HOW TO CHOOSE WINNING STOCKS

REWRITING FORMULAS FOR INVESTMENT

G B R K PRASAD

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Rewriting Formulas for Investment

G.B.R.K. Prasad

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Dedicated to the holy lotus feet of
Samarth Sadguru
Shri Shirdi Sai Baba Garu

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Foreword

This book owes its inspiration to many investors who have been trying so hard to know the basics of investing in equity. It brings together and synthesizes recent technical analysis with basic fundamental analysis. Such a book is necessary because the basic analysis of the stocks and interpretation of these stocks in the current market scenario represent a compilation of extensive knowledge to which readers may not have been exposed.

This book is an explanation of the author's work which will allow a healthy reader to make intelligent decisions about investing in equities. Readers are advised to use it to have a clear understanding of equity instruments and the way to look at the valuations of the equity stocks. The guidance given by the author provides immense opportunity for investors to hone their skills for investing in equities.

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Preface

This book has taken shape out of the personal analyses carried out by the author during 2004–2007 for his investment planning and the research has been based on data gathered from *Business Standard, Capital Market,* and such. Wherever possible the reference dates have been mentioned, but some tables have been presented without the dates. Any errors in the data reported are not intentional or meant to misguide anyone, and are sincerely regretted. This book, which is a unique attempt spread over a period of three years, aims to share investment research methodology with one and all. Considering its objective, any errors in the analyses are sincerely regretted. The author or the publisher do not hold any responsibility for investments made based on the suggestions in this book and the reader is well advised to use his/her judgment in taking investment decisions, which may have prospects for advancement or losses depending on the market conditions which are very dynamic.

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Last, I thank Y. Ramalingeswara Rao for helping me prepare the manuscript.

List of Abbreviations

CEMP	Capital Employed
Div	Dividend
NPM	Net Profit Margin
MCAP	Market Capitalization
ROCE	Return on Capital Employed
ROE	Return on Equity
EPS	Earnings Per Share
R&D	Research and Development
OPM	Operating Profit Margin
FII	Foreign Institutional Investor
UTI	Unit Trust of India
IMFI	Indian Mutual Fund Industry
NAV	Net Asset Value

1 Introduction

Investments in stock markets have attracted the mighty and the low equally well. It is not the level of intelligence but the ability to spot trends and apply common sense that has made many individuals rich in their own rights. Fortunes fluctuate and there is no decisive science to this subject. This book is an attempt to develop a methodology and systematize the effort involved in the art of investing in a scientific fashion based on the experiences of the author and the approach practiced by him. This book aims at generating a supplementary income for the investor who pursues this as a part-time activity in addition to his main professional interest. Therefore, full-time investors are advised to adopt more rigorous tools taught in business schools; however, the layman and the part-time investor can make decent gains by adopting this approach of systematically evaluating options and picking the right one to place bets on. The readers are advised to keep booking profits once they practice this approach because of the uncertainty of markets. There is no real target price to book profit–it depends on the market conditions and profitability of the company in question and various other economic conditions as well as the herd mentality found in stock markets these days. Some of the basic definitions of terms are given subsequently to refresh the naïve reader and to facilitate a better appreciation of the concepts.

The driving forces of stock markets of today and yesteryears have been the same underlying factors as put forth by many. They are:

- Fear
- Greed
- Mass psychology
- Mania making
- Now, in today's technology world, media coverage of the events
- Last, the most neglected fundamentals of investments:
  - Expected growth rate of economy
  - Expected growth rate of company's profits

There are many advocates of various driving forces, and the foremost are Benjamin Graham and Warren Buffett who have advocated the last of the above driving forces, such as the fundamentals of company and investing based on value-based philosophy.

While it is possible to make money with other driving forces if you are on the right side of the coin, what is not realized is that underlying forces of the market are the fundamentals that drive the market. For example, the mania witnessed for Japanese stocks in the 1980s and the technology stocks later on are classic examples of how markets go crazy with investor behavior and how reputed opinion gets formed about the stocks with everyone agreeing on the themes and creating a buying pressure for the theme stocks.

This book covers only the driving force of fundamentals of a company and prescribes an approach based on analyzing the fundamentals of the investment principles by examining the relationship between various entities in valuation, thus deriving a common sense approach to investments based on value principle as advocated by Benjamin Graham and Warren Buffett. While it should be remembered that this prescribes evidence-based systematic analysis of factors that influence a stock price movement based on fundamentals of a company, various approaches described in the book are tools of analysis to arrive

at an investment plan. It can go haywire in the short term due to disturbances in the market and imperfections in market on the basis of news and other criteria. However, in the long term, the theory advocated by many pundits in this field is that the price will move towards its value. Buffett had held on to his stocks for a considerably long time to realize the value and profits—if the fundamentals of the company are improving over a period of time it is better to hold on to the stock rather than selling them. It all depends on the staying power of the investor and also his objective while setting up the investment plan.

For example, different investors may have different objectives, like:

1. I want to generate supplementary income in addition to my professional/business income.
2. I want a quick buck and get out as soon as possible with quick gains.
3. I want value-based investment for long term; say a period of 10 to 30 years.

Let us understand what is value-based investment and its approach to investing conceptually.

VALUE INVESTMENT PHILOSOPHY

Wikipedia gives the definition of value investing as an investment paradigm that derives from the ideas on investment and speculation that Ben Graham and David Dodd began teaching at Columbia Business School in 1928 and subsequently developed in their 1934 text, *Security Analysis*. Although value investing has taken many forms since its inception, it generally involves buying securities whose shares appear underpriced by some form(s) of fundamental analysis. Such securities may be stocks in public companies that trade at discounts to book value or tangible book value, have high dividend yields, have low price-to-earning multiples or have low price-to-book ratios (definitions of these ratios are given subsequently for the understanding of

the reader). Investments based on these principles have stood the test of time over the past 80 years and therefore nothing can be deceitful with this approach. However, one needs to develop a judgment as to which company's share price is at a discount and if there is a margin of safety (which can be defined as ratio of intrinsic value to market price of share). If the margin of safety is more than 1, then one can safely invest in the stock, provided there is no adverse trend developing in the stock.

As mentioned above, value investing is a technique pioneered by Benjamin Graham and perfected and practiced successfully by Warren Buffett. This approach requires that you must master the self discipline to avoid the advice of stock brokers, agents and the plethora of middlemen who promise sky-high returns and such. In addition, you must have a working knowledge of accounts to read the financial statements of companies so that you can interpret them correctly and identify positive and negative points of a company. Just remember you are investing not in the company but in its business and its prospects. Moreover, you should avoid going with the crowd in the stock market so that your analysis and foresight on the business of the company can fetch you gains and you should have the discipline and the wherewithal to avoid shuffling the portfolio at the drop of a hat. These are the basic conditions you must master if you want to be a value investor. Many studies have proven that value investing scores over even the growth investing style and other new fads that have come into the market. Some of the advices given by Buffett in the great book, *How Buffett Does It: 24 Simple Investing Strategies from the World's Greatest Value Investor* by James Pardoe are summarized here for those who want to practice value investing:

- Be patient and invest for the long term for a period of more than 10 years.
- If you have found a great business, stay with it till you reap the rewards and do not exit from the stock on the basis of day-to-day price movements and other short-term trends developing out of the stock. Keep reading a lot about the business and keep adding on to more quantity

if the price comes down below the value due to market imperfections.

- Keep the big picture in mind, do not be swayed by short-term adverse developments and avoid losing confidence in the stock. For example, it is often quoted that Buffett had turned an investment of $10 million into a $1 billion investment by holding on to these shares for life. He did not lose his cool and did not get out of the stock when the stock plummeted by 50 percent within 2 years of his initial purchase. The underlying logic of Buffett was that it was not a volatile business, so he held on and was rewarded for his judgment in collecting an annual dividend check of $10 million every year, which was his initial investment into the company.
- Business analysis and performance is the key to investment. It is always good to study the long-term track record of the company. One should learn to buy into those companies whose business one can understand—this is the thumb rule that one should use.

  It is a well known fact that Buffett did not buy into any of the fancy technology stocks when there was so much clamor for them in the Internet boom era. Buffett did not buy into them as he did not understand their business model. For example, companies like Coca Cola are investment worthy as they have predictable cash flows and are stable companies that will exist even 50 years from now.
- Earnings and cash flows are two foundation stones based on which a company can build its safe future. Look for companies that have sustainable competitive advantage. Here it is advantageous to determine those companies that stand out from their competitors. Remember, though Buffett bought into Berkshire Hathway in 1965, textile operations of the company had to be closed down 20 years later as it was not making money. Similarly, Buffett bought into PetroChina as it was the fourth most profitable oil company in the world and had an assured market in China. After a company is identified, one needs to wait for its price to become attractive.

- It should be borne in mind that businesses wherein change is ubiquitous should be avoided as any technological innovation is likely to make these investments obsolete. Using this criterion it is always preferable to invest in old economy stocks as these are more sustainable.
- Once you are convinced of a company to invest in using this approach, then do not spread your risks by investing less in the company. Focus your attention by putting your big money into that league. The distinguishing style of Buffett is the concentration of portfolio rather than the usual theory of diversification of stocks as practiced by many in the world. For example, Buffett took huge positions in the following companies after his analysis and they are worth billions now: (*a*) Coca Cola: 200 million shares, (*b*) American Express: 151 million shares, and (*c*) PetroChina: 2 billion shares. What is demonstrated by Buffett is that concentration of portfolio rather than diversification is the essence of the game. For example, Berkshire Hathaway, in 2004, had investments only in 10 companies; at times it had invested only in 5 companies. Therefore, buying into the companies with the right businesses and the right price is the essence of value investments as practiced by Buffett.
- If the company you invested in and its business are strong, it will automatically reflect in the operating results and the market price will adjust accordingly in the long term. If your goal is the long-term success of your investments, avoid looking at the prices daily and subjecting yourself to emotions that can make you take a wrong decision. Remember that the stock market is much more than you and your company and reflects the collective opinion and prospects of the company. Remember the popular words of Benjamin Graham who said, 'Markets in the short run is a voting machine and in long run it is like a weighing machine.' If you want to invest like Buffett, practice performance analysis for the company like him and innovate. This book is about new criteria for investments

that have been developed out of fundamental concepts that have been practiced for long and thus prescribes a unique approach to value investing.

