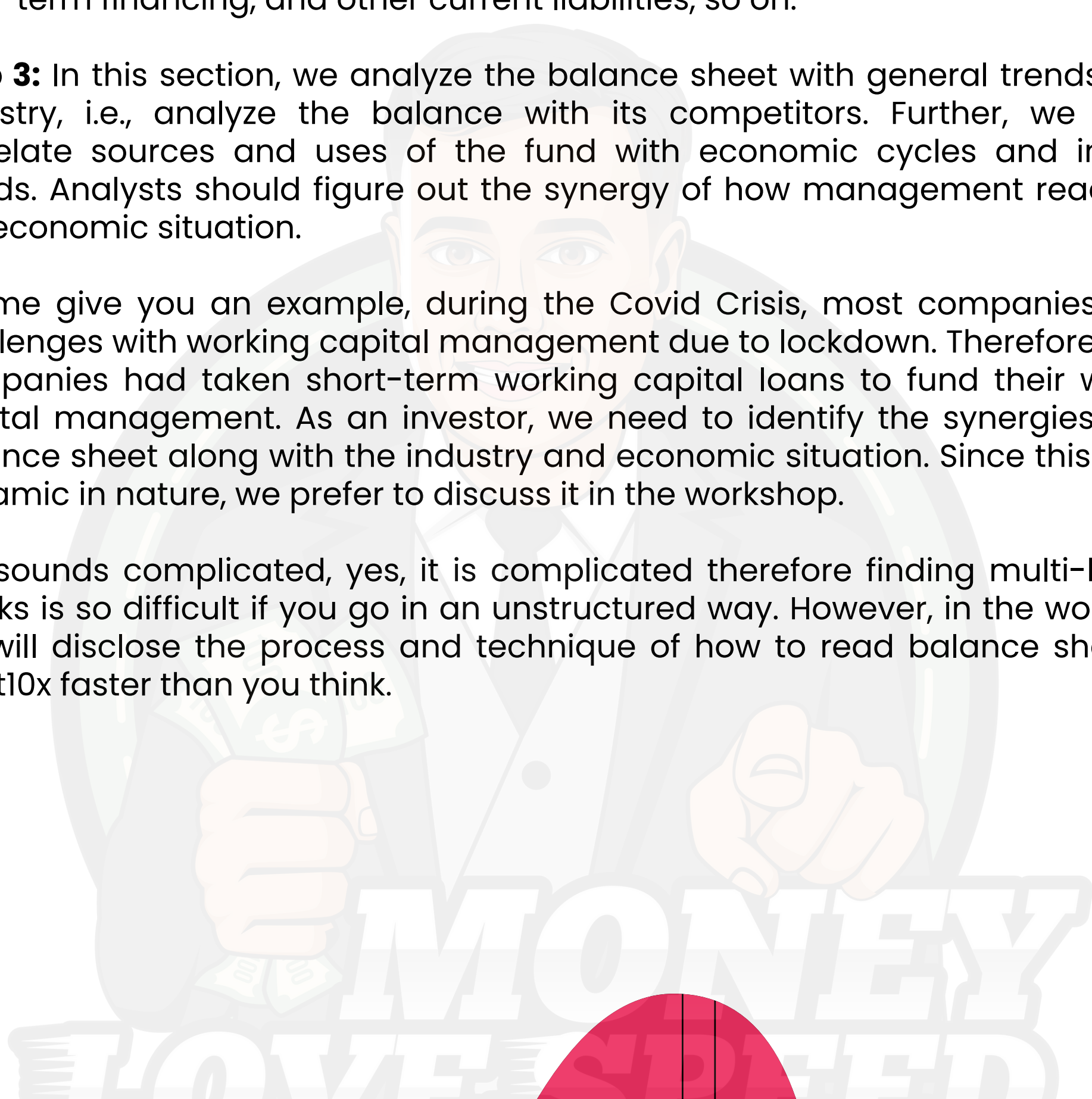
**Step 1:** The first step we have already discussed in the previous pages. Where you need to analyze historical trends of the balance. Take at least a five-year balance sheet and analyze the trend of its source of funds and usages of funds, you will get a fair idea of where the company is going. By looking at the balance sheet you will get to know whether it is a mature company or a growth company.

**Step 2:** The second step we will discuss in detail is our ratio analysis section. Here we will analyze the condition of the balance sheet, such as the leverage or gearing position, liquidity position, working capital cycles, quality of assets (intangible vs tangible), debt repayment capability, short-term financing vs long-term financing, and other current liabilities, so on.

**Step 3:** In this section, we analyze the balance sheet with general trends in the industry, i.e., analyze the balance with its competitors. Further, we should correlate sources and uses of the fund with economic cycles and industry trends. Analysts should figure out the synergy of how management reacted to the economic situation.

Let me give you an example, during the Covid Crisis, most companies faced challenges with working capital management due to lockdown. Therefore, many companies had taken short-term working capital loans to fund their working capital management. As an investor, we need to identify the synergies of the balance sheet along with the industry and economic situation. Since this step is dynamic in nature, we prefer to discuss it in the workshop.

If it sounds complicated, yes, it is complicated therefore finding multi-bagger stocks is so difficult if you go in an unstructured way. However, in the workshop, we will disclose the process and technique of how to read balance sheets at least 10x faster than you think.





**CHAPTER 6**

**INTRODUCTION**  
**INCOME**  
**STATEMENT**





## What is an Income Statement?

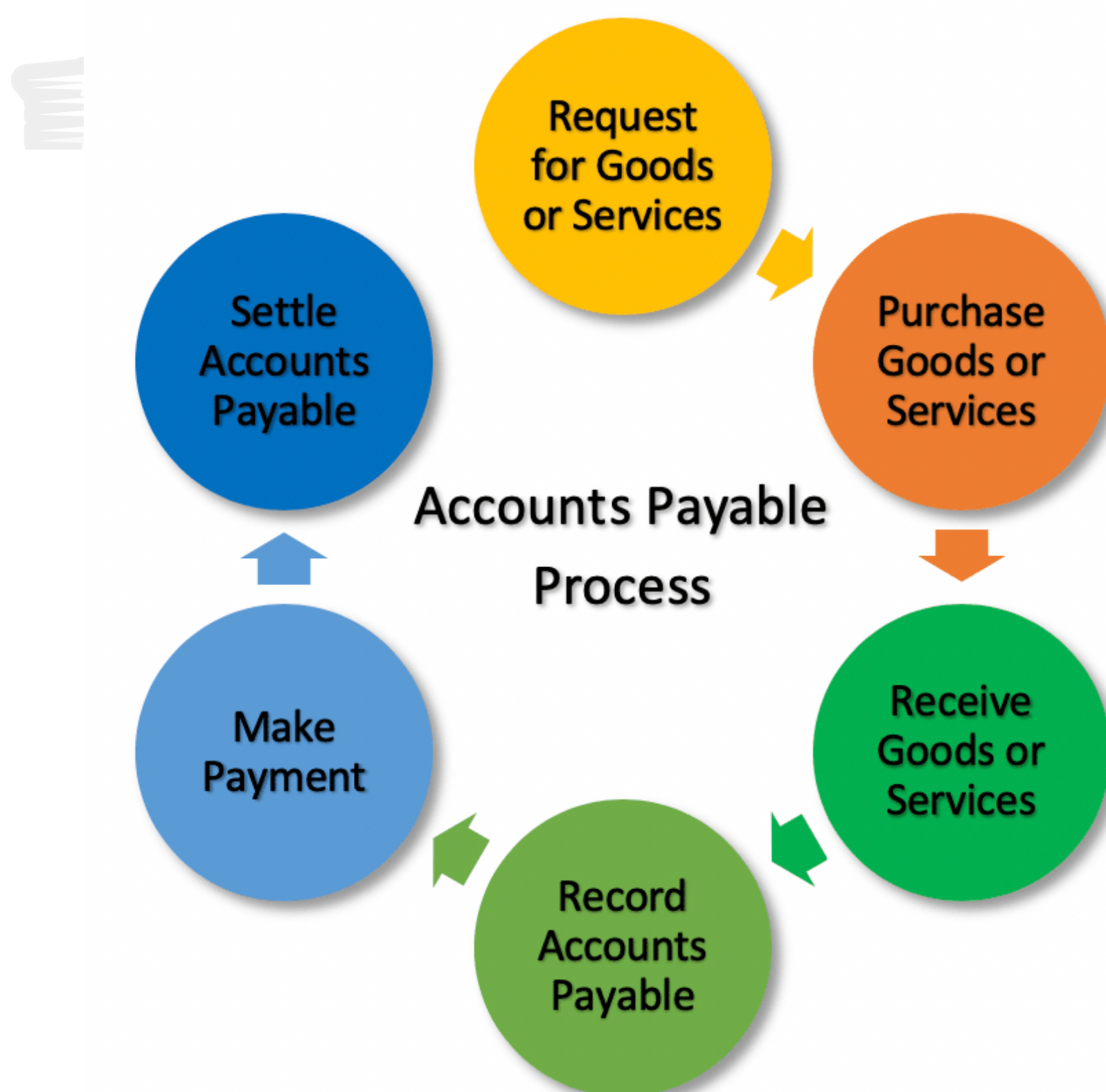
Income Statement summarizes all income and expenses over a given period, including the cumulative impact of revenue, gain, expense, and loss transactions. Income statements are often shared as quarterly and annual reports, showing financial trends and comparisons over time.

## How to read the Income Statement?

Your income statement is broken down into different line items. Some of those line items can be grouped together into categories, while others stand alone as categories of their own. Before we start analyzing the income statement, let us look at the different line items:

- Revenue: The amount of money a business takes in during a reporting period
- Expenses: The amount of money a business spends during a reporting period
- Costs of goods sold (COGS): The cost of component parts of what it takes to make whatever it is a business sells
- Gross profit: Total revenue less COGS
- Operating income: Gross profit less operating expenses
- Income before taxes: Operating income less non-operating expenses
- Net income: Income before taxes less taxes
- Earnings per share (EPS): Division of net income by the total number of outstanding shares
- Depreciation: The extent to which assets (for example, aging equipment) have lost value over time
- EBITDA: Earnings before interest, depreciation, taxes, and amortization

Try to analyze the income statement in terms of Direct and Indirect costs. Direct cost is often known as the cost of goods sold, which means to produce a product what are the costs are absolutely essential. Let's take an example of the manufacturer company of Pencil. A company needs to purchase raw materials, wages to pay its labor, Overhead costs, like utilities for the manufacturing site, shipping or freight costs, and other direct expenses like power or electricity. This type of direct expense is known as the cost of goods sold.





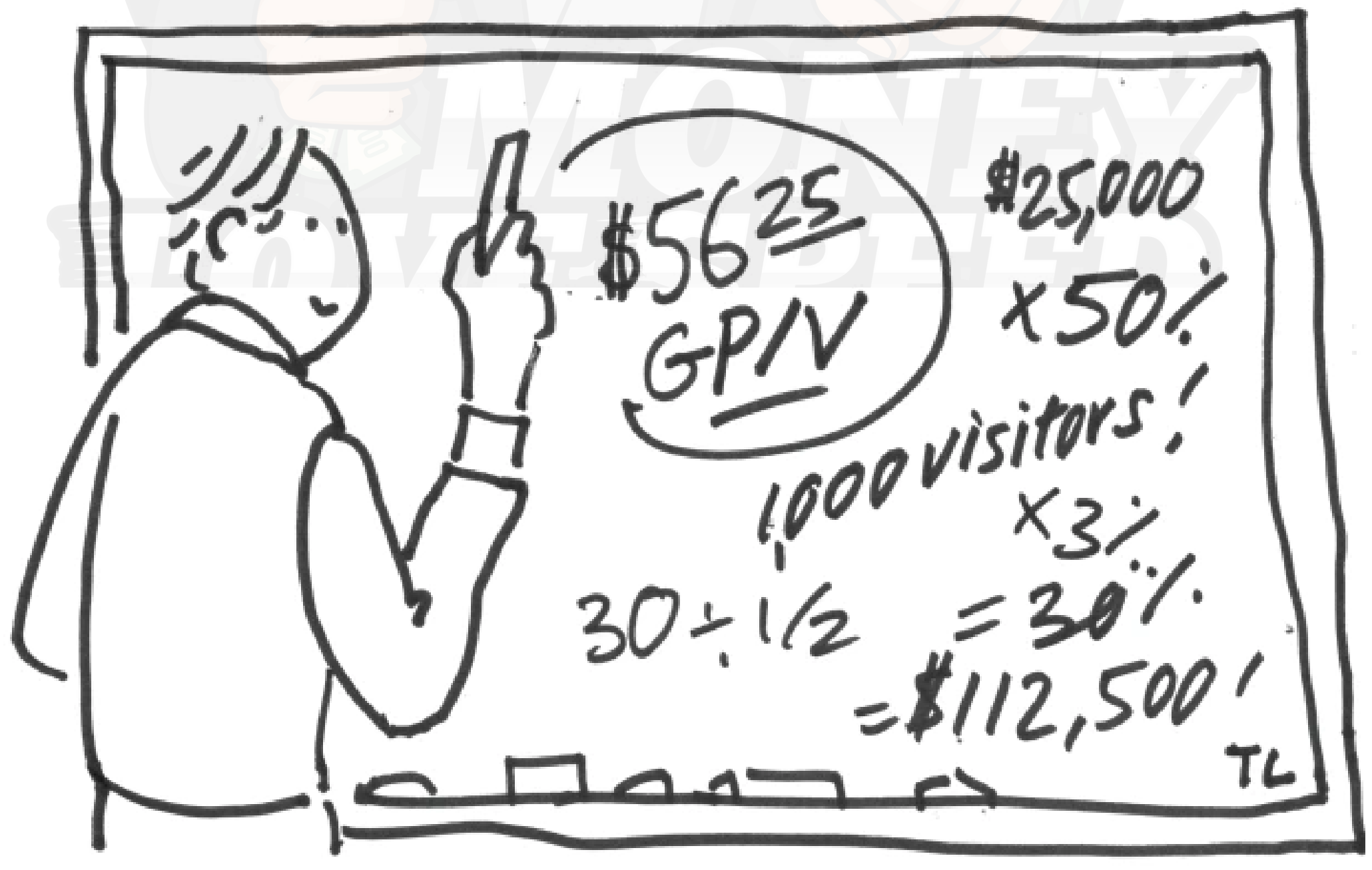
### Gross Profit = Revenue - Cost of Goods Sold

After gross profit, we have Operating profit. It is the total income a company generates from sales after paying off all operating expenses, such as rent, employee payroll, equipment, and inventory costs. Let's take a similar example of a pen manufacturing company, what should be its operating expenses, it may be rent for the office, employee expenses, marketing, payroll, insurance, step costs, and funds allocated for research and development. The company also records depreciation and amortization as operating expenses. Whenever a company purchases an asset, it is used for a long period of time, and hence, the company writes off the expenses over a period of time as a depreciation.

### Operating Profit = COGS - Other Day-to-Day Expenses

### EBITDA = Operating Income + Depreciation & Amortization

Non-operating expenses can be explained as those costs which are not related to a firm's core operations and are recorded in the income statement. These expenses are loan interest, accounting fees, currency fluctuation, gain/loss of sale of assets. After adjusting nonoperating expenses and taxes, the company calculates net profit and loss.





Many non-operating gains or losses are non-recurring, which leaves room for accounting manipulation. A company may record a high non-operating income to hide its poor performance on core operations. It may also manipulate its operating income by including gains incurred by activities unrelated to the core business. A sudden, substantial increase in profit could be caused by the inclusion of non-operating income

Therefore, an investor should scrutinize the financials report thoroughly and also analyze the quality of profit the company is reporting. Always check if the net profit increases due to an increase in sales or efficient cost management or recording one-off extraordinary incomes. Income such as a gain from the sale of assets, or provision written back or foreign currency gains, etc may increase the net profit for a particular period, however, this is not sustainable in long term. The investor should look at the company's net profit with skepticism if there is any abnormal growth due to extortionary items.

## Income Statement

For the Year 20xx

Sales	1,480	
Cost of Good Sold	600	
<b>Gross Profit</b>		<b>880</b>
Operating expenses		
Employee	100	
Selling and Marketing	120	
Adminstrative	83	
Depreciation	75	
<b>Operating Profit</b>		<b>502</b>
Non-Operating Expenses		
Interest expenses	122	
Unsal Gains (Sale of fixed assets)	-21	
Interest received	-45	
<b>Profit Before Tax</b>		<b>446</b>
Taxes		85
<b>Net Profit</b>		<b>361</b>

The net profit is either distributed to shareholders or is accumulated to reserve or surplus. Reserves and Surplus are all the cumulative amount of Retained earnings recorded as a part of the Shareholders' Equity and are earmarked by the company for specific purposes like buying fixed assets, payment for legal settlements, debts repayments, payment of dividends, etc.

Higher net profit increases the shareholder wealth, so an investor should look at the company with a healthy bottom line (net profit). Higher the net profit, the higher the shareholder wealth so the higher the share price. If an investor wants to build a multi-bagger stock portfolio, select the stocks which are a higher growth prospect of net profit.



## Let's look at the Ambuja Cements Income Statement

### STATEMENT OF PROFIT AND LOSS

for the year ended 31st December 2021

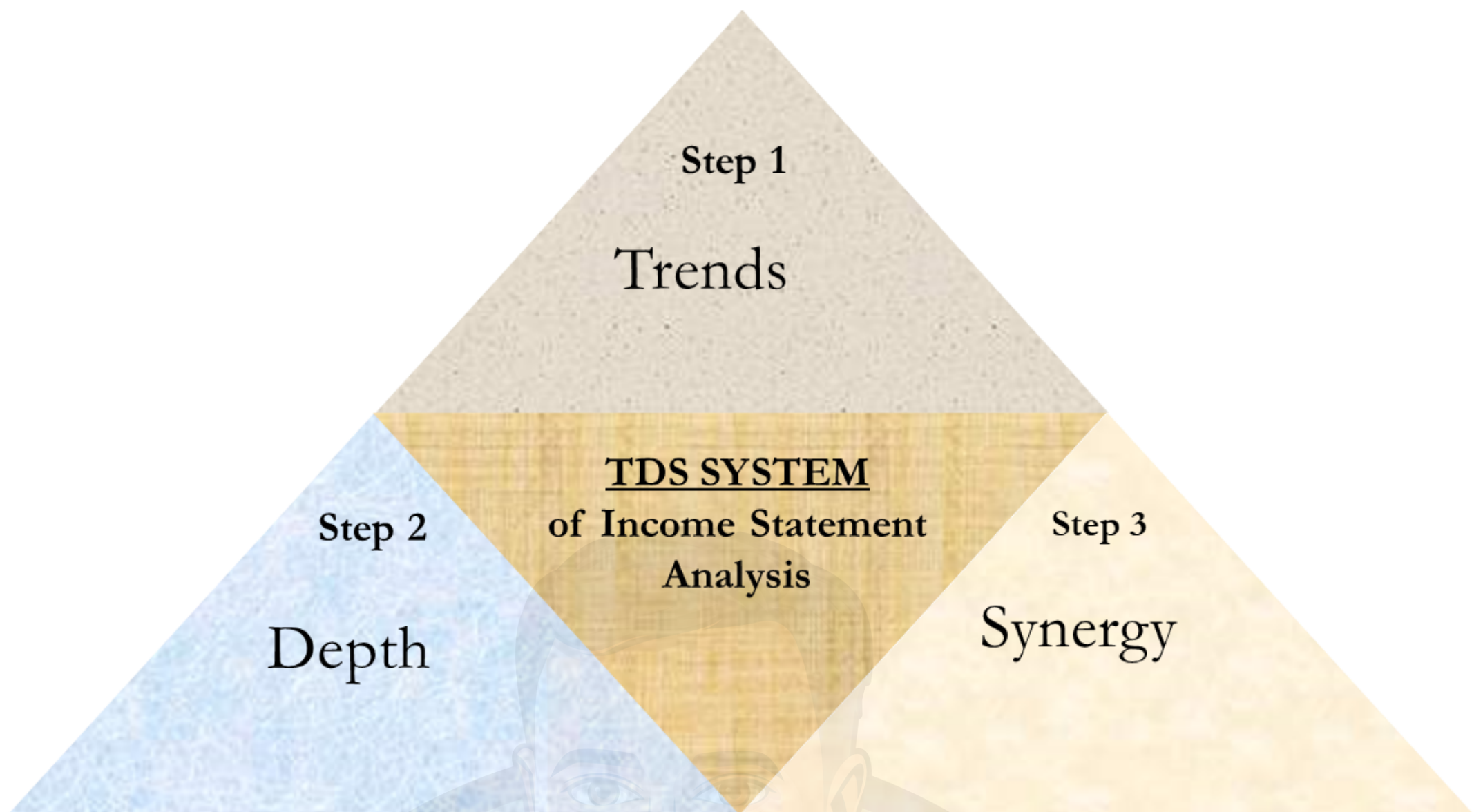
Particulars	Notes	For the year ended 31st December 2021 ₹ in crore	For the year ended 31st December 2020 ₹ in crore
<b>1 INCOME</b>			
a) Revenue from operations	37	13,964.95	11,371.86
b) Other income	38	285.64	372.00
<b>Total Income</b>		<b>14,250.59</b>	<b>11,743.86</b>
<b>2 EXPENSES</b>			
a) Cost of materials consumed	39	1,134.25	874.88
b) Purchase of stock-in-trade	40	381.39	197.31
c) Changes in inventories of finished goods, work-in progress and stock-in-trade	41	(356.13)	114.08
d) Employee benefits expense	42	677.65	668.78
e) Finance costs	43	90.94	83.05
f) Depreciation and amortisation expense *	44	551.24	521.17
g) Power and fuel		3,421.01	2,251.91
h) Freight and forwarding expense	45	3,308.33	2,854.88
i) Other expenses	46	2,211.15	1,784.54
<b>Total Expenses</b>		<b>11,419.83</b>	<b>9,350.60</b>
j) Self consumption of cement		(20.18)	(21.12)
<b>3 PROFIT BEFORE TAX (1-2)</b>		<b>2,850.94</b>	<b>2,414.38</b>
<b>4 EXCEPTIONAL ITEMS</b>	59	65.69	-
<b>5 PROFIT BEFORE TAX (3-4)</b>		<b>2,785.25</b>	<b>2,414.38</b>
<b>6 TAX EXPENSE</b>	31		
a) Deferred tax charge / (credit)		690.79	652.04
b) Deferred tax - (credit)		13.92	(27.76)
		<b>704.71</b>	<b>624.28</b>
<b>7 PROFIT FOR THE YEAR (5-6)</b>		<b>2,080.54</b>	<b>1,790.10</b>
<b>8 OTHER COMPREHENSIVE INCOME</b>			
Items not to be reclassified to profit or loss in subsequent periods			
Remeasurement gains / (losses) on defined benefit plans		7.51	(9.32)
Tax expenses on above		(1.92)	2.35
<b>Total other comprehensive income</b>		<b>5.59</b>	<b>(6.97)</b>
<b>9 TOTAL COMPREHENSIVE INCOME FOR THE YEAR (7+8)</b>		<b>2,086.13</b>	<b>1,783.13</b>
<b>10 EARNINGS PER SHARE OF ₹ 2 EACH - IN ₹</b>	47		
Basic		10.48	9.02
Diluted		10.48	9.01

\*Treatment of Depreciation is a little critical. If the company is in the manufacturing industry, take depreciation direct cost, if it is in the service sector, then depreciation should be the indirect cost.