- Successful investments of Buffett were made during the market downturns when the usual investor gets out of the falling market by typically cutting his losses. For example, Buffett bought into Washington post at $6 a share when the marked was down in 1973 and more than 30 years later the share reached a price of $900, the second most expensive share in the New York Stock Exchange (NYSE). It is important that one does not run out of cash, particularly during periods of market crisis and should have adequate resources like Buffett to buy into the stock at the bottom of the market.
- Even the great Buffett had his share of misjudgments as admitted by him in the case of Walmart. He admitted that he did not like the share price and missed the opportunity which could have earned him $10 billion later on.

It is crucial that one develops a judgment about the market and companies and their fundamentals so that one who is keen to invest is ready to exercise his/her judgment and reap the rewards later on.

HOW THE STOCK MARKET WORKS IN THE LONG RUN

A study by Barclays bank reproduced from the book, *How the Stock Market Works: A Beginners Guide to Investment* by Micheal Becket is given next to reinforce Buffett's observations. Tables 1.1 and 1.2 show how various types of securities have appreciated if one has invested £100 in 1945 and 1990. This gives an indication of how different classes of securities behave and whether they can beat the inflationary trends in economy and give you real appreciation of your money.

TABLE 1.1 Value of UK Sterling Pound 100 Invested in 1945, Gross Income Reinvested

Type of Security	*Nominal Terms*	*Real Terms*
Equity	97,023	4,132
Gilts	3,296	140
Cash	4,165	177

Source Barclays Capital Gilt Study, 2001

TABLE 1.2 Value of UK Sterling Pound 100 Invested in 1990, Gross Income Reinvested

Type of Security	*Nominal Terms*	*Real Terms*
Equity	405	306
Gilts	324	245
Index-linked gilts	242	182
Treasury bills	200	151
Corporate bonds	361	272

Source Barclays Capital Gilt Study, 2001

It can be clearly seen that Warren Buffett's observation to invest long term in equities is upheld by this study by Barclays over a period of last 50 years. As can be seen, equity as a class of security has outperformed both in nominal and real terms over other types of securities available in the market.

Temperament Required in the Stock Market

A person with a good temperament and an average intelligence can do better in the stock market than a brilliant person with a bad temperament and emotional attachment. This is a must to qualify for investing as stocks fluctuate greatly and require a sober mentality and cool calculatedness. It should be remembered that stocks rarely move up in a straight line and one should learn to invest in the underlying business of the company irrespective of short-term fluctuations in the stock of that company. One should learn to discipline his/her behavior in the stock market while investing and stick by those principles and adapt to circumstances like Buffett has in the market over a period of time.

What this Book Covers and its Learning Objectives

The book teaches different ways of identifying and picking stocks that have the potential for better returns using the intricacies of investment strategies and forming a judgment about how valuation ratios can be used in a better way and about what is good to invest and what is good not to invest by applying the concepts from first principles. The book has a limitation in that it does not teach methods of portfolio analysis, risk minimization, and so on, once the stocks are identified. That is another topic of relevance and is beyond the scope and purview of this book. The book covers ample and different techniques of identifying stocks for possible returns and also has formulas meant to determine when they can be sold to book profits accordingly.

MOST COMMONLY USED TERMS EXPLAINED

Before defining the most important terms commonly used in stock markets, it is ideal to understand what the Profit and Loss statement, Balance Sheet, and Cash Flow Statement of a typical company consist of. Every reader should understand and interpret these statements correctly and learn to use them wisely. It is a skill one has to master over years as there are many intricate financial techniques that are used to sugarcoat the annual reports of a company. One has to learn to understand the implications of these techniques.

A typical Profit and Loss (P&L) statement would consist of the following elements (Table 1.3):

TABLE 1.3 Profit and Loss Statement of XYZ Company for the Year Ended March 2009

Item	*Rs in Crores*
Income	
Expenditure	
EBIDT	
Depreciation	
EBIT	

(*Table 1.3 contd*)

Interest	
Other Income	
PBT	
Tax	
PAT	
Face Value of Share	
EPS	
Margins %	
EBIDT	
EBIT	
NPM	

EBIDT is earnings before interest, depreciation and taxes; EBIT is earnings before interest and taxes; PBT means profit before taxes. PAT means profit after taxes. EPS is earnings per share. Expenditure is the aggregate of all expenses incurred by the company, consisting of raw materials, manufacturing expenses, selling overheads, research and development (R&D) expenses, and so on, which are typically incurred to run the day-to-day operations of the company.

One of the important things to see is how much profit the company is making on its operations and also monitor other income as a percent of sales so that one knows the basic profitability of its core businesses. It is also important that the company maintains a healthy net profit margin (NPM) ratio.

Now, after studying the P&L statement of a company, let us take a look at a typical balance sheet of a company and what it would consist of (Table 1.4):

TABLE 1.4 Balance Sheet of XYZ Company as on 31 March 2009

Item	*Rs in Crores*
Share Capital	
Reserves	
Total Shareholder Funds	
Secured Loans	

(*Table 1.4 contd*)

Unsecured Loans	
Total Debt	
Total Liabilities	
Gross Block	
Less Accumulated Depreciation	
Net Block	
Capital WIP	
Inventories	
Sundry Debtors	
Cash and Bank	
Loans and Advances	
Total Current Assets (A)	
Total Current Liabilities (B)	
Net Current Assets (A – B)	
Miscellaneous Assets Not Written Off	
Net Deferred Tax	
Total Assets	

The balance sheet lists down the assets and liabilities as on a particular date, whereas the P&L statement is for a period and reflects the transactions carried out during that period.

The most important thing to look for in the balance sheet is the debt to equity ratio. Debt carried out beyond reasonable limits can cause problems for the company and the company may go bankrupt, and so on. A reasonable debt–equity ratio for a typical company is 2. Some industries by their very nature require a higher debt–equity ratio (shipping, cement, and so on). Net current assets reflect the working capital amount, which is nothing but excess of current assets over current liabilities and is used to run the day-to-day operations of the company.

Another statement that is important is the cash flow statement, which is a tool to analyze whether the company is generating operating cash flows, and if so, at what level, and so on. This is an important parameter to measure how cash is generated by the company (see Table 1.5).

TABLE 1.5 Cash Flow Statement

PAT	a
Depreciation	b
Change in NWC	c
Operating Cash Flow	d = a + b + c
Capex	
Investment Cash Flow	e
Loans Raised	f
Capital Issue	g
Dividend	h
Financial Cash Flow	i = f + g − h
Opening Cash	j
Closing Cash	k = j + i + d + e

One caution that the reader is advised is that some companies generate cash easily and some companies are hard-pressed due to capital expenditure to be carried out periodically to keep assets in good condition. Thus, one needs to exercise caution in companies that have greater capital spending. Greater the capital spending, the more one needs to utilize this investment carefully and deploy those assets strategically to yield profits–this is the technique that pays off well. Therefore, one needs to evaluate free cash flows of the company (which is nothing but operational cash flow minus capital expenditure), which is a good indicator of the health of the company.

Some of the most popular ratios used in stock market analysis are presented in a structured fashion here (Table 1.6). The most popularly used figures are return on equity (ROE) and return on capital employed (ROCE). These two determine how a typical company rewards its shareholders and adds value to the shareholders. Enterprise value (EV) to sales is a valuation ratio to measure how the company fares over a period of time. Ratio analysis is a quantitative analysis of information contained in financial statements of a company. This analysis is used to compare how a company is performing over a period of time or in relation to its competitors.

TABLE 1.6 Ratio Analysis

Ratios
EBITDA Margin %
EBIT Margin %
Net Profit Margin %
Asset Turnover = Sales/Assets
ROE %
ROCE %
Debt to Equity Ratio
Current Ratio
EV/Sales
EV/EBITDA
P/E
P/BV
Book Value

The quality of management is an important distinguishing factor between good performance and average performance in the stock market. One needs to evaluate the quality of management by asking the following questions:

- Is the management working for shareholders' interest or not?
- Is the management frugal or extravagant?
- Does the annual report truly disclose all relevant information about the business affairs of the company?

The famous Satyam Computers case can reopen the eyes of the investors in analyzing about the management of any company by asking these questions and finding their answers.

Now, since we have a general idea of the stock market and its various related issues, one can define the terms commonly used in stock markets to understand them.

Dividend Yield

One of the basic terms used often is dividend yield of a share. Dividend yield is defined as the return that the investor gets if

he buys into the company at the market price prevalent on that day by calculating the ratio of latest dividend declared by the company per share to the market price prevalent on the day of buying. Therefore, it can be defined as:

Dividend yield = Dividend per share/market price of the share

For the companies being traded in the stock market these days this figure can vary between 0 and 10 percent in the normal range, and more in extreme cases. Generally, this is a conservative return that one gets if one is eligible for dividend. In addition, one can look at share price appreciation as a possible return. One should learn to evaluate a company's share price as to whether it is high or low depending on the dividend yield. If it is low, then the price may not be attractive as the company is not declaring adequate returns in terms of dividend and may be conserving profits for a growth-oriented approach, and so on. There can be many ways in which a company can try to enhance value to its shareholders, but they do not come under the purview of this book.

Dividend Payout

Dividend payout is defined as ratio of dividend per share to earnings per share of the company. In short, this measures how much percent of profits is being distributed as dividend by the company. This declares the company's approach to reward the shareholders. It could be liberal or it could be conservative. This ratio can vary from 0 to more than 100 percent depending on the policy of the company. However, it should be remembered that if it is more than 100 percent, then the company is declaring dividend from past years' profits as well.