I have given you a simple example, of how to derive gross profit, operating profit (EBIT), EBITDA, etc., from the income statement. Of course, you need to go to the notes to accounts and refer to individual ledgers for better judgment.

We have given an overall idea of how to read an income statement. In our 5 Days of the workshop, you how you can download and analyze the financials information of a company within 5 minutes. You can see get financial information from any company on a website like a [screener.in](https://www.screener.in) or [moneycontrol.com](https://www.moneycontrol.com). Information is easily available on the internet, what is important is how you interpret that information and make an investment decision in your favor.

Let's get back to our example, how we can analyze the income statement. We had already discussed, 3 simple steps to the balance sheet, the same approach we will apply in income statements



Let's look at the Trends of Revenue of Ambuja Cement:

	GRI Std. / GCCA KPIs	SDG Target	Assurance	2018	2019	2020	2021	TARGET 2021
<b>Economic Performance &amp; Value Creation</b>								
Net Sales	₹ crores	201-1	8.1,8.2	10,977	11,353	11,175	13,794	

I have given you a simple example, of how to derive gross profit, operating profit (EBIT), EBITDA, etc., from the income statement. Off course, you need to go to the notes to accounts and refer to individual ledgers for better judgment.

Despite the economic slowdown, the company reported stable revenue. FY22 revenue had increased by 23%, which is good by looking at trends. But you need to factor in that post covid in 2020, the economy had grown a sharp rise and there is a demand for infrastructure in the country. Overall cement industry growth is 8%, hence if you factor out the growth of the industry the Company had grown 15% more than the industry. This looks like a good picture of the company. Similarly, we need to see other items in the income statement such as operating profit, EBITDA, PBT, and Net Profit.

Let's take another example of operating expenses:

EXPENSES		
a) Cost of materials consumed	39	1,134.25
b) Purchase of stock-in-trade	40	381.39
c) Changes in inventories of finished goods, work-in progress and stock-in-trade	41	(356.13)
d) Employee benefits expense	42	677.65
e) Finance costs	43	90.94
f) Depreciation and amortisation expense	44	551.24
g) Power and fuel	45	3,421.01
h) Freight and forwarding expense	45	3,308.33
i) Other expenses	46	2,211.15
		<b>11,419.83</b>
		<b>9,350.60</b>

We observe that the power and fuel cost of the company had increased during the year. As an analyst you need to checkout what was the reason for the increase, where the increase in fuel cost make any sense with the market and economic condition. Checkout what management had to say on rising fuel cost. As discussed with the diagram above, you need to analyse the income statement with TDS system, here you need to find out if there is any synergy with economic and market condition with increase in cost.

- Raw material costs per tonne increased by 8.8% due to increase in input material cost
- Power and fuel costs per tonne increased by 27% due to steep increase in fuel prices
- Logistics cost per tonne decreased by 2.8%. This was a result of our digitalisation efforts in logistics as well as increased volume under master supply agreement with ACC Limited

Other expenses per tonne increased by 4% in 2021 over 2020.

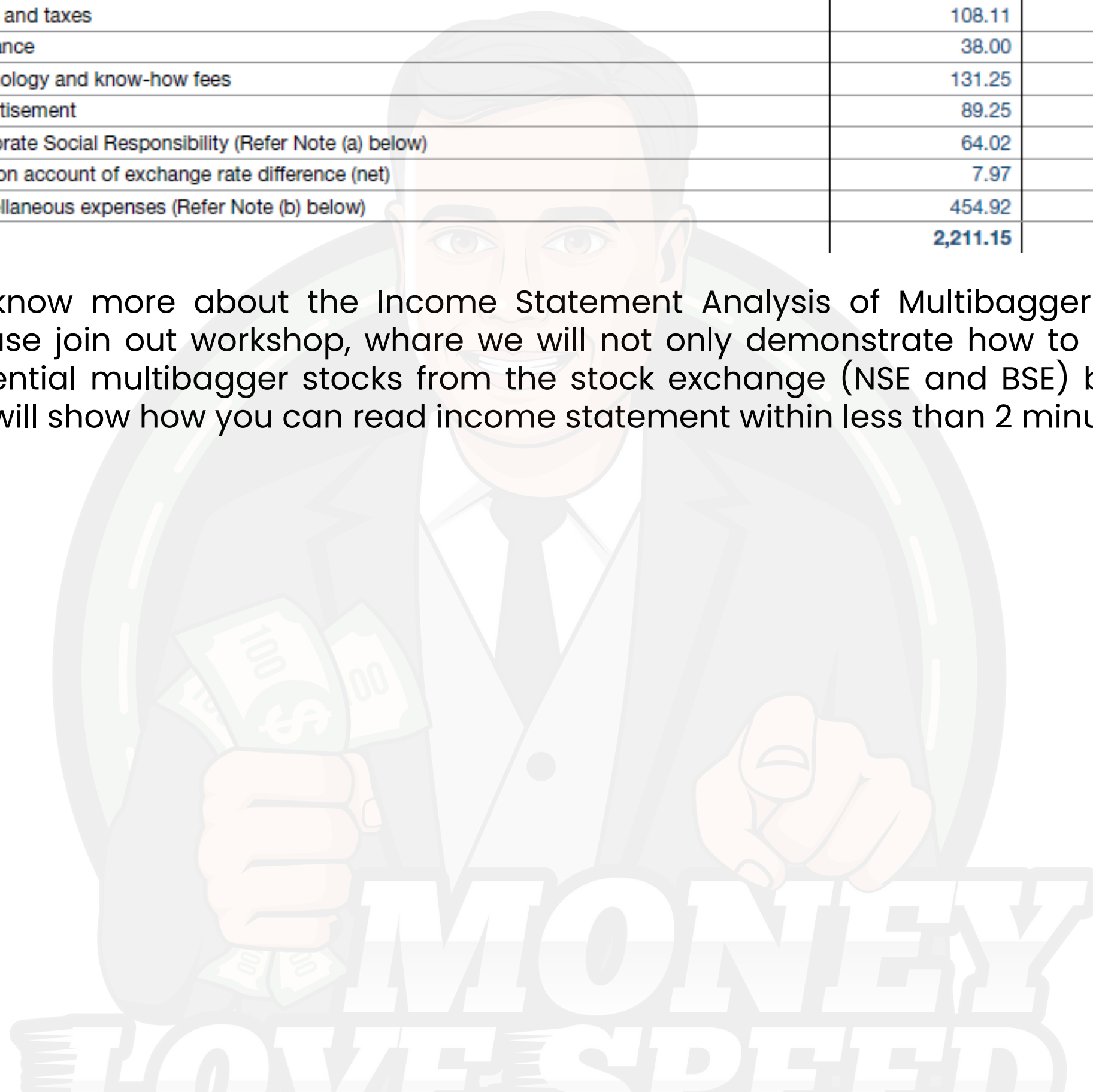


Similarly, you need to go to notes to account to understand what are the items the company putting as expenses. This will give you fair idea about the company's operations. Please check a notes to accounts of other expenses of Ambuja Cement:

#### NOTE 46 - OTHER EXPENSES

Particulars	For the year ended 31st December 2021 ₹ in crore	For the year ended 31st December 2020 ₹ in crore
Royalty on minerals	292.60	231.10
Consumption of stores and spare parts	274.28	224.82
Consumption of packing materials	501.02	344.97
Repairs	187.42	148.15
Rent (Refer Note 52)	62.31	57.99
Rates and taxes	108.11	92.02
Insurance	38.00	25.76
Technology and know-how fees	131.25	107.86
Advertisement	89.25	63.93
Corporate Social Responsibility (Refer Note (a) below)	64.02	52.31
Loss on account of exchange rate difference (net)	7.97	9.94
Miscellaneous expenses (Refer Note (b) below)	454.92	425.69
<b>Total</b>	<b>2,211.15</b>	<b>1,784.54</b>

To know more about the Income Statement Analysis of Multibagger stocks, please join our workshop, where we will not only demonstrate how to analyze potential multibagger stocks from the stock exchange (NSE and BSE) but also we will show how you can read income statement within less than 2 minutes.



## CHAPTER 7

# HOW TO READ CASH FLOW STATEMENT





# What is an Cash Flow Statement?

The purpose of a cash flow statement is to provide a detailed picture of what happened to a business's cash during a specified period, known as the accounting period. It demonstrates an organization's ability to operate in the short and long term, based on how much cash is flowing into and out of the business.

The cash flow statement is typically broken into three sections:

- Operating activities
- Investing activities
- Financing activities

## 1. Cash From Operating activities:

Firstly, here the first step in the preparation of a CFS is the identification of cash inflows and outflows from operating activities. Operating activities includes only revenue-producing activities or direct cost incurred during production: such as the purchase of raw material, cash received from customers, salaries paid to employees, and other operating cash inflows and outflows.

So, how to calculate operating activities? In accounting, there are two procedures for calculating operating activities, to clarify, the first one is the Direct method and the second one is the Indirect Method.

Cash Flow Statement (CFS)		
As of December 31, 20XX		
<b>Cash Flow from Operations</b>		
Profit before interest and tax (EBIT)		
Add: Adjustment to net income	xxx	
Depreciation	xxx	
Amortization	xxx	
Gain on sale of equipment	xxx	
Change in operating asset and liabilities		
Increase in inventory	(xxx)	
Decrease in receivable	xxx	
Decrease in payable	(xxx)	
Increase in deferred tax	xxx	
<b>Net cash from Operating Activates</b>		<b>XXX</b>
<b>Cash Flow from Investing Activities</b>		
Investment in Capex	(xxx)	
Proceed from sale of equipment	xxx	
Other cash flow from in investing activates	xxx	
<b>Net cash from Investing Activates</b>		<b>XXX</b>
<b>Cash Flow from Financing Activities</b>		
Stock issuance	xxx	
Increase in debt	xxx	
Dividend paid	(xxx)	
<b>Net cash from Financing Activates</b>		<b>XXX</b>
<b>Cash and Cash Equivalent</b>		<b>XXX</b>
<b>Add: Opening Cash Balance</b>		<b>XXX</b>
<b>Net Cash and Cash Equivalent</b>		<b>XXX</b>

For most of the annual reports, you will get the indirect method. Let's check the indirect method, under this method accountants undo all the impact of accruals by eliminating non-cash items from net income. Because the net income is calculated by using an accrual accounting basis which reported each revenue and expense in the period in which they incurred. Consequently, the adjustments are made by subtracting all non-cash expenses and revenues from net income.