Earnings Per Share

Earnings per share (EPS) is defined as ratio of net profit to the number of shares issued by the company.

Price to Earnings Ratio

Another term most commonly used in share markets is price to earnings ratio, or in short, P/E ratio. This ratio is nothing but the ratio of market price to earnings per share of the company. Most of the financial dailies give this statistic in the share quotes papers. P/E ratio can be based on different earnings per shares, namely trailing 12-month basis, historic basis, or futuristic scenario. Therefore, one needs to verify which earnings per share is being talked about when the P/E ratio is mentioned as a yardstick for investment in the shares of a company.

Market Capitalization (MCAP) to Sales

Another important valuation ratio that is discussed and needs to be introduced in this book is the ratio of market capitalization (MCAP) to sales, short form of which is MCAP/Sales.

In general, market capitalization refers to the market value of the shares of the traded company. This fluctuates daily for the company depending on trends in the market. This fluctuation creates an opportunity to invest in the company when they are bought at low prices and sold at high prices later on for profit. This is not so simple in the market, as what is low and what is high is relative in market language and one needs to develop a sharp eye and a knack to judge. In short, the ratio of MCAP to sales is a barometer of valuation of markets in aggregate, as a whole, and also for individual companies. In general, the cut-off point to analyze companies based on this yardstick is whether this ratio is less than one or greater than one. The criteria suggested later on in the book fine-tunes the investment using this ratio.

MCAP/Assets

Another ratio that is used to assess a company's worth is the ratio of market capitalization to value of assets deployed in the company. Therefore, MCAP/Assets throws light on whether the

market is valuing the company at less than its assets or more than its assets. It all depends on how efficiently the company deploys its assets and creates profits. The cut-off point again is one and the explanation for MCAP/Sales holds good for MCAP/Assets too.

Capital Employed

Capital employed in business is nothing but its net worth and long-term borrowings. Net worth is defined as the sum of capital and reserves (accumulated profits) of the company. Long-term borrowings are nothing but the debt that is borrowed for long-term purpose and needs to be deployed in business carefully as it bears interest cost.

Return on Capital Employed

Return on capital employed (ROCE) is nothing but an efficiency measure. It is the ratio of net profit of the company to capital employed in business. The higher the ratio the better the company's performance, as it reveals that the company is leveraging its capital in an optimum manner and is thus on a high profit trajectory. This figure varies from year to year depending on the profitability of the company. Thus, one needs to identify companies that have this ratio growing in a steady manner and ignore temporary boosts in profitability due to the impact of market forces.

Many books have been written on this topic that have added to the thought processes of investors across the globe. This book is an attempt to bring clarity to the thought process and lay down an approach that is purely through data analysis, wherein the insight gained by analysis is used for taking investment decisions. This analysis has been performed successfully by the author and has fetched handsome returns during the past 4–5 years, even though the market was in bull phase and volatile. The author has confidence that the approaches suggested in this book are value-

based investment approaches derived from the fundamentals and will work in any type of market. It is to be noted that the approaches suggested are not for trading in stocks and the investor has to wait patiently for these approaches to yield positive returns. This book advises only on fundamentals in analysis and does not recommend any trading techniques. Therefore, stop-loss criteria is not applicable for all the approaches suggested in this book. Investors have to continuously monitor market conditions and the stocks they have invested in to verify whether the fundamentals of the company are in good shape or not; if they have deteriorated, then exiting the stock is the best option. Therefore, investors are advised to monitor their investments carefully and periodically and revisit the assumptions of these approaches at periodic intervals.

This book is for a reader who is already doing investments haphazardly and prescribes a data analysis methodology wherein the investor can gain handsomely. The investor is advised to keep copies of *Business Standard* newspaper and *Capital Market* fortnightly magazine, which are readily available in the market, so that the reader can identify where to look for the relevant information for working out further the ideas in this book. The published data about the companies in *Capital Market* fortnightly magazine and also *Business Standard* financial daily can be utilized to a great extent and *supplementary income can be generated for sincere investors who follow this approach. This is the entire objective of the book*. The author strongly advocates systematic analysis of factors and data so that investment can become a science. While this approach is not foolproof and is subject to the vagaries of the stock market, it will enable the investor to remain fully armed when the situation is right so that he can move in like Warren Buffett and track stocks and keep adding when the value is attractive for any specific stock. The investor can make use of information available in the following sources:

- *Capital Market* (fortnightly magazine)
- *Business Standard* (daily)
- *Business Line* (Sunday edition)

The first question that an investor should ask is: "What should be the P/E ratio of the company and is it attractive to buy?" The following formula helps one identify companies worthy of investment and accurately predict what should be the *theoretical* price to earnings ratio for any company.

Dividend payout/dividend yield of any company is equal to the theoretical price to earnings ratio.

$$\text{Dividend payout/dividend yield} = \frac{\text{dividend per share/earnings per share}}{\text{dividend per share/market price}} = \text{theoretical price to earnings ratio} \quad \ldots (1)$$

Assumptions and conditions under which this formula can be applied

The P/E ratio is a dynamic variable and depends on market conditions, which fluctuate greatly. However, informed investors who observe the market closely find gaps when a particular scrip is a value buy, and so on, depending on the variations of this ratio. The above formula can be applied to any company that regularly declares dividend. The formula can be applied only if the dividend and EPS are likely to be sustained in future years at the same levels as that of the current year. In essence, the formula should not be applied when earnings and dividends are likely to decrease in future years. Therefore, the holding period for review of decisions made on this formula is *one year* and needs to be reviewed when the next quarterly results are announced as to whether the EPS is maintained at the same level or not. Otherwise, the investor has to book his profits and exit from the scrip as indicated by this formula if the conditions are not fulfilled. It is immaterial if the market is in a bull phase or bear phase, or sideways (that is, when the market is neither going up or down, but in a steady state or consolidating, etc.). The only thing to remember is that the return is faster or slower depending on the market conditions, and so on, and the waiting period for the profits depends exactly on the market conditions. However, one needs to be watchful of the environment of the company

in which investments are made when using this formula. For instance, say it is a sugar company or an oil company and the price of sugar or oil is falling, then investments based on this formula can lead to erroneous results though the formula may recommend based on current year's profitability.

The simple equation (1) analyzes what should be the price to earnings ratio of the firm, which comes very handy for investors. It also identifies value buys when the model predicts a high theoretical P/E ratio and the actual P/E ratio (based on trailing 12 months' EPS) is small. The real reason why these two ratios differ is the basis of calculation. The actual P/E ratio is calculated using the trailing 12 months' EPS (which is the latest possible EPS available and given in *Business Standard* newspaper), whereas, the theoretical P/E ratio indicated by the above formula considers the historic and just-concluded financial year's EPS. If the trailing 12 months' EPS is more than the historic EPS, it gives an opportunity for the price to go up and that is the reason why this formula holds true in investment approach of value buying and predicts correctly despite the market uncertainty, vagaries, and so on. Then the next question that comes to mind is what should be the holding period for buys based on this decision. There can be no answer to this question as the investment horizon indicated by this formula is maximum one year and the formula needs to be applied particularly in view of new evidence in terms of latest dividends and EPS announced by the company; accordingly, the same needs to be updated every year based on the formula. The formula predicts that the company's P/E ratio should get adjusted to the figure indicated in equation (1) over a period of time. The author has time and again verified that the target price given by this formula for a specific company closely reflects the target figures reported using complicated discounted cash flow models worked out by reputed equity research firms (Kotak Securities, for instance, has been verified by the author personally). Thus, the formula gives an opportunity to invest in a particular scrip. Application of this principle can be illustrated through worked out examples from the data published in *Business Standard* dated 24 November 2005 (all Thursday editions of this

paper contain the relevant data for top 200 traded companies of the previous day). In Table 1.7, the data for the first three columns is from the actual P/E ratio to dividend yield taken from this newspaper. Upside potential indicated in the last column is a calculated figure–the ratio of theoretical P/E ratio to actual P/E ratio. This table calculates the gain the investor would make if he/she invests in the particular scrip with its actual P/E ratio and holds on to the stock till its actual P/E ratio becomes equivalent to the theoretical P/E ratio. The experience of the author shows that stock market invariably discovers the value and accordingly the P/E ratio adjusts over a period of time.

TABLE 1.7 Data Analysis for Various Companies as per Dividend Yield Model

Company	*Actual P/E Ratio*	*Div Payout*	*Div Yield*	*Theoretical P/E ratio*	*Upside Potential in Percentage*
Tata Steel	5.31	37.25	1.17	31.83761	499.57
Mphasis BFL	16.99	63.25	1.64	38.56707	126.99
Zee	19.87	23.42	0.66	35.48485	78.58
Kotak Mahindra	33.34	14.23	0.24	59.29167	77.83
Bajaj Hindustan	19.01	4.37	0.16	27.3125	43.67
BPCL	6.12	24.01	2.96	8.111486	32.54
Amtek Auto	26.6	8.9	0.26	34.23077	28.68
Ballarpur	9.68	22.85	1.85	12.35135	27.59
Sun Pharma	28.27	20.55	0.58	35.43103	25.33
Syndicate Bank	7.85	24.23	2.52	9.615079	22.48
Hexaware	17.36	20.2	0.98	20.61224	18.73
Siemens	42.46	17.12	0.34	50.35294	18.58
ABB	40.87	16.99	0.37	45.91892	12.35
Wockhardt	17.63	24.13	1.22	19.77869	12.18
SBI	8.43	13.01	1.39	9.359712	11.02
Nagarjuna Constructions	25.4	14	0.5	28	10.23
Canara Bank	6.29	18.15	2.69	6.747212	7.26
Balrampur Chini	11.62	22.85	1.85	12.35135	6.29
ONGC	10.15	42.17	3.92	10.75765	5.98
UTI Bank	16.51	21.09	1.21	17.42975	5.57