## 2. Cash From Investing Activities:

Secondly, the second step in the preparation of CFS is the calculation of investing activities. So, Investing activities are associated with the buying and selling of non-current assets. Therefore, it includes changes in cash position made due to purchasing and selling of long-term assets- purchase or sale of equipment, contracting new building, or buying of vehicles.

## 3. Cash From Financing Activities:

Thirdly, the third step is the calculation of financing activities. So, Financing activities deal with the equity and borrowing structure of the company. Thus, any increase and reduction in the company's capital or long-term liabilities are reported in the financing activities. Moreover, it includes issuance or repurchase of common stock, any dividend paid, and borrowing or repayment of debt. Further, non-cash financing activities such as discounts made should not be included in the financing activities because it has no cash effect.



## Analyzing Cash Flow Statement

Let's discussed again, we have an Income statement, Balance sheet, and Cash Flow Statements, they show us different pictures of the company. Now if you want to be an investor, you got to learn the language of business is found in these three financial statements, the balance sheet, the income statement, and the cash flow statement.

A cash flow statement is used to determine if a company is healthy. As an investor, you need to look at how cash is coming into the business and how cash is going out. That's the critical aspect of the cash flow statement. An earnings statement tells you if you're profitable. The balance sheet tells you that you have a company that's worth more than what you owe, and the cash flow statement is there to show you that the cash is available for you to function. So, the cash flow statement it's kind of like looking at the fuel on a car.

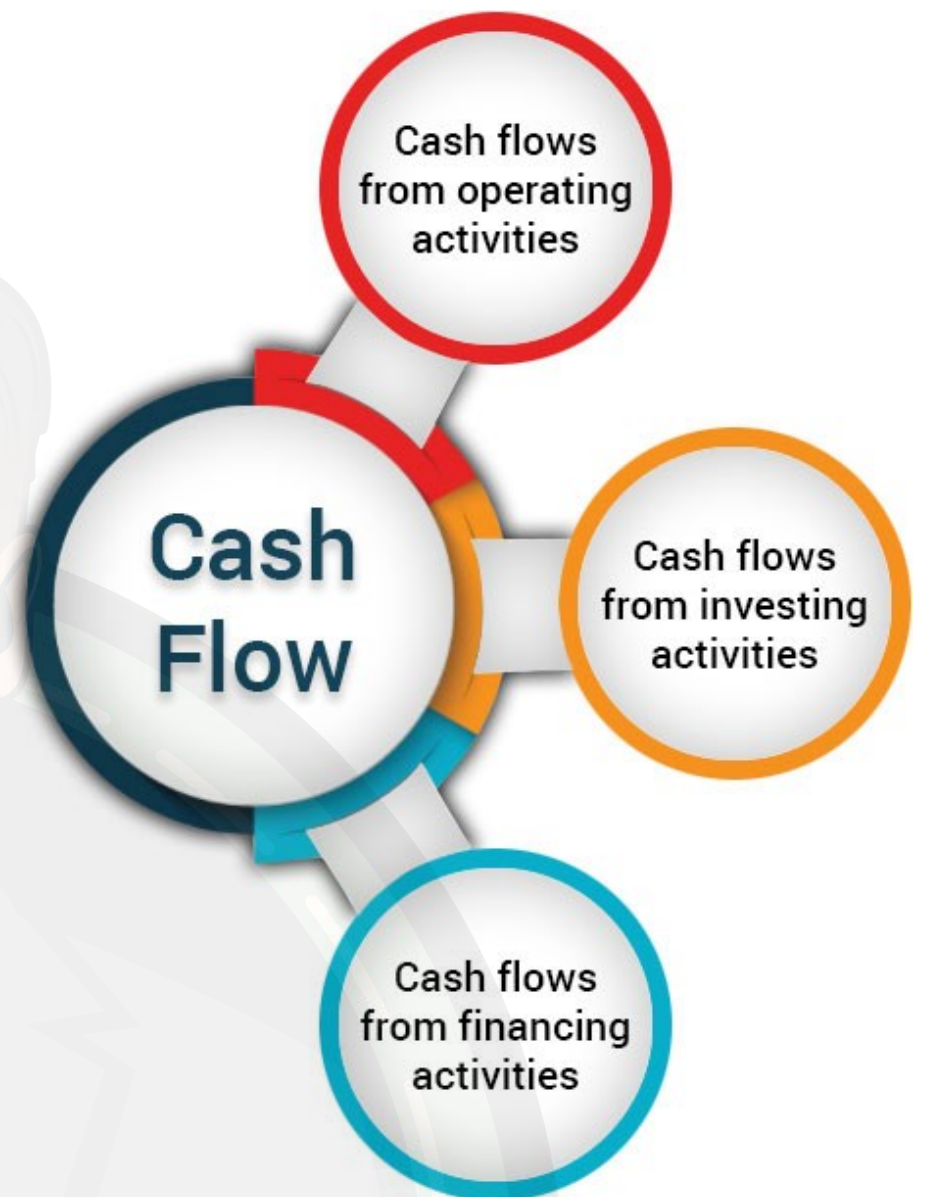
Looking at the cash flow statement, analysts should look at the big red flags in the Cash flow statement. So, the first big red flag to work for when we're looking at a cash flow statement is you go down to the first major section of it, which is operating cash flow, or cash flow from operations.

If cash flow is negative, then that means you're losing cash as you're going forward. That does not mean the company will file for bankruptcy. The Company gets bankrupt when it cannot pay its external obligations not because it had negative results. As long as the company is liquid, that means it is continuing to receive funds it will continue to operate. Negative operating cash flow must be funded either by investing activity or financing activities. That means negative operating cash flow is either coverup by selling the asset (investing activities) or selling equity or raising debt (financing activities).

Now, check for a big, big, big red flag on a cash flow statement, when the Company had negative operating cash flow, however it is taking its debt to pay its dividend. You've noticed that the company doesn't have to cash flow out of operating cash to pay the dividends. So where did they get the money? Taking debt to pay its shareholders, is a red alert for investors.

If the money isn't coming from actual operations, check where is it coming from? And then you see that they're borrowing as much money as they're paying out dividends. Huge red flag! You need to watch for a reason.

There are some exceptions, Apple computers are exactly the opposite. They have huge cash flow, the giant cash flow that comes in cash flow is way bigger even than their earnings. And so, when you're looking at a company like Infosys, you could put a value on it. That's maybe larger than what you would expect to see these earnings grow. Because it's so much cash, Reliance back in its heyday, same kind of thing, just drawing cash like a maniac. So really good companies produce real good cash flow growth. And of course, some point that turns into free cash flow can go into the pockets of the investors.



## Let's look at the Ambuja Cements Income Statement

### CASH FLOW STATEMENT

for the year ended 31st December 2021

Particulars	Notes	For the year ended 31st December 2021 ₹ in crore	For the year ended 31st December 2020 ₹ in crore
<b>AJ CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit before tax		2,785.25	2,414.38
Adjustments to reconcile profit before tax to net cash flows			
Depreciation and amortisation expense	44	551.24	521.17
Exceptional Item	59	65.69	-
Loss on property, plant and equipment sold, discarded and written off (net)		25.09	21.82
Dividend income from subsidiary	38	(131.58)	(131.58)
Dividend income from joint venture	38	(2.75)	(2.50)
Gain on sale of current financial assets measured at fair value through profit and loss	38	(8.26)	(10.82)
Net gain on fair valuation of liquid mutual fund measured at fair value through profit and loss	38	(0.10)	(0.31)
Unwinding of discounting charge on interest free sales tax loan	43	3.34	3.18
Finance costs	43	87.60	79.87
Interest income		(113.54)	(219.97)
Provision for slow and non moving store and spares (net)		23.03	17.38
Discounting income on interest free loan		-	(3.25)
Unrealised exchange loss (net)		2.48	7.95
Fair value movement in derivative instruments		5.92	1.02
Interest on tax written back		-	(5.77)
Provisions no longer required written back	37	(11.07)	(6.06)
Impairment loss/ (Reversal) on trade receivable (net)		2.08	15.21
Compensation Expenses under Employees Stock Options Scheme	49	3.63	1.00
Inventories written off		2.40	1.68
Profit on buy back of shares of joint venture		-	(0.94)
Other non-cash items		(0.02)	(0.05)
<b>Operating profit before working capital changes</b>		<b>3,290.61</b>	<b>2,703.39</b>
Changes in Working Capital			
Adjustments for Decrease / (Increase) in operating assets			
Decrease / (Increase) in Trade receivables, loans & advances and other assets	11-13, 15, 17-20	(98.88)	262.00
Decrease / (Increase) in Inventories	14	(742.39)	188.42
Adjustments for (Decrease) / Increase in operating liabilities			
Increase / (Decrease) in Trade payables, other liabilities and provisions	26-30, 32-36	379.78	(82.79)
Cash generated from operations		<b>2,829.12</b>	<b>3,071.02</b>
Direct taxes paid (net of refunds) (Refer Note (1) below)		(362.66)	(464.84)
<b>Net cash flow from operating activities (A)</b>		<b>2,466.26</b>	<b>2,606.18</b>

Now look at the cash from operating activities first, what we can see despite the increase in Profit After Tax (PAT), cash from Net Cash From Operating Activities (NOCF) had decreased. Analysts need to find out why NOCF had decreased despite an increase in EBITDA. If you look at the working capital changes, the adjustment is negative. This means when the current liabilities exceed the current assets.

Negative working capital can come about in cases where current assets increases or a payment is made to creditors. Let's check, what happening in Ambuja Cement, here you can see inventories and receivables have increased. Therefore, we can say that the company had extended more credit to sell its products to its distributors. Most of the sales increase (in the income statement) was due to the company's relaxing credit policy. Now, look at the inventories, it had increased YoY, which may be from stock absolute. The Company is unable to sell its inventories, therefore relaxing its credit policy so that it can push sales. See, how analysts should look at the cash flow statement. You can also check out the balance sheet, it will reflect the same statement.

Remember, do not try to jump to a conclusion just by looking at the cash flow statement, an analyst should find out the reason behind the numbers.

<b>2 Current assets</b>			
a) Inventories	14	1,463.57	746.61
b) Financial assets			
i) Trade receivables	15	293.17	191.51
ii) Cash and cash equivalents	16	3,984.70	2,716.91
iii) Bank balances other than cash and cash equivalents	17	178.37	207.43
iv) Loans	18	4.76	4.43
v) Other financial assets	19	224.88	78.88



Remember, we have to talk about the TDS system, we need to analyze the Cash Flow Statement based on the logic applied in both Income Statement and Balance Sheet. Now look at the Cash From Investing Activities:

<b>B) CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Purchase of property, plant and equipment, intangibles etc. (including capital work in progress and capital advances)			(1,160.07)	(985.47)
Proceeds from sale of property, plant and equipment			17.60	7.65
Proceeds from buyback of shares of joint venture			-	2.24
Inter corporate deposits and loans given to subsidiaries			(0.01)	(0.15)
Gain on sale of current financial assets measured at fair value through profit and loss			8.26	10.82
Investments in bank deposits (having original maturity of more than 3 months and upto 12 months)			(5,457.58)	(8,200.67)
Redemption of bank deposits (having original maturity of more than 3 months and upto 12 months)			5,483.10	8,189.28
Investments in bank deposits (having original maturity of more than 12 months)			(10.81)	(27.84)
Redemption of bank deposits (having original maturity of more than 12 months)			0.98	19.02
Purchase of non current investment			(4.70)	(4.50)
Dividend received from subsidiary	38		131.58	131.58
Dividend received from joint venture	38		2.75	2.50
Interest received			107.15	214.11
<b>Net cash used in investing activities (B)</b>			<b>(881.75)</b>	<b>(641.43)</b>

If you look at the cash flow statement, you can see the capital expenditure section first. See, the number is increasing YoY, which means, the company is expanding its operation. Generally, the company increase its CAPEX for various reason, say expanding factories, building new factories, venturing into new markets, etc. In any case, it signifies the company's growth face. If you check the management discussion section, the management opinion should speak the same language. Other than CAPEX, there are no major changes in the line item in the investing activities. Let's look at financing activities.

<b>C) CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Proceeds from non-current borrowings			-	8.47
Repayment of current maturity of non-current borrowings			-	(5.86)
Repayment of lease liability	52		(27.46)	(26.26)
Interest portion of lease repayment	43		(15.22)	(16.81)
Interest paid			(75.58)	(46.53)
Net movement in earmarked balances with banks			3.54	(8.84)
Dividend paid on equity shares			(202.10)	(3,664.61)
<b>Net cash used in financing activities (C)</b>			<b>(316.82)</b>	<b>(3,760.44)</b>
<b>Net increase / (decrease) in cash and cash equivalents (A + B + C)</b>			<b>1,267.69</b>	<b>(1,795.69)</b>
<b>Cash and cash equivalents</b>				
Cash and cash equivalents at the end of the year	16		3,984.70	2,716.91
Adjustment for fair value (gain) / loss on liquid mutual funds measured through profit and loss	38		(0.10)	(0.31)
Cash and cash equivalents at the beginning of the year	16		2,716.91	4,512.29
<b>Net increase / (decrease) in cash and cash equivalents</b>			<b>1,267.69</b>	<b>(1,795.69)</b>

Looking at the Cash Flow from Financing Activities, the major line item that draws our attention is the dividend. Last year the company made a huge dividend payout as compared to this year. Also, we can see the year-end cash balance had increased after adjusting for negative investing and financing activities, which is a healthy sign. As discussed earlier, the company does not file for bankruptcy due to negative net results. but it goes out of business if the company had no cash to pay is an external obligation. By looking at the cash flow statement an analyst can assist the liquidity of the company.

A Cash Flow Statement is critical for analysts. A seasoned analyst can infer the company's performance by just looking at the cash flow only. In the workshop, we will show how you identify multi-bagger stock by looking at the cash flow statement only.

## CHAPTER 8

# FINANCIAL RATIO ANALYSIS





## What is Ratio Analysis?

Ratio analysis is the comparison of line items in the financial statements of a business. Ratio analysis is used to evaluate a number of issues with an entity, such as its liquidity, efficiency of operations, and profitability.

Top 4 Categories of Ratio Analysis:

1. Liquidity Ratios
2. Leverage Ratios
3. Profitability Ratios
4. Valuation Ratios or Market Related Ratios

### 1. Category # Liquidity Ratios

The liquidity ratios measure the liquidity of the firm and its ability to meet its maturing short-term obligations. Liquidity is defined as the ability to realize the value in money, the most liquid of assets. It refers to the ability to pay in cash, the obligations that are due. Corporate liquidity has two dimensions viz., quantitative and qualitative concepts.

The quantitative aspect includes the quantum, structure, and utilization of liquid assets and in the qualitative aspect, it is the ability to meet all present and potential demands on cash from any source in a manner that minimizes cost and maximizes the value of the firm. Thus, corporate liquidity is a vital factor in business.

Excess liquidity, though a guarantor of solvency would reflect lower profitability, deterioration in managerial efficiency, increased speculation and unjustified expansion, and extension of too liberal credit and dividend policies. Too little liquidity then may lead to frustration, business objections, reduced rate of return, missing of profitable business opportunities, and weakening of morale.

The important ratios in measuring short-term solvency are:

- (a) Current ratio
- (b) Quick ratio

#### Current Ratio:

This ratio measures the solvency of the company in the short-term. Current assets are those assets which can be converted into cash within a year. Current liabilities and provisions are those liabilities that are payable within a year.

##### **Current Assets, Loans & Advances/Current Liabilities & Provisions**

A current ratio of 2: 1 indicates a highly solvent position. A current ratio of 1.33: 1 is considered by banks as the minimum acceptable level for providing working capital finance. The constituents of the current assets are as important as the current assets themselves for evaluation of a company's solvency position.

A very high current ratio will have adverse impact on the profitability of the organization. A high current ratio may be due to the piling up of inventory, inefficiency in collection of debtors, high balances in cash and bank accounts without proper investment etc.

#### Quick/Liquid/Acid Test Ratio:



A quick ratio of 1: 1 indicates a highly solvent position. This ratio serves as a supplement to the current ratio in analyzing liquidity.

## 2. Category # Leverage Ratios

The long-term financial stability of the firm may be considered dependent upon its ability to meet all its liabilities, including those not currently payable.

The ratios which are important in measuring the financial leverage of the company are as follows:

### Debt–Equity Ratio:

This ratio indicates the relationship between loan funds and the net worth of the company, which is known as 'gearing'. If the proportion of debt to equity is low, a company is said to be low-g geared, and vice versa.

A debt-equity ratio of 2: 1 is the norm accepted by financial institutions for financing projects. A higher debt-equity ratio of 3:1 may be permitted for highly capital-intensive industries like petrochemicals, fertilizers, power etc. The higher the gearing, the more volatile the return to the shareholders.

#### Long-term Debt/Shareholders Funds

The use of debt capital has direct implications for the profit accruing to the ordinary shareholders, and expansion is often financed in this manner with the objective of increasing the shareholders' rate of return. This objective is achieved only if the rate earned on the additional funds raised exceeds that payable to the providers of the loan.

The shareholders of a highly geared company reap disproportionate benefits when earnings before interest and tax increase. This is because interest payable on a large proportion of total finance remains unchanged. The converse is also true, and a highly geared company is likely to find itself in severe financial difficulties if it suffers a succession of trading losses.

It is not possible to specify an optimal level of gearing for companies but, as a general rule, gearing should be low in those industries where demand is volatile, and profits are subject to fluctuation. A debt-equity ratio that shows a declining trend over the years is usually taken as a positive sign reflecting on increasing cash accrual and debt repayment.

In fact, one of the indicators of a unit turning sick is a rising debt-equity ratio. Usually in calculating the ratio, the preference share capital is excluded from debt, but if the ratio is to show the effect of use of fixed interest sources on earnings available to the shareholders, then it is to be included. On the other hand, if the ratio is to examine financial solvency, then preference shares shall form part of the capital.

### Shareholders Equity Ratio

This ratio is calculated as follows:

#### Shareholders' Equity/Total Assets (tangible)

It is assumed that larger the proportion of the shareholders' equity, the stronger is the financial position of the firm. This ratio will supplement the debt-equity ratio. In this ratio, the relationship is established between the shareholders' funds and the total assets. Share-holders funds represent both equity and preference capital plus reserves and surplus less accumulated losses.



A reduction in shareholders' equity signaling the over-dependence on outside sources for long-term financial needs and this carries the risk of higher levels of gearing. This ratio indicates the degree to which unsecured creditors are protected against loss in the event of liquidation.

## Long-Term Debt to Shareholders Net worth Ratio:

This ratio is calculated as follows:

### **Long-term Debt/Shareholders Net worth**

The ratio compares long-term debt to the net worth of the firm i.e., the capital and free reserves less intangible assets. This ratio is finer than the debt-equity ratio and includes capital that is invested in fictitious assets like deferred expenditure and carried forward losses.

This ratio would be of more interest to the contributors of long-term finance to the firm, as the ratio gives a factual idea of the assets available to meet the long-term liabilities.

## Interest Cover

The interest coverage ratio shows how many times interest charges are covered by funds that are available for payment of interest.

### **Profit before Interest, Depreciation and Tax/Interest**

A very high ratio indicates that the firm is conservative in using debt and a very low ratio indicates excessive use of debt. Interest cover indicates how many times a company can cover its current interest payments out of current profits.

It gives an indication of problem in servicing the debt. An interest cover of more than 7 times is regarded as safe and more than 3 times is desirable. An interest cover of 2 times is considered reasonable by financial institutions.

## Debt Service Coverage Ratio (DSCR):

This ratio is the key indicator for the lender to assess the extent of the ability of the borrower to service the loan in regard to the timely payment of interest and repayment of loan installment. It indicates whether the business is earning sufficient profits to pay not only the interest charges but also the installments due of the principal amount.

The ratio is calculated as follows:

### **Profit after Taxes + Depreciation + Interest on Loan/Interest on Loan + Loan repayment in a year**

A ratio of 2 is considered satisfactory by the financial institutions. The greater debt service coverage ratio indicates the better debt servicing capacity of the organization. By means of cash flow projection, the borrower should work DSCR for the entire duration of the loan. This will enable the lender to take the correct view of the borrower's repayment capacity.



## Dividend Cover

This ratio indicates the number of times the dividends are covered by net profit. This highlights the amount retained by a company for the financing of future operations.

(a) Preference Dividend Cover:  
Net profit after Tax Preference Dividend

(b) Equity Dividend Cover:  
Net Profit after Tax – Preference Dividend Equity Dividend

## Category # Profitability Ratios

The purpose of the study and analysis of profitability ratios is to help assess the adequacy of profits earned by the company and to discover whether profitability is increasing or declining.

The profitability of the firm is the net result of many policies and decisions. The profitability ratios show the combined effects of liquidity, asset management, and debt management on operating results. Profitability ratios are measured with reference to sales, capital employed, total assets employed, shareholders' funds, etc.

The major profitability rates are as follows:

### Gross Profit Margin:

The gross profit margin is calculated as follows:

$$\text{Sales} - \text{Cost of Goods Sold} \text{ Gross Profit/Sales} \times 100 \text{ or } \text{Gross Profit/Sales} \times 100$$

The ratio measures the gross profit margin on the total net sales made by the company. The gross profit represents the excess of sales proceeds during the period under observation over their cost, before taking into account administration, selling and distribution, and financing charges.

The ratio measures the efficiency of the company's operations, and this can also be compared with the previous year's results to ascertain the efficiency. When everything is normal, the gross profit margin should remain unchanged, irrespective of the level of production and sales, since it is based on the assumption that all costs deducted when computing gross profit are directly variable with sales.

**A stable gross profit margin is, therefore, the norm and any variation from it call for careful investigations, which may be caused due to the following reasons:**

#### I. Price cuts:

A company needs to reduce its selling price to achieve the desired increase in sales.

#### II. Cost increases:

The price which a company pays its suppliers during the period of inflation is likely to rise and this reduces the gross profit margin unless an appropriate adjustment is made to the selling price.

#### III. Change in the mix:

A change in the range or a mix of products sold causes the overall gross profit margin, assuming individual product lines earn different gross profit percentages.



#### IV. Valuation of stocks:

If closing stocks are undervalued, the cost of goods sold is inflated and profit is understated. An incorrect valuation may be the result of an error during stock-taking or it may be due to fraud.