(*Table 1.7 contd*)

Tata Chemicals	11.03	29.24	2.52	11.60317	5.19
Larsen & Toubro	18.76	33.09	1.7	19.46471	3.75
Aftek	13.21	8.05	0.59	13.64407	3.28
TCS	32.55	25.55	0.76	33.61842	3.28
Iflex Solutions	31.82	16.72	0.51	32.78431	3.03
BHEL	26.67	16.7	0.61	27.37705	2.65
Bombay Dyeing	27.36	33.59	1.22	27.53279	0.63
Cipla	25.51	22.59	0.89	25.38202	–0.50
Bank of Baroda	9.23	22.01	2.41	9.13278	–1.05
HCL Info	29.3	74.11	2.56	28.94922	–1.19
M&M	14.55	21.65	1.51	14.33775	–1.45
Gujarat Alkalies	4.64	4.98	1.09	4.568807	–1.53
Bank of India	12.68	25.22	2.02	12.48515	–1.53
Sesa Goa	8.03	18.15	2.31	7.857143	–2.15
Allahabad Bank	6.32	20.73	3.38	6.133136	–2.95
Hero Honda	19.37	44.38	2.37	18.72574	–3.32
Wipro	37.69	20.93	0.58	36.08621	–4.25
BEML	16.47	18.89	1.2	15.74167	–4.42
Dabur India	30.63	43.36	1.49	29.10067	–4.99
Bharat Forge	37.87	25.2	0.71	35.49296	–6.27
HDFC Bank	28.43	17.3	0.65	26.61538	–6.38
Hindustan Unilever	30.95	83.37	2.91	28.64948	–7.43
Mcdowell	60.05	24.41	0.44	55.47727	–7.61
3i Infotech	21.38	15.6	0.79	19.74684	–7.63
PNB	9.23	10.93	1.29	8.472868	–8.20
HDFC	27.47	40.13	1.61	24.92547	–9.26
Andhra Bank	6.86	20.69	3.36	6.157738	–10.23
ITC	14.43	30.88	2.39	12.9205	–10.46
IVRCL	26.93	9.73	0.41	23.73171	–11.87
Ashok Leyland	10.95	31.25	3.24	9.645062	–11.91
Infosys	39.52	14.56	0.42	34.66667	–12.28
SAIL	2.98	17.16	6.59	2.603945	–12.61
ND TV	28.33	11.62	0.47	24.7234	–12.73
IPCL	5.1	8.65	1.96	4.413265	–13.46
Adlabs	48.57	27.55	0.66	41.74242	–14.05
Voltas	31.01	27.16	1.02	26.62745	–14.13

(*Table 1.7 contd*)

JSW Steel	3.23	9.4	3.42	2.748538	–14.90
Indian Oil	9.78	24.32	2.93	8.300341	–15.12
Glaxo Pharma	29.95	59.78	2.36	25.33051	–15.42
Bajaj Auto	26.07	26.57	1.21	21.95868	–15.77
Gateway	57.23	36.35	0.76	47.82895	–16.42
HCL Technologies	49.17	127.24	3.11	40.91318	–16.79
GAIL	9	23.32	3.12	7.474359	–16.95
Colgate	31.9	70.18	2.65	26.48302	–16.98
Satyam	29.24	18.69	0.77	24.27273	–16.98
Tata Motors	15.25	26.8	2.18	12.29358	–19.38
Patni Computers	25.06	9.01	0.45	20.02222	–20.10
NTPC	13.82	25.48	2.33	10.93562	–20.87
GE Shipping	5.01	15.55	4.01	3.877805	–22.59
GNFC	5.6	17.65	4.08	4.32598	–22.75
SCI	3.38	11.51	4.41	2.609977	–22.78
Cummins	22.5	45.79	2.64	17.3447	–22.91
NALCO	9.49	15.2	2.1	7.238095	–23.72
Union bank	8.63	20.32	3.11	6.533762	–24.29
Oriental	9.84	6.77	0.92	7.358696	–25.21
Rolta	10.72	15.03	1.89	7.952381	–25.81
Matrix	25.58	12.14	0.64	18.96875	–25.84
Grasim	13.95	12.53	1.22	10.27049	–26.37
Indian Hotels	35.2	30.9	1.2	25.75	–26.84
HPCL	7.74	26.3	4.65	5.655914	–26.92
Titan Industries	79.77	18.02	0.31	58.12903	–27.12
ICICI Bank	21.12	24.39	1.62	15.05556	–28.71
ACC	22.91	22.11	1.36	16.25735	–29.03
VSNL	13.47	17.09	1.79	9.547486	–29.12
Reliance Energy	18.3	10.08	0.79	12.75949	–30.27
Hindalco	11.81	10.35	1.28	8.085938	–31.53
Gujarat Ambuja Cements	24.02	28.5	1.74	16.37931	–31.80
Maruti	19.63	4.41	0.33	13.36364	–31.92
Reliance Industries	15.21	9.25	0.9	10.27778	–32.42
Tata Power	14.93	16.31	1.7	9.594118	–35.73
Polaris	20.93	18.68	1.41	13.24823	–36.70

(*Table 1.7 contd*)

GTL	7.66	7.3	1.52	4.802632	–37.30
Jindal Stainless	5.71	7	2	3.5	–38.70
Jaiprakash	27.86	12.41	0.74	16.77027	–39.80
MTNL	8.78	18.45	3.73	4.946381	–43.66
Visual Soft	15.17	10.51	1.27	8.275591	–45.44
Century Textiles	20.91	9.41	0.87	10.81609	–48.27
Arvind Mills	19.25	7.07	0.86	8.22093	–57.29
GHCL	31.97	25	1.98	12.62626	–60.50
CESC	11.35	4.24	0.97	4.371134	–61.48
Ranbaxy	66.25	53.69	2.32	23.14224	–65.06
Gammon	113.41	4.87	0.13	37.46154	–66.96
Reliance Cap	243.01	27.48	0.41	67.02439	–72.41
Orchid	47.62	14.69	1.25	11.752	–75.32
Dr Reddys	222.29	24.23	0.54	44.87037	–79.81

Source *Business Standard*, 24 November 2005 (for columns 1–3).

The model clearly shows that Tata Steel, Mphasis BFL, Kotak Mahindra, Bajaj Hindustan, and so on, had good potential to go up as on that date. One can decide and invest in these stocks based on other risk considerations and actual status of the market by looking at other parameters (like sugar prices falling for instance in case of Bajaj Hindustan) and then take a decision on which scrip to invest. The model has clearly shown in actual practice to be helpful in identifying companies whose P/E ratio is not reflected correctly in the market. Most of the time the decisions using the above approach have benefited the author considerably. The author has found that in practice this simple model predicts correctly the same target price recommended by reputed research firms using complicated discounted cash flow models. This model is simple in approach and offers definite clarity and comes handy for analysis. The only shortcoming of this approach is that this calculation does not predict what would be the returns in a short span of time. One has to wait till the market recognizes the particular scrip, and sufficient time is given for adjustment of P/E ratio to theoretical parameters. In a bull market the returns will be faster and in a bear market the returns would be slower as the market has to discount negative news and recognize the value in the stock.

One aspect that has to be mentioned is that whenever the upside potential is indicated as negative for some companies, it only reinforces the observations that current dividend payout policy of the company does not justify the actual P/E ratio and that the price may have been arrived at based on the earnings growth rate projected, expectations of new products, takeover, acquisitions, or some other good news factored in, and so on. Any other inference can be misleading since P/E ratio discounted by market may be considering the growth rate of the company and other factors and hence, the actual P/E ratio can become more than the theoretical P/E ratio, as is the case in most of the firms in the Table 1.7.

One can decide whether to wait till the actual P/E ratio equals the theoretical P/E ratio. But the author suggests that one can book profit at an appropriate time as markets are uncertain. One should partially book profits once this approach yields positive results as the objective is to generate a supplementary income to the investor, which means booking a profit after a reasonable rise in price as per market conditions.

Results are once again verified in the latest possible way to show that this method works even in bear market, which was the case in 2008 (Table 1.8).

TABLE 1.8 Movement of P/E Ratios of Stocks Identified

Company	*Actual P/E ratio as on 24/11/2005*	*P/E ratio as on 2/7/2007*	*Theoretical P/E ratio indicated by the firm*	*P/E ratio as on 6/8/2008*
Tata Steel	5.31	8.68	31.83761	6.14
Mphasis BFL	16.99	47.21	38.56707	16.77
Kotak Bank	33.34	41.27	59.29167	63.24
Bajaj Hindustan	19.01	12.73	27.3125	31.32

Source *Business Standard*, 6 August 2008.

It can be seen that Tata Steel and Mphasis BFL have appreciated considerably and Bajaj Hindustan has corrected due to correction in sugar scrips. Therefore, considering the experience of Bajaj

Hindustan, it is preferable for investors to keep booking the profit periodically after there is an appreciation of 15 percent. If the individual has staying power in the market then he can wait till the actual P/E ratio equals the theoretical P/E ratio.

Valuation Ratios Related to Market Capitalization 2

While there is no doubt that there are many parameters to judge whether valuations are right or wrong, the ratio of market capitalization to sales is one ratio that gives a beautiful insight into the working of the various parameters. Other parameters to consider are the following:

- Price to earnings ratio, which is the ratio of market capitalization to net profit.
- Price to book value, which is the ratio of market capitalization to net worth.
- Dividend yield.
- Enterprise value to EBIDT.
- Market capitalization to operating profit.
- Market capitalization to sales.