The gross profit margin may be compared with that of competitors in the industry to assess the operational performance relative to the other players in the industry

## Net Profit Margin

The ratio is calculated as follows:

$$\text{Net Profit before Interest and Tax/Sales x 100}$$

The ratio is designed to focus attention on the net profit margin arising from business operations before interest and tax are deducted. The convention is to express profit after tax and interest as a percentage of sales. A drawback is that the percentage which results varies depending on the sources employed to finance business activity; interest is charged above the line while dividends are deducted below the line.

It is for this reason that net profit i.e., earnings before interest and tax (EBIT) is used. This ratio reflects the net profit margin on the total sales after deducting all expenses but before deducting interest and taxation. This ratio measures the efficiency of the operation of the company. The net profit is arrived at from gross profit after deducting administration, selling, and distribution expenses.

The non-operating incomes and expenses are ignored in the computation of net profit before tax, depreciation, and interest. This ratio could be compared with that of the previous years and with that of competitors to determine the trend in net profit margins of the company and its performance in the industry.

This measure will depict the correct trend of performance where there are erratic fluctuations in the tax provisions from year to year. It is to be observed that the majority of the costs debited to the profit and loss account are fixed in nature and an increase in sales will cause the cost per unit to decline because of the spread of the same fixed cost over the increased number of units sold.

## Cash Profit Ratio

The cash profit ratio measures the cash generation in the business as a result of the operations expressed in terms of sales.

$$\text{Cash Profit/Sales x 100}$$

$$\text{Cash Profit} = \text{Net profit} + \text{Depreciation}$$

The cash profit ratio is a more reliable indicator of performance where there are sharp fluctuations in the profit before tax and net profit from year to year owing to the difference in depreciation charged.

The cash profit ratio evaluates the efficiency of operations in terms of cash generation and is not affected by the method of depreciation charged. It also facilitates inter-firm comparison of performance since different methods of depreciation may be adopted by different companies.



## Return on Total Assets

This ratio is calculated as follows:

$$\text{Net Profit after Tax/Total Assets} \times 100$$

The profitability of the firm is measured by establishing a relation of net profit with the total assets of the organization. This ratio indicates the efficiency of utilization of assets in generating revenue.

## Return on Shareholders' Funds or Return on Net Worth

This ratio expresses the net profit in terms of the equity shareholders' funds. This ratio is an important yardstick of performance for equity shareholders since it indicates the return on the funds employed by them. However, this measure is based on the historical net worth and will be high for old plants and low for new plants.

$$\frac{\text{Net Profit after Interest and Tax}}{\text{Net worth = Equity capital + Reserves and Surplus}} \times 100$$

The factor which motivates shareholders to invest in a company is the expectation of an adequate rate of return on their funds and periodically, they want to assess the rate of return earned in order to decide whether to continue with their investment. This ratio is useful in measuring the rate of return as a percentage of the book value of shareholders equity.

The further modification of this ratio is given below:

### Return on Equity (ROE):

i.e.,  $\text{ROE} = \text{Net profit margin} \times \text{Total assets turnover ratio} \times \text{Total assets to Net worth}$

#### The ratio indicates:

- (a) Measure of profitability
- (b) The efficiency in use of assets in achieving sales
- (c) Measure of leverage.

## Return on Capital Employed (ROCE):

This ratio is also called as Return on Investment (ROI). The strategic aim of a business enterprise is to earn a return on capital. If in any particular case, the return, in the long run, is not satisfactory, then the deficiency should be corrected, or the activity is abandoned for a more favorable one.

Measuring the historical performance of an investment center calls for a comparison of the profit that has been earned with capital employed. The rate of return on investment is determined by dividing net profit or income by the capital employed or investment made to achieve that profit.

ROI consists of two components viz. (i) Profit Margin, and (ii) Investment Turnover, as shown below:

It will be seen from the above formula that ROI can be improved by increasing one or both of its components viz., the profit margin and the investment turnover in any of the following ways:

- (a) Increasing the profit margin,
- (b) Increasing the investment turnover, or
- (c) Increasing both profit margin and investment turnover.



The obvious generalizations that can be made about the ROI formula are that any action is beneficial provided that it:

- (i) Boosts sales,**
- (ii) Reduces invested capital,**
- (iii) Reduces costs (while holding the other two factors constant).**

Return on investment analysis provides a strong incentive for optimal utilization of the assets of the company. This encourages managers to obtain assets that will provide a satisfactory return on investment and to dispose of assets that are not providing an acceptable return. In selecting amongst alternative long-term investment proposals, ROI provides a suitable measure for the assessment of the profitability of each proposal.

The returns on capital employed ratio help measure the managerial performance in the following ways:

- (a) helps in measuring the profitability of the firm.**
- (b) The actual return on capital employed can be compared with the targeted rate of return.**
- (c) It indicates how effectively the operating assets are used in earning a return.**
- (d) It can be used as a sensitive gauge of the profit-making ability of the firm.**
- (e) Divisional performance measurement can be done easily with ROI.**
- (f) It helps in making a comparison of interdivisional and inter-firm comparisons.**
- (g) It focuses the attention on the efficiency of management in managing the investments.**
- (h) It correlates the return with various assets used in the business.**

## **4. Category # Market-Based Ratios**

The market-based ratios relate the firm's stock price to its earnings and book value per share. These ratios give management an indication of what investors think of the company's past performance and future prospects. If a firm's profitability, solvency, and turnover ratios are good, then the market-based ratios will be high, and its share price is also expected to be high.

The market-based ratios are as follows:

### **Earnings Per Share (EPS):**

The objective of financial management is the wealth or value maximization of a corporate entity. The value is maximized when the market price of equity shares is maximized. The use of the wealth maximization objective or net present value maximization objective has been advocated as an appropriate and operationally feasible criterion to choose among the alternative financial actions.

In practice, the performance of a corporation is better judged in terms of its earnings per share (EPS). The EPS is one of the important measures of the economic performance of a corporate entity.



The flow of capital to the companies under the present imperfect capital market conditions would be made on the evaluation of EPS. Investors lacking inside and detailed information would look upon the EPS as the best base to take their investment decisions. A higher EPS means better capital productivity.

#### **Net Profit after Tax and Preference Dividend/No. of Equity Shares**

EPS is one of the most important ratios which measures the net profit earned per share. EPS is one of the major factors affecting the dividend policy of the firm and the market prices of the company. Growth in EPS is more relevant for the pricing of shares from absolute EPS. Steady growth in EPS year after year indicates a good track of profitability.

## **Cash Earnings Per Share**

The cash earnings per share (Cash EPS) is calculated by dividing the net profit before depreciation by a number of equity shares.

#### **Net Profit after Tax + Depreciation/No. of Equity Shares**

This is a more reliable yardstick for measuring of performance of companies, especially for highly capital-intensive industries where provision for depreciation is substantial. This measures the cash earnings per share and is also a relevant factor for determining the price for the company's shares. However, this method is not as popular as EPS and is used as a supplementary measure of performance only.

## **Dividend Pay-out Ratio**

The dividend payout ratio is the dividend per share divided by the earnings per share. Dividend pay-out indicates the extent of the net profits distributed to the shareholders as dividends. A high pay-out signifies a liberal distribution policy and a low pay-out reflects a conservative distribution policy.

#### **Dividend per Share/Earnings per Share**

## **Dividend Yield**

This ratio reflects the percentage yield that an investor receives on this investment at the current market price of the shares. This measure is useful for investors who are interested in yield per share rather than capital appreciation.

#### **Dividend per Share/Market Price x 100**

## **Book Value**

This ratio indicates the net worth per equity share. The book value is a reflection of the past earnings and the distribution policy of the company. A high book value indicates that a company has huge reserves and is a potential bonus candidate.

A low book value signifies a liberal distribution policy of bonus and dividends, or alternatively, a poor track record of profitability. Book value is considered less relevant for the market price as compared to EPS, as it reflects the past record whereas the market discounts the future prospects.

#### **Equity Capital + Reserves – Profit and Loss A/c Debit balance/Total number of Equity Shares**



## Price Earnings Ratio (P/E Ratio)

The ratio indicates the market price of an equity share to the earnings per share. It measures the number of times the earnings per share discounts the market price of an equity share.

### Current Market Price of Equity Share/Earnings per Share

The ratio indicates how much an investor is prepared to pay per rupee of earnings. The ratio helps to ascertain the value of equity share, if the EPS and probable price-earning ratio of the industry to which the company belongs.

The intrinsic value of a share may be more or less than the market value which is influenced by company's track record and dividend distribution policy, speculative trading, state of the economy, the efficiency of management, capital gearing, etc.

Price-earning approach to share valuation is simple and more popular. This ratio reflects the market's assessment of the future earnings potential of the company. A ratio reflects high earnings potential and a low ratio reflects the low earnings potential. The ratio reflects the market's confidence on the company's equity.

## Market Price to Book Value Ratio (P/BV ratio):

This ratio measures the relationship between the accounting value of the firm's assets and the market price of its stock. The ratio is calculated by dividing the stock price per share by the book value of the share.

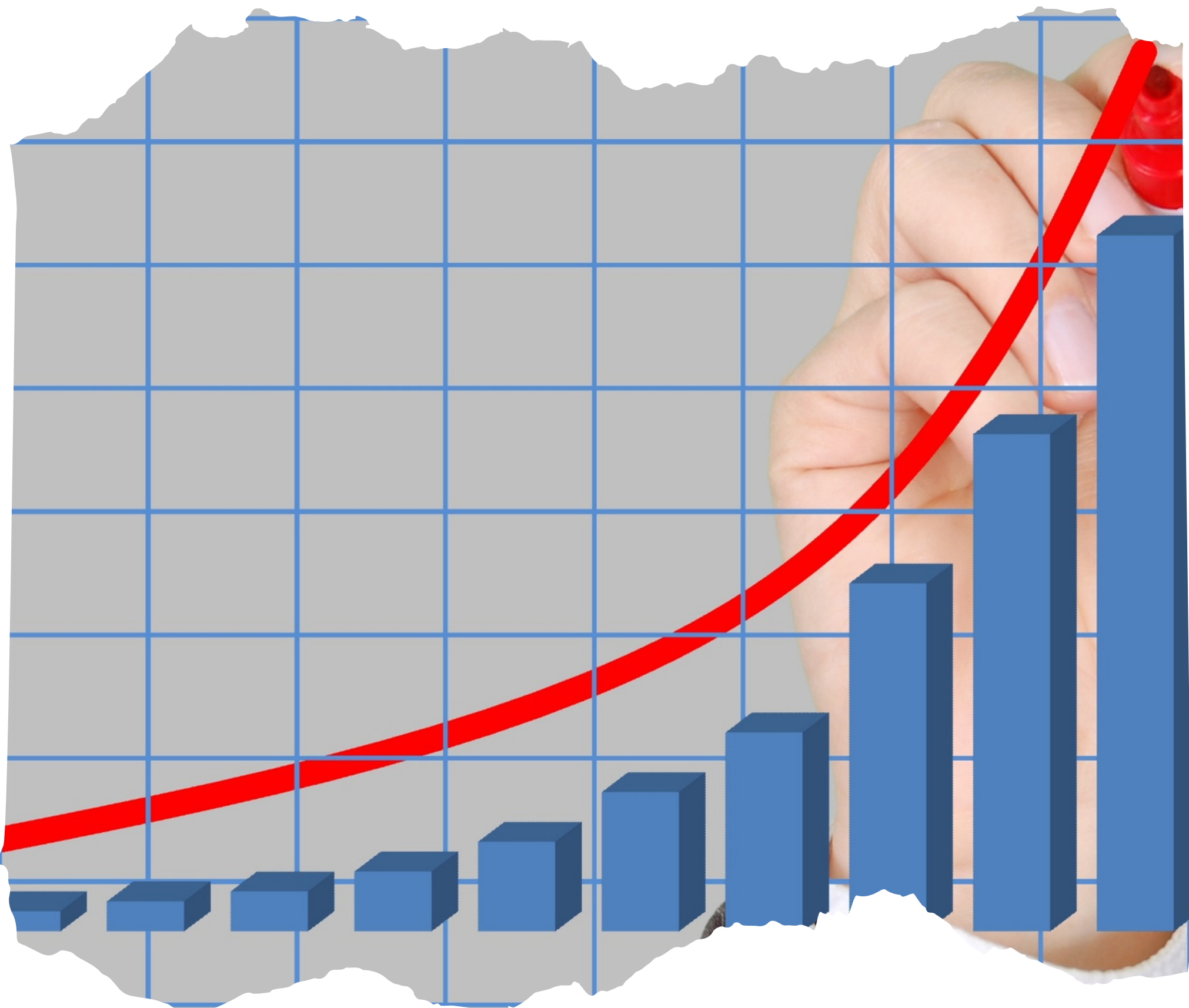
### Market Price per Share/Book Value per Share