FIRST MODEL

Here we will discuss the intricacies and making use of market capitalization to sales ratio in an innovative way.

$$\text{Market capitalization/sales} = \text{number of shares} \times \text{market price/sales}$$

Using this formula and dividing and multiplying by net profit will result in the following:

$$\frac{\text{MCAP}}{\text{Sales}} = \frac{\text{number of shares} \times \text{market price}}{\text{sales}} \times \frac{\text{net profit}}{\text{net profit}}$$

$$= \left(\frac{\text{net profit}}{\text{sales}}\right) \times \left(\frac{\text{market price}}{\text{earnings per share}}\right)$$

$$= \text{net profit margin} \times \frac{\text{P}}{\text{E}} \text{ ratio} \qquad \ldots(2)$$

While formula (2) is simple and taught to many students and listed in many books on finance and investment management, the application of this formula to stock market investing is on the lower side. While it requires judgment to say whether the MCAP/Sales ratio is attractive or not, what is not correctly seen is that this model can pick out winners from the basic principles.

Using the aforementioned model, the following scenarios arise for analysis (Table 2.1).

TABLE 2.1 Analysis of Scenarios of MCAP/Sales Ratios

MCAP/Sales	*Net Profit Margin*	*P/E Ratio*	*Action Proposed*
High	High	High	Risky for investment. Opportunity for value appreciation may be limited.
Value needs to be judged.	High	Low	Attractive for investment and hence less risky. There may be more value in these stocks and it needs to be harnessed.
Value needs to be judged.	Low	High	Risky for investment.
Low	Low	Low	Not so attractive for investment.

Source Author.

Using the above formula, one can say that I will not invest in any company that has a net profit margin of less than bank savings rate and then I will develop a strategy to analyze the stocks that give attractive returns. While practicing this formula, it is seen that MNCs and FMCGs have very high MCAP/Sales ratios and they have to be valuated accordingly. It is a relative valuation, based on either sector average net profit margin or P/E ratio as given in capital market publications; comparing the competing companies in the same sector would reveal opportunities for investment. How do we use the aforementioned formulae to our advantage? Thus as shown in Formula 2:

$$\frac{\text{MCAP}}{\text{Sales}} = \text{NPM} \times \frac{\text{P}}{\text{E}} \text{ ratio} \qquad \ldots(3)$$

Table 2.2 analyzes the range of ratio of MCAP/Sales in the market for different companies and how segmentation of the same can be done to arrive at investment decisions.

TABLE 2.2 Basis for Investment Logic Using MCAP/Sales Ratio

MCAP/ Sales	*Explanation*	*Conditions under which to Exit*
< 1.0	One needs to identify companies, which have high net profit margin (NPM) and less P/E ratio and invest in them.	Investment decisions based on this criteria have to be looked at along with market sentiments. In addition the company invested in should not have a drop in its NPM when the next financial results are out (there should not be a drop in NPM even in quarterly results). Then you can hold on and continue to wait as long as the company's P/E ratio is less than its competitors but the NPM is more and its performance does not deteriorate. These are small to mid cap companies and value needs to be harnessed in them by using this formula.

(*Table 2.2 contd*)

> 1.0 to < 2.0	High performing companies have this range. One needs to identify companies that have high NPM and less P/E ratio and invest in them.	This is a reasonable range for any company's MCAP/Sales to fall within, and it is not overpriced. However, one needs to frequently cross-check market conditions for the company so that it does not get overvalued.
> 2.0	Only high growth prospect companies, MNCs and FMCGs are discounted with this high value. Here also, one needs to identify companies that have high NPM and less P/E ratio and invest in them.	Investments in these companies are more risky than the above two categories of companies and one has to be careful about investing in these companies. However, most of the companies that have this range are MNCs and FMCGs and they have better brand images. Drastic fall in the prices of stocks of these companies may not happen as compared to the first type of companies, which invariably are small cap and mid cap companies. Most of the companies in this range are reputed large cap companies, which offer reasonable returns but not extraordinary returns.

Source Author.

How Does One Decide When to Exit The Stock Using This Model?

If you feel that MCAP/Sales has grown faster for the company than the market as a whole or in aggregate, then you should book profits. MCAP/Sales ratio is also a good indicator of overheatedness in the market and whether it is overvalued. One should learn to see if MCAP is growing at a faster rate than sales of the companies or profitability of companies is coming down, and so on. Then it is better to exit the stock irrespective of the market conditions, whether bull or bear. Not greed or wishful thinking but plain objective assessment of data indicated by the companies should be used for value-based investment approach advocated in this book.

Assuming that we want to conservatively look at companies with MCAP/Sales ratio of less than one and find whether there exists value in them, then the companies which we want to identify can be looked in the following ways:

- Identify companies with NPM ≥ 10 percent and companies with price to earnings (P/E) ratio of < 10.
- One can identify companies which have high NPM and simultaneously have low P/E ratio.

This will ensure that one finds value in the buying using the above approach. Table 2.3 lists companies sorted out in descending order of MCAP/Sales ratio.

TABLE 2.3 Companies Sorted Out on the Basis of MCAP/Sales

Company	*Sales (in Rs crores)*	*MCAP (in Rs crores)*	*MCAP/Sales*
Infosys	9,521	120,312	12.64
Bharti Airtel	11,664	109,403	9.38
Suzlon Energy	3,841	35,449	9.23
TCS	13,263	109,505	8.26
Wipro	10,602	80,452	7.59
NMDC	3,710	26,366	7.11
Cipla	2,897	18,678	6.45
ITC	10,317	65,280	6.33
Satyam	4,792	28,957	6.04
Gujarat Ambuja Cements	3,074	17,734	5.77
ACC	3,318	18,220	5.49
Container Corpn.	2,433	13,218	5.43
Dr Reddys	2,355	12,521	5.32
ABB	2,963	14,733	4.97
Siemens	3,637	17,606	4.84
Dabur India	1,722	8,096	4.70
Indian Hotels	1,837	8,411	4.58
BHEL	13,442	59,448	4.42
Jaiprakash	3,273	14,313	4.37
Hindustan Unilever	11,579	49,361	4.26

(*Table 2.3 contd*)

Neyveli Lignite	2,201	9,210	4.18
NTPC	26,985	112,798	4.18
HCL Tech.	4,571	19,054	4.17
Nestle	2,475	10,063	4.07
Reliance Energy	3,976	15,417	3.88
Motor Industries	2,977	10,627	3.57
United Phosphorous	1,668	5,636	3.38
Pantaloon	1,867	5,912	3.17
Bajaj Auto	8,161	25,584	3.13
PCS	1,954	5,392	2.76
Punj Lloyd	1,727	4,761	2.76
Cummins	1,806	4,971	2.75
NALCO	4,854	12,947	2.67
ONGC	65,523	172,288	2.63
Ranbaxy	5,157	13,404	2.60
Lupin	1,685	4,377	2.60
Bharat Electronics	3,653	9,306	2.55
IVRCL	1,712	4,164	2.43
Sesa Goa	1,907	4,596	2.41
Jindal Steel & Power	2,564	6,140	2.39
VSNL	4,562	10,881	2.39
L&T	16,537	39,117	2.37
Godrej Industries	2,034	4,791	2.36
Bharat Forge	2,971	6,961	2.34
Grasim	10,213	22,980	2.25
Aditya Birla Nuovo	4,817	10,685	2.22
Asian Paints	3,166	6,762	2.14
Sterlite	13,102	27,890	2.13
Nagarjuna Constructions	1,829	3,884	2.12
Maruti	12,106	25,540	2.11
Reliance	80,055	168,402	2.10
Century Textiles	2,589	5,441	2.10
M&M	9,807	18,766	1.91
TATA Power	5,739	10,691	1.86
HCC	2,024	3,560	1.76
Hero Honda	8,713	14,478	1.66
Voltas	1,954	3,243	1.66

(*Table 2.3 contd*)

BEML	2,056	3,397	1.65
Hindalco	11,761	19,418	1.65
Crompton	4,132	6,561	1.59
Britannia	1,713	2,631	1.54
Moser Baer	1,663	2,553	1.54
Raymond	1,717	2,621	1.53
GE Shipping	2,036	3,062	1.50
MTNL	5,572	8,051	1.44
Videocon	6,709	9,322	1.39
TATA Motors	23,587	31,618	1.34
Nirma	2,088	2,797	1.34
GAIL	16,770	21,471	1.28
TATA Chemicals	3,502	4,473	1.28
TATA Steel	20,244	25,572	1.26
TATA Tea	3,101	3,912	1.26
SCI	3,531	4,392	1.24
SAIL	28,346	34,220	1.21
Ashok Leyland	5,329	5,179	0.97
CESC	2,556	2,404	0.94
Ballarpur	1,908	1,739	0.91
Jet Airways	5,693	5,172	0.91
JSW Steel	6,018	4,911	0.82
Jindal Sawd	2,267	1,774	0.78
Vardhman Text	1,949	1,489	0.76
ITI	1,660	1,195	0.72
DCM Shriram Consolidate	2,398	1,723	0.72
Apollo	2,613	1,687	0.65
Welspun Gujarat Stahl	1,787	1,099	0.61
RCF	3,044	1,864	0.61
Jindal Stainless	3,131	1,869	0.60
IPCL	10,864	6,475	0.60
MRF	2,950	1,748	0.59
MMTC	16,393	9,525	0.58
Essar Steel	6,168	3,550	0.58
GNFC	2,448	1,360	0.56
Sundaram Clayton	4,112	2,181	0.53

(*Table 2.3 contd*)

Bhushan Steel	2,716	1,357	0.50
GSFC	2,832	1,372	0.48
Arvind Mills	2,125	1,006	0.47
Chambal Fertilizers	3,084	1,438	0.47
Adani	12,336	5,428	0.44
EID Parry	2,892	1,183	0.41
Usha Martin	1,796	706	0.39
National Fertilizer	3,590	1,400	0.39
Mukand	1,667	566	0.34
Indo Rama Synthetics	1,912	626	0.33
HCL Info	11,368	3,676	0.32
CEAT	1,744	535	0.31
IOCL	162,418	46,486	0.29
Ispat Industries	4,914	1,295	0.26
JK Industries	2,078	479	0.23
PTC India	3,108	713	0.23
Rajesh Exports	5,283	1,131	0.21
Ruchi Soya	5,687	871	0.15
BPCL	75,850	11,428	0.15
Uttam Galva	1,788	239	0.13
Zuari	3,585	456	0.13
HPCL	75,143	8,763	0.12
STC India	7,595	418	0.06
National Steel	1,911	61	0.03
Surana Corp.	1,693	45	0.03
Vishal Exports	3,936	79	0.02

Source Data compiled from *Capital Market*, January 2007.

Table 2.3 lists down companies in descending order of MCAP/Sales ratio and serious investors can identify companies for further research by short listing the companies that have a MCAP/Sales ratio of less than 1 and in the range indicated in Table 2.1 and Table 2.2.

Table 2.4 analyzes the Equation (2) parameters and shows how to identify shares in the Nifty basket of companies for investment.

TABLE 2.4 NPM and P/E Ratio for Nifty Basket of Companies

Company	*NPM*	*P/E Ratio*	*MCAP/Sales*
Reliance Industries	0.1112	18.7	2.079
ONGC	0.2919	12.5	3.648
Bharti Airtel	0.178	42.3	7.52
TCS	0.2414	34.7	8.37
Infosys	0.2682	40.2	10.78
ICICI Bank	0.1346	27.4	3.68
Wipro	0.1954	34	6.64
BHEL	0.1247	29.9	3.72
ITC	0.2324	25.8	5.99
SBI	0.1019	16.2	1.65
SAIL	0.1415	7.4	1.04
L&T	0.0586	40.6	2.37
HLL	0.1197	32.2	3.85
HDFC	0.2826	29.6	8.19
Suzlon Energy	0.2167	37.5	8.12
HDFC Bank	0.1529	32	4.89
Tata Steel	0.2316	7.7	1.78
Satyam Computers	0.2186	24.5	5.35
Sterlite Industries	0.0689	34.3	2.36
Tata Motors	0.068	20.6	1.40
Bajaj Auto	0.1393	23.0	3.2
GAIL	0.1413	10.4	1.469
Maruti Udyog	0.0996	18.5	1.84
Grasim	0.119	24.2	2.879
HCL Tech	0.1856	28.9	5.36
Sun Pharma	0.2676	34.6	9.25
Cipla	0.2122	26.3	5.58
Siemens	0.0798	34.2	2.72
M&M	0.0858	24.1	2.06
Ambuja Cement	0.2196	22.2	4.87
Hindalco	0.1444	9.4	1.35
ABB	0.074	50	3.7
Nalco	0.3170	6.2	1.96

(*Table 2.4 contd*)

PNB	0.1295	10.2	1.32
ACC	0.097	22.9	2.22
Hero Honda	0.1028	16.5	1.69
Ranbaxy	0.048	47	2.25
Zee	0.083	213	17.67
VSNL	0.1377	23.2	3.19
Relaince Energy	0.1614	16.2	2.61
Dr Reddys	0.092	31.8	2.92
BPCL	0.0038	8.4	0.03
Tata Power	0.1024	19.9	2.03
Glaxo Pharma	0.2081	27.4	5.7
IPCL	0.0988	7.1	0.70
MTNL	0.105	17.4	1.827
HPCL	0.00569	5.9	0.03
Dabur	0.1393	37.4	4.97

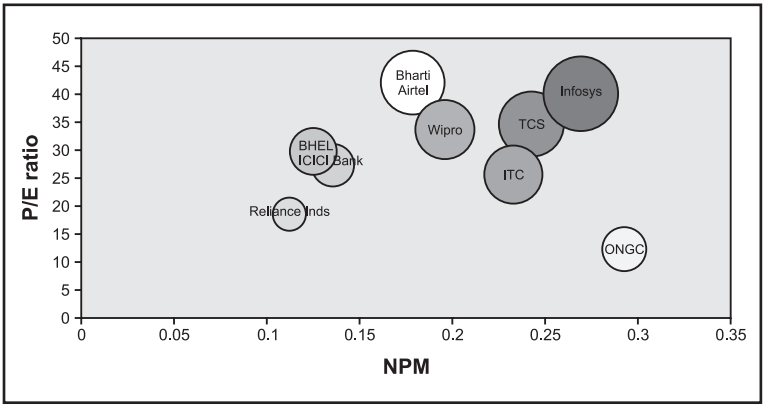
Source *Capital Market,* 1–14 January 2007.

From Table 2.4 it can be seen that value lies in buying the following shares among the Nifty stocks as they have high NPM, low P/E and thus a reasonable MCAP/Sales Ratio.

- SBI
- Tata Steel
- M & M
- Maruti
- Hero Honda
- IPCL

Converting the above table by grouping 10–12 companies into one category and projecting it as bubble chart, wherein the X-axis is NPM and Y-axis is P/E ratio, helps to clearly know the implications of this model. The bubble size indicates the value of MCAP/Sales. This kind of graph can help us identify which companies are attractive to buy to invest. In Figure 2.1, the bubble size indicates the ratio of MCAP/Sales.

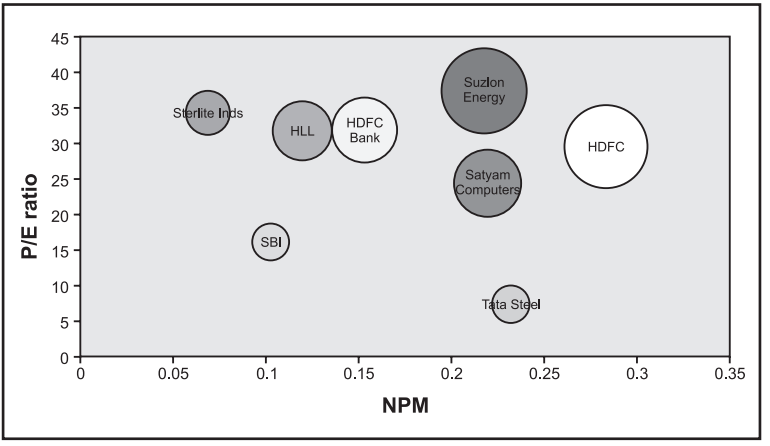
FIGURE 2.1 NPM vs P/E Ratio: Illustration 1



Source Created from the data in Table 2.4.

Figure 2.1 clearly illustrates that ONGC is a clear choice for investment as its P/E ratio is low but NPM is high.

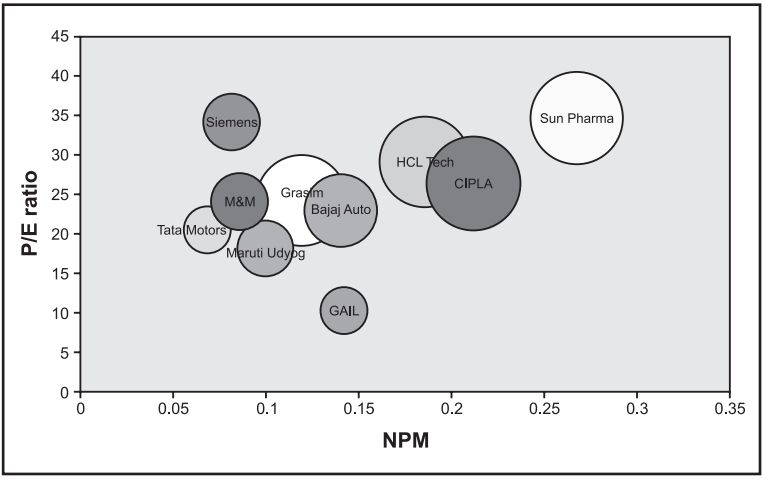
FIGURE 2.2 NPM vs P/E Ratio: Illustration 2



Source Created from the data in Table 2.4.

Figure 2.2 clearly illustrates that Tata Steel is a clear choice for investment as its P/E ratio is low but NPM is high.

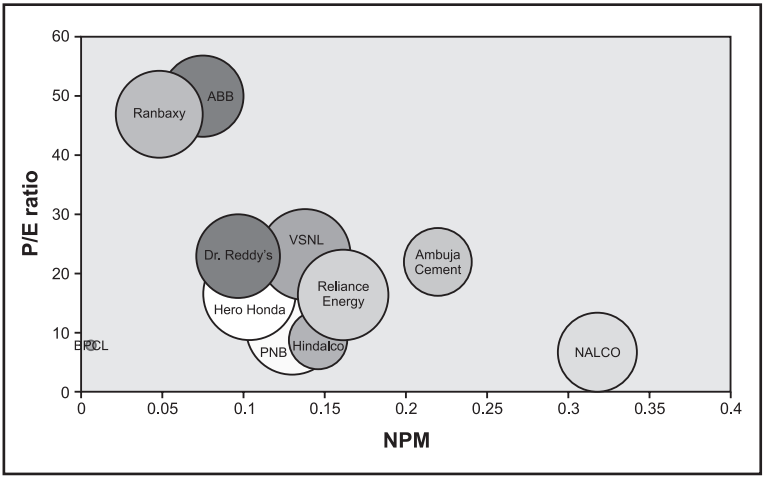
FIGURE 2.3 NPM vs P/E Ratio: Illustration 3



Source Created from the data in Table 2.4.

Figure 2.3 clearly illustrates that GAIL is a clear choice for investment as its P/E ratio is low but NPM is high.

FIGURE 2.4 NPM vs P/E Ratio: Illustration 4



Source Created from the data in Table 2.4.

Figure 2.4 clearly illustrates that Nalco is a clear choice for investment as its P/E ratio is low but NPM is high.

However, one can justify higher valuation of MCAP/Sales ratio if the growth rates of business are high for that company and accordingly decisions have to be taken. One can also compare the competing companies in the same sector and arrive at conclusions as to where to put your money based on this parameter. For example, using data from Table 2.4, we can create Table 2.5, which shows a summary about how competing companies are faring in terms of NPM and P/E ratio.