Generally, the higher the rate of return a firm is earning on its common equity the higher will be the P/BV ratio. In case of growth firms i.e. firms with high growth of sales and earnings will have this ratio higher than 1, for the reason that the potential future growth in earnings is reflected in the current stock price. Whereas as the book value of equity share is based on historical costs it does not consider the potential growth.

In the workshop, we will share a spread sheet that calculates all the ratios in one click, you do not have to go to the financial statements and calculate all the ratios manually. In the book, we provide you with all the theoretical knowledge so that you can be able to get the logic behind the numbers.

CHAPTER 9

# HOW TO PICK MULTIBAGGER STOCKS





A growing economy like India provides companies with unique growth opportunities. Home-grown 100-baggers in India include well-known companies and brands like Infosys, Axis Bank, Motherson Sumi, Titan, and many more. What's more, these and the other 100-baggers in India do not belong to a single industry or sector, these multi-baggers have historically occurred in multiple sectors.

By definition, a multi-bagger is an equity stock that gives you a return of more than 100%. Make Rs. 100,000 by investing Rs.100. Sounds crazy, doesn't it? Well, Eicher Motors has done it. The equity share of Eicher Motors was trading at Rs. 22 in the year 2000, was quoting at Rs. 20,830 in July 2020. This is a 950x return in 20 years. The share price of Eicher Motors currently is Rs. 2500 after the Eicher Motor stock split which happened in FY21 in the ratio of 1:10.

2,729.00 INR

+2,727.78 (223,588.52%) ↑ all time

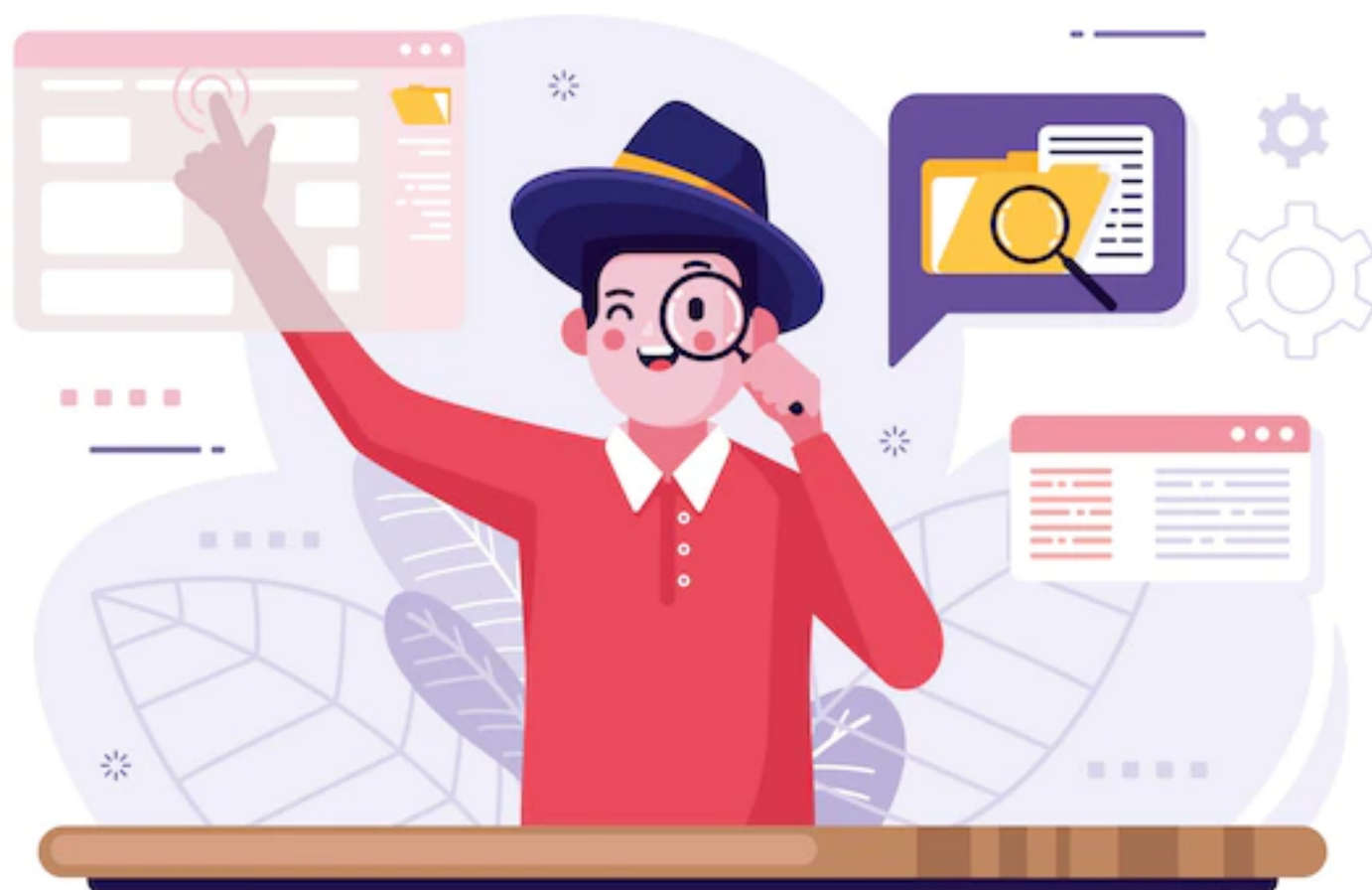
23 May, 3:30 pm IST • Disclaimer



Every investor wishes to own multibaggers in his or her portfolio, but it is not an easy task to find such stocks. Primarily, there are 7 Steps one needs to look at when scouting for these gems. Let's take a look at them below:

## 7 Steps to filter out multi-bagger stocks:

**Step 1:** Principle number one is you have to look for the multi-bagger stocks, we have limited time, limited resources, limited energy, limited money, and limited mental bandwidth. So please don't waste your time on finding a stock that can generate a 5% return or 10% Return. Channelize your energy and focus your energy on finding a stock that can generate a 200% return, 500% return, or 1,000% return. If you look for them, you will find them.





**Step 2:** Principle number two is very important that is high growth in revenues and net profits are nothing but the sales of the company. So, sales and net profits are very important to consider. Without net profit growth share price growth will never happen. And these calculations lead to multi-bagger returns because they are all high-growth companies. For example, in the last 16 years, Bajaj Finance sales revenues are nothing, but the sales of the company and the sales went up by 146 times net profits increased by 104 times.

So, growth is very important and if I must put it into a number, sales growth should be more than 10% and net profit growth should be more than 15%. So, all the businesses in the multi-bagger study were substantially bigger businesses at the end than when they began. Why? Because of growth. They are all high-growth companies and that is principle number two.

Market Summary > Bajaj Finance Ltd

5,782.00 INR

+5,776.25 (100,456.52%) ↑ all time

23 May, 3:30 pm IST • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



**Step 3:** Principle number three is lower multiples PE which is nothing but a favorable price. According to value investing, there are three types of thoughts in your mind about the market, overvalued stocks, fairly valued stocks, and undervalued stocks. 99% of investors lose their hard-earned money in the stock market because they go and invest in overvalued stocks. You can invest even in the fundamentals of capitalism to generate consistent profit in the stock market if you tend to invest in undervalued stocks.

Simply, we can use a simple metric known as the price-to-earnings ratio. Let me give you an example. Let's assume that you want to buy a house as an investment. You don't want to say that as an investment bank, and let's say the price of this house is one crore rupees and the rental income that you can generate from this house is let's say 10 lakh rupees per year. So, what is the price-to-earnings ratio near one crore divided by 10 lakh so it's a price-to-earnings ratio of 10? The maximum PE ratio that you can pay is 20. Never pay more than 20 times your earnings.

If you apply these simple principles, then 99.99% of the time you will not lose your hard-earned money in the stock market and you will have a higher probability of making money in the stock market. So, principle number three is never paying more than 20 times earnings, that is the maximum, and as you can see all the multi-baggers stocks that generated humongous returns were trading at a cheap price. That is the reason they all generated such extraordinary returns.



**Step 4:** Principle number four which is high profitability is very important. Let me give you an example. Let's assume that you have 10 lakh rupees with you today. And if you invest those 10 lakh rupees into a bank every then you will generate around 6% or 7%. But that return is risk-free and stress-free, right. But let's assume that instead of investing that money into bank FD, let's say you want to start a business.

Now, business is risky, there are many micro-level and macro-level risks that you have to face while running a business right. It can be a company-specific risk, it can be an industry-specific risk, it can be market-specific risk or economists disagree. So, there are many micro and macro levels that you have to face while running a business. Staking the return that you generate should compensate for the risk that you are taking right, generating a 6% return while running a business is not enough.

The return that you generate should compensate for the risk you're taking right how do we measure it in India, we call it hurdle rate cost of equity cost of capital there are many names, but just put it this way. The minimum return or the minimum profitability that a business should generate in India is 15%. Any business should generate a minimum return of 15% on its capital. And how do we measure that? We use metrics like return on equity or return on capital employed to measure the profitability of a company and that should be meaningful to 10% in India here you can see all these thoughts in the multi-bagger, they are all highly profitable companies.



**Step 5:** Principle number five is smaller companies. Starting with a calf ends up as an elephant. But if you start as an elephant, then you won't have quite the same dramatic goal. It may seem obvious but people rarely apply this in the stock market. More than 90% of the people who go and invest in large-cap stocks and large-cap stocks are already elephants. If you invest in elephants, then there is no growth. So, it is impossible for you to generate high returns by investing in large-cap companies. Let me give you an example. Reliance Industries is the biggest company in India. This is the number one company in India in terms of market cap. Today its market cap is around 16 lakh crores or 17 lakhs.