TABLE 2.5 Examples of High NPM and Low P/E Ratio for Competing Companies

Company	*NPM*	*P/E Ratio*	*Conclusion*
Reliance Energy	0.1614	16.2	Reliance Energy is fundamentally stronger based on this model when compared to Tata Power as its NPM is more and P/E ratio is lesser.
Tata Power	0.1024	19.9	

Source Author (created from the data in Table 2.4).

Similarly, one can conclude that HPCL is a better bet to put your money over BPCL based on this analogy. Similar is the case between two companies in the Aluminium sector, namely Nalco and Hindalco. Nalco appears to be a better bet with relatively low P/E ratio and better NPM.

Sifting through this data, one can identify such opportunities among the Nifty-based stocks themselves. This only leads to conclude that there are many such opportunities available when the entire database of corporations is analyzed.

The author has deliberately ignored the banking stocks as this criterion does not assess them properly and has applied this criterion to manufacturing companies only. Oil companies can be ignored due to the vagaries of government policy and accordingly other companies may be considered. A different variant of Dogs of Dow theory can be practiced using this valuation ratio. Dogs of Dow theory suggests that one should identify the top 5 or top 10 companies for investment amongst the SENSEX or Nifty

basket of companies wherein the dividend yield is the highest. This has proved to be a good investment option over the period of time since this strategy is suggested by Micheal O'Higgins in 1991. Taking cue from this, it is suggested that the same strategy be tried out on SENSEX or Nifty companies wherein the ratio of MCAP/Sales is the least.

SECOND MODEL

MCAP/capital employed can be written as ROCE × P/E Ratio

$$\text{MCAP/capital employed} = \frac{\text{number of share} \times \text{price}}{\text{capital employed}}$$

Multiplying and dividing the above equation by net profit, we get:

$$\text{MCAP/capital employed} = \left(\frac{\text{number of shares}}{\text{net profit}}\right) \times \frac{\text{price} \times \text{net profit}}{\text{capital employed}}$$

$$= \text{price/EPS} \times \text{return on capital employed (ROCE)} \qquad ...(4)$$

This model identifies potential and risk free investments that have high ROCE and less P/E ratio, similar to the applications indicated for MCAP/Sales (Table 2.6).

TABLE 2.6 Risk Assessment of Investments Using ROCE Approach

MCAP/Capital Employed	*Return on Capital Employed*	*P/E Ratio*	*Action Proposed*
High	High	High	Risky for investment
Value cannot be judged	High	Low	Attractive for investment
Value cannot be judged	Low	High	Risky for investment
Low and needs to be studied in greater depth	Low	Low	Not so attractive for investment

Source Author.

Table 2.6 depicts the options available for investment and explains the logic for investments. Table 2.7 lists select companies from *Business Standard* dated 27 April 2007 using the aforementioned approach for companies in the Nifty index.

TABLE 2.7 ROCE vs P/E Ratio

Company	*Return on Capital*	*P/E Ratio*	*MCAP/Capital Employed*
Reliance Industries	0.1728	23.7	4.09
ONGC	0.3281	13.32	4.37
Bharti Airtel	0.2080	50.09	10.42
TCS	0.5147	28.63	14.73
Infosys	0.3968	29.88	11.85
Reliance Comm.	0.06	218.11	13.08
ICICI Bank	0.0632	35.73	2.25
Wipro	0.3621	28.09	10.17
BHEL	0.3337	28.82	9.61
ITC	0.3558	26.48	9.42
SBI	0.0718	7.05	0.501
SAIL	0.3653	13.66	4.99
L&T	0.2564	39.63	10.16
HLL	0.7827	25.1	19.64
HDFC	0.0794	30.36	2.41
Suzlon Energy	0.3031	46.37	14.05
HDFC Bank	0.0611	28.71	1.75
Tata Steel	0.4407	8.12	3.57
Satyam Computers	0.3333	21.92	7.30
Sterlite Industries	0.1299	5.27	0.68
Tata Motors	0.2782	17.10	4.75
Bajaj Auto	0.2534	21.24	5.38
GAIL	0.2854	11.69	3.33
Maruti Udyog	0.3205	14.51	4.65
Grasim	0.1873	10.23	1.91
HCL Tech.	0.2574	31.28	8.05
Sun Pharma	0.1557	29.47	4.58
Cipla	0.2972	29.81	8.86
Siemens	0.4922	49.54	24.38

(*Table 2.7 contd*)

M&M	0.2982	13.4	3.99
Ambuja Cement	0.4488	10.86	4.87
Hindalco	0.1606	10.83	1.74
ABB	0.3881	46.21	17.93
Nalco	0.4179	6.73	2.81
PNB	0.0574	10.45	0.60
ACC	0.4282	30.37	13.00
Hero Honda	0.6447	14.63	9.43
Ranbaxy	0.0669	26.54	1.77
Zee	0.0566	49.45	2.80
VSNL	0.1118	179.39	20.05
Reliance Energy	0.086	14.15	1.21
Dr Reddys	0.0905	24.63	2.23
BPCL	0.0281	10.65	0.299
Tata Power	0.1179	18.52	2.18
Glaxo Pharma	0.6169	18.48	11.40
IPCL	0.2819	7.33	2.066
MTNL	0.0619	10.17	0.62
HPCL	0.0288	20.55	0.59
Dabur	0.4709	32.61	15.35

Source *Business Standard*, 27 April 2007.

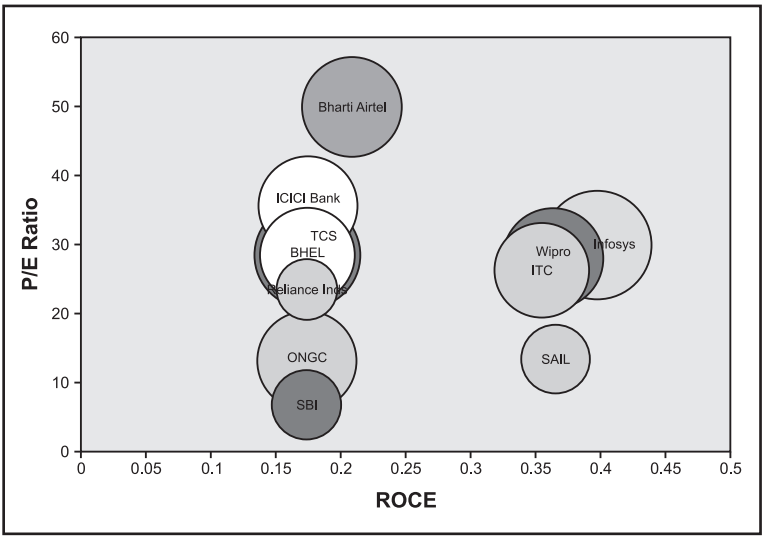
Converting Table 2.7 into bubble charts with 10–12 companies each with X-axis being ROCE and Y-axis being P/E ratio will help to clearly know the implications of this model and thus identify which companies are attractive to invest into. In the charts, the bubble size indicates the ratio of MCAP/Capital Employed.

From Figure 2.5 it is clear SBI, SAIL and ONGC are clear choices for investment purpose. Considering the next 10 companies the following chart is depicted (Figure 2.6).

Figure 2.6 indicates that Tata Steel is a clear choice for further investment.

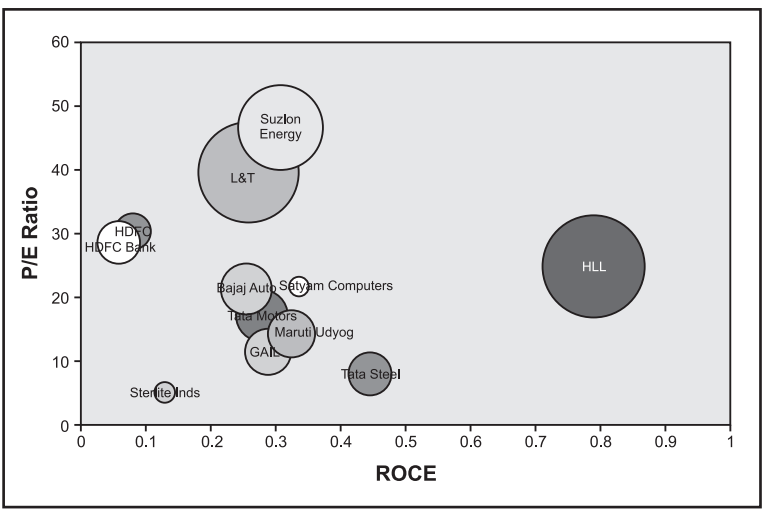
From Figure 2.7 it is clear that Ambuja Cement, Hero Honda, Nalco, Hindalco, M&M, and Grasim are clear choices for further investment as they have higher ROCE and lesser P/E ratio than other Nifty basket of companies.

FIGURE 2.5 ROCE vs P/E Ratio: Illustration 1



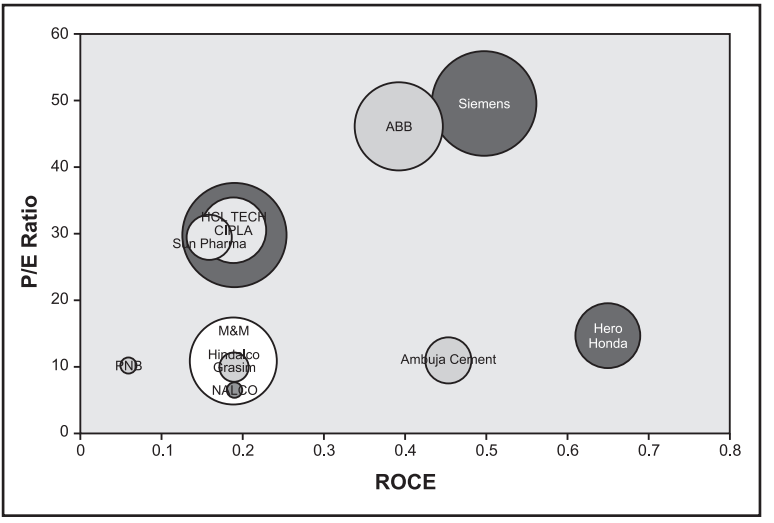
Source Based on Table 2.7.