Now, let's assume that you want to make tremendous growth in Reliance Industries then what should happen from 17 lakh crores the market cap should increase to 170 lakh crores, what is the total size of the Indian stock market today around \$3 trillion that is 200 to 250 lakh crores that is the total size of the Indian stock market today. And if you want to make 10x in Reliance Industries, then Reliance Industries should become almost 60-70% of the Indian market. So, in order to become a 10x bagger, it needs to add an additional 18,000 crores to its market cap in a country like India with almost 140 crores of population. I don't mean to say that Reliance Industries cannot become a multi-bagger but I think you know it is a lot easier for Lao Balaji to grow its sales and net profits because of its small base. So as a general rule while searching for multi-bagger ideas, focus more on small-cap and mid-cap companies because that is where you will find potential multi-bagger stocks that's where you can generate 5x, 10x or 50x kind of return. So, this is your hunting ground.

Focus on companies with 1000 crores to 30,000 crores market cap. So this is the hunting ground where you will find potential multi-bagger stocks that can generate 5x, 10x or 50x.



**Step 6:** Principle number six is good management. Finding a high-quality business is only half the equation. The other half is high-quality management and management plays a very important role especially when you are investing in small-cap and mid-cap companies. Now for example, if you are analyzing or investing in nest egg ligation paints or Pidilite industries, the business model is already set you know pan India distribution network is there. All the retail and outlet outlets are their brand loyalty and their loyal customer base is already set.

So as long as the management is not doing anything stupid, the business will do fine. But there's something different with small-cap and mid-cap companies because here the management should build the business model and they have to protect it. So, make sure that the management is competent and honest as well. Competency and honesty should be there. That is principle number six.

Market Summary > Pidilite Industries Limited

2,188.60 INR

+2,182.34 (34,861.66%) ↑ all time

23 May, 3:30 pm IST • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



**Step 7:** Principle number seven is the biggest weapon in the stock market. This can be your biggest weapon. This is what Warren Buffett said, you can't make a baby in a month by getting nine women pregnant. Good things just take time, while multi-baggers may take a little longer time. So be patient and give adequate time for our stocks to prove their potential. What kind of returns we are looking for 200% return, 500% return, or 1,000% return these returns cannot be generated in one week or one month, or even two months. It will take time. A stock market is simply a place where the money is transferred from an impatient person to a patient person. So, time is the biggest weapon in the stock market. If you have two years of time, then no one can stop you from making money. In the stock market. It's as simple as that.

We have discussed all the stocks that had provided multifold returns over 5 to 10 years time. Now the question is how to find this type of stock in the future, we will disclose how to find the multi-bagger in our workshop. You will not only pick the right stocks that provide you multifold returns but also you will learn how to build the portfolio of the right combinations so that you can eliminate diversification risk.

## CHAPTER 10

# HOW TO BUILD RISK ADJUSTED MULTIBAGGER PORTFOLIO





## Risk Vs Return Tradeoff:

We all are aiming for higher returns in the stock market. But one thing we need to think always, that in the stock market everybody either sells stock or buys the stock. So, there should be a selling price like a buy price as well. Then how everybody can only make a profit in the market? Basic economics says when a market is based on trade and all stakeholders are in a buyer-seller relationship, it's a zero-sum game, which means all profit and loss sum up to Zero. So, if you want to make a consistent profit, you need to take risks. Now if you ask me, do we need to take risks to earn profit altogether? The answer is no, as that will not be consistent. But if you take the trade-off between risk and return and have a complete understanding of that then consistent profit is possible.

Now questions may come if the risk is more does the return also higher? The answer is, yes, it is true to a certain point, but not beyond that. So, you cannot gain always by taking risks, you must have the knowledge of the saturation point from where the additional risk does not give you a higher return.

## Let us understand why risk is so important in the investment decision:

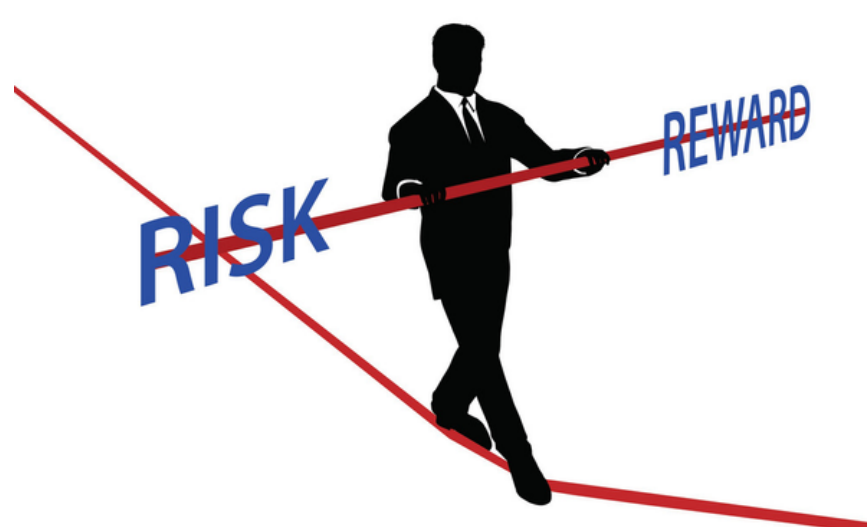
Every investment demands a certain amount of risk and for an investor to undertake this risk demands proper compensation in proportion to the risk taken. In stock market parlance this compensation is known as the risk premium. So, for a regular investor in the stock market the balance between investment, return and risk premium is the key to maintaining consistent positive returns from his or her investments.

You are familiar with the disclaimer from multiple fund houses that "Mutual fund investments are subject to market risks, please read all scheme-related documents carefully before investing." Since mutual fund houses invest in the stock market, they are also exposed to the risk that is in the financial market system. Now as an investor you may have a question in mind that, I understood, there are some risks, but what are the risks? how many of them and what an investor should do to safeguard him/herself against this risk?

Here we will introduce you to two types of risks. One is related to the daily market movement and transactions. This is known as Market risk and another, related to the systematic nature of the market and with the market economy, is known as Inflation risk. In the following paragraphs, let's understand what are these two risks are, and what the impact is?

Market risk is related to the trade done by an investor. The amount of fund you have invested in the market and its actual value today reflects the impact of market risk. Let us understand from a simple example.

Assume you have a two-stock portfolio in the market. Stock A you have purchased ten units at Rs. 225 each and stock B you have purchased twenty units at Rs. 115 each. So, your total portfolio value is Rs. 4550. Now let's say you have a target to earn 16 % return in a year. So, you can consider the target achieved if your total portfolio value is Rs. 5278 at the end of the first year.





## Scenario I

Let's say at the end of 1st-year stock A is being traded at Rs. 220 each and Stock B is traded at Rs. 125 each. So, 1 year after your portfolio value is  $(2200 + 2500) =$  Rs. 4700. Which means your portfolio is in Rs. 150 profits but does it meet the projected return that you are looking at? No. Let me explain.

If you examine carefully, in a year, you have made a return of only 3.29% over your investment. Which is way below of your target 16% and even lower than the minimum risk-free savings bank rate of 4%. This means your investment is exposed to market risk and hence performed poorly despite making some minuscule profit. From the further deep analysis you have found that the stocks are from a similar industry segment and since in the last one-year business outlook of that industrial sector was grossly negative, your overall portfolio has not performed in the desired direction.

## Scenario II

Another associated risk is inflation risk, which has a more direct connection with the country & global macro-economic situation. Inflation risk undervalued the currency hence the real value of the investment become grossly diluted. In the previous case if the rate of annual inflation is around 7%. Then you have made a net loss in your portfolio around  $(7\% - 3.29\%) = 3.71\%$  means your 1-year prior investment of Rs. 4550 has a real value of Rs. 4371 a net real value loss of Rs.179 despite your Rs. 150 profits in the nominal term.

There are ways to manage market risk with proper planning and approaches. however, inflation risk is a longer-term phenomenon and hence cannot be avoided. However, if your strategies and your portfolio consider the inflation forecasts you can avoid devaluation loss due to inflation.

Let's be familiar with some of the risk management strategies of the stock market, which can take care of your investment if followed judiciously and with proper understanding.

**Trend neutral view on the market:** The stock market moves on the trends, there are short-term trends (intraday or a week) or longer-term trends (6 months to 5 years). For a retail investor understanding the trend and acting accordingly is exceedingly difficult as millions of information flow in the market, and correct interpretation of those individually is almost impossible. Hence it is advisable to safeguard against all such trends is to have a 5 to 10-year horizon on investment and follow a correct buy-sell strategy to ward off all adverse trends and be insulated for the longer term.

**Portfolio Diversification:** the most useful risk management strategy in the stock market is to diversify your risk by investing in a multi-stock, multi-sectoral portfolio. The economy has an impact on all sectors. So economic cycle influence differently across sectors and that impact the performance of the companies. For e.g during the covid time, most of the manufacturing, banking, travels & tourism, trade, and hospitality sector was negatively impacted, however, the opposite story was in pharma, medical equipment, and digital technology. If somebody has well-distributed investments in all these sectors, the overall loss was much lesser than other undiversified investors.



**3. Stop Loss:** Stop loss is a common risk management strategy in the short term. It triggers to sell the stock if the traded price starts going below a certain level. This is a powerful self-constrained tool to reduce losses. Knowledge of market exit strategy is very important to apply the correct stop-loss limit. So, for an investor, it is very important to apply stop loss while buying stock in intraday trading.

Warren Buffet always says, 'don't lose money!' but in the highly dynamic and uncertain economic environment and the stock market, it is difficult to save money properly. For a stock market investor, the knowledge of risk management is very vital to safeguard his/her performance. It is commonly said, earning money in the market is a tough ask, but it is even tougher to save the earned money. So, apply your risk understanding and investment knowledge in the market to maintain a consistent profit.

If you want to know the strategy how to make a portfolio that suits your risk appetite, please join our workshop 'How to identify Multibagger Stocks with Value Investing style'. We will disclose all the techniques and strategies. In addition, you will get bonus of worth Rs17,000/ - absolutely free.





[ THIS PAGE INTENTIONALLY LEFT BLANK ]

# A STEP-BY-STEP GUIDE FOR MULTIBAGGER SELECTION

## *Stock Fundamental Analysis & The Secret of Mega Profit*

When it comes to investing, we see that investment in yourself is the best investment as that gives maximum satisfaction. However, when it comes to direct benefit in terms of money/wealth, then the first thing that comes to our mind is the stock market investment. Where we can invest some and get the visible return in a certain time even in days intervals.

The kind of return we receive from invested capital after a long duration (say 5+ years) is the actual benefit of investment. As it is often to be multi-fold than the investment made earlier. This is only possible how better you applied our logic, analysis, and the wisdom that you will learn in our 5 days Bootcamp. You will not only learn the science of investment but also the step-by-step methods to apply it while investing.

In the 5 - Days Live Bootcamp You will learn the nitty-gritty of Value Investing to have sustainable growth in your portfolio. Value investing not only provides the stability in your return by considering the risk factors in the market but also will create an opportunity for you to learn the risk-return trade-off specifically on your risk appetite and your personality.

Open a Demat account and start investing actively or passively by using our e-learnings to maximize profitability today...



*When it comes to investing in the share market, certain key considerations should be kept in mind, the first is timing, the second is consistency, and last but not the least is continuous learning.*

- Saikat Halder, CFA, FRM, MS Finance



**VALUE INVESTMENT  
STRATEGY**

**COPYWRITE FROM  
MONEY LOVES SPEED AND INSTITUTE OF DERIVATIVES**