FIGURE 2.6 ROCE vs P/E Ratio: Illustration 2



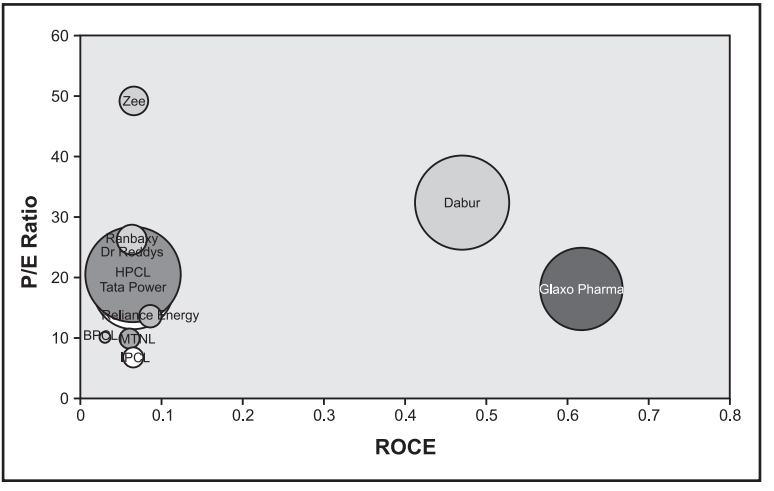
Source Based on Table 2.7.

FIGURE 2.7 ROCE vs P/E Ratio: Illustration 3



Source Based on Table 2.7.

FIGURE 2.8 ROCE vs P/E Ratio: Illustration 4



Source Based on Table 2.7.

From Figure 2.8 it is seen that Glaxo Pharma is a clear choice for further investment.

One has to be very careful in using this model as inefficient companies, which have high capital employed in business, tend to have this ratio to be less and on the first look are attractive for investment. One has to guard against this possibility in using this model. From Table 2.7, one can consider investigating into the following companies for investment purposes:

- HPCL
- MTNL
- BPCL
- Reliance Energy
- M&M
- Grasim
- Sterlite Industries
- IPCL
- Tata Steel
- Nalco
- Maruti Udyog
- GAIL
- ONGC

The above analysis can be extended and compared for peer companies like Infosys and TCS. As one can see in Table 2.7, TCS has a better ROCE but relatively lower P/E ratio than Infosys, which is a case for attractive investment opportunity among the blue-chip companies. The case that the author wants to highlight is if these kinds of opportunities are available in Nifty basket of companies for investment, one can look for more such opportunities in mid cap and small cap space when this data analysis is applied, and that can result in more number of investment opportunities.

THIRD MODEL

Another approach is to sort out companies on the basis of MCAP/Assets ratio. This would identify companies wherein MCAP is

less than the assets deployed in business and thus, one would be able to identify value buys using any one of the aforementioned approaches.

It is well known that investors who have timed their decisions by picking up companies that have an MCAP less than the assets of the company, as cheap buys, have been handsomely rewarded. Therefore, one needs to verify the companies after this criterion is met, and check if there are any adverse profitability conditions that need to be looked into. Table 2.8 compiles and analyzes the MCAP/Sales and MCAP/Assets ratios for leading companies in India by bringing data from different sources. The data is shown as summarized, in order to take meaningful decisions.

TABLE 2.8 Companies Sorted on the Basis of MCAP to Assets Ratio

Company	*Sales (Rs crores)*	*MCAP (Rs crores)*	*MCAP/ Sales*	*Assets (Rs crores)*	*Sales/ Assets*	*MCAP/ Assets*
Suzlon Energy	3,841	35,449	9.23	1,121	3.43	31.62
Infosys	9,521	120,312	12.64	9,048	1.05	13.30
TCS	13,263	109,505	8.26	8,488	1.56	12.90
Nestle	2,475	10,063	4.07	1,037	2.39	9.70
Wipro	10,602	80,452	7.59	9,382	1.13	8.58
Dabur	1,722	8,096	4.70	999	1.72	8.10
HLL	11,579	49,361	4.26	6,351	1.82	7.77
ABB	2,963	14,733	4.97	2,319	1.28	6.35
Cipla	2,897	18,678	6.45	3,275	0.88	5.70
Satyam	4,792	28,957	6.04	5,132	0.93	5.64
Bharti Airtel	11,664	109,403	9.38	19,419	0.60	5.63
NMDC	3,710	26,366	7.11	4,808	0.77	5.48
Container Corpn.	2,433	13,218	5.43	2,485	0.98	5.32
Reliance Energy	3,976	15,417	3.88	2,937	1.35	5.25
ITC	10,317	65,280	6.33	13,422	0.77	4.86
HCL Tech	4,571	19,054	4.17	4,041	1.13	4.72
Pantaloon	1,867	5,912	3.17	1,401	1.33	4.22
Motor Ind	2,977	10,627	3.57	2,604	1.14	4.08
Guj Amb Cem	3,074	17,734	5.77	4,374	0.70	4.05
Asian Paints	3,166	6,762	2.14	1,706	1.86	3.96

(*Table 2.8 contd*)

ACC	3,318	18,220	5.49	4,669	0.71	3.90
Cummins	1,806	4,971	2.75	1,287	1.40	3.86
Siemens	3,637	17,606	4.84	4,675	0.78	3.77
Hero Honda	8,713	14,478	1.66	3,873	2.25	3.74
BHEL	13,442	59,448	4.42	17,505	0.77	3.40
Britannia	1,713	2,631	1.54	854	2.01	3.08
Maruti	12,106	25,540	2.11	8,420	1.44	3.03
Sesa Goa	1,907	4,596	2.41	1,531	1.25	3.00
Godrej Ind	2,034	4,791	2.36	1,622	1.25	2.95
MMTC	16,393	9,525	0.58	3,629	4.52	2.62
Jet Airways	5,693	5,172	0.91	2,118	2.69	2.44
L&T	16,537	39,117	2.37	16,312	1.01	2.40
Ranbaxy	5,157	13,404	2.60	5,813	0.89	2.31
Century Text	2,589	5,441	2.10	2,476	1.05	2.20
Lupin	1,685	4,377	2.60	1,998	0.84	2.19
Naga Constructions	1,829	3,884	2.12	1,774	1.03	2.19
PCS	1,954	5,392	2.76	2,519	0.78	2.14
Punj lloyd	1,727	4,761	2.76	2,263	0.76	2.10
Bharat Electronics	3,653	9,306	2.55	4,434	0.82	2.10
Dr Reddys	2,355	12,521	5.32	6,131	0.38	2.04
Bajaj Auto	8,161	25,584	3.13	12,804	0.64	2.00
Bharat Forge	2,971	6,961	2.34	3,524	0.84	1.98
Indian Hotels	1,837	8,411	4.58	4,277	0.43	1.97
IVRCL	1,712	4,164	2.43	2,150	0.80	1.94
HCL Info	11,368	3,676	0.32	1,935	5.87	1.90
Grasim	10,213	22,980	2.25	12,158	0.84	1.89
ONGC	65,523	172,288	2.63	91,588	0.72	1.88
PTC India	3,108	713	0.23	395	7.87	1.81
Nalco	4,854	12,947	2.67	7,380	0.66	1.75
Tata Motors	23,587	31,618	1.34	18,065	1.31	1.75
Reliance	80,055	168,402	2.10	96,871	0.83	1.74
Sterlite	13,102	27,890	2.13	16,403	0.80	1.70
United Phos.	1,668	5,636	3.38	3,328	0.50	1.69
Shipping Corp.	3,531	4,392	1.24	2,675	1.32	1.64
BEML	2,056	3,397	1.65	2,122	0.97	1.60

(*Table 2.8 contd*)

NTPC	26,985	112,798	4.18	73,193	0.37	1.54
Voltas	1,954	3,243	1.66	2,136	0.91	1.52
Ashok Leyland	5,329	5,179	0.97	3,692	1.44	1.40
M&M	9,807	18,766	1.91	13,525	0.73	1.39
Crompton	4,132	6,561	1.59	4,865	0.85	1.35
Chambal Fert	3,084	1,438	0.47	2,762	1.12	0.52
IOCL	162,418	46,486	0.29	94,058	1.73	0.49
Ballarpur	1,908	1,739	0.91	3,599	0.53	0.48
Eid Parry	2,892	1,183	0.41	2,462	1.17	0.48
Welspun Guj Stahl	1,787	1,099	0.61	2,290	0.78	0.48
National Fert	3,590	1,400	0.39	2,963	1.21	0.47
JSW Steel	6,018	4,911	0.82	11,541	0.52	0.43
Jindal Stainless	3,131	1,869	0.60	4,597	0.68	0.41
GSFC	2,832	1,372	0.48	3,424	0.83	0.40
CEAT	1,744	535	0.31	1,393	1.25	0.38
Bhushan Steel	2,716	1,357	0.50	3,536	0.77	0.38
BPCL	75,850	11,428	0.15	31,173	2.43	0.37
CESC	2,556	2,404	0.94	6,914	0.37	0.35
HPCL	75,143	8,763	0.12	25,846	2.91	0.34
Indo Rama Synth	1,912	626	0.33	1,862	1.03	0.34
Usha Martin	1,796	706	0.39	2,177	0.82	0.32
Essar Steel	6,168	3,550	0.58	11,254	0.55	0.32
Mukand	1,667	566	0.34	2,133	0.78	0.27
Arvind Mills	2,125	1,006	0.47	4,050	0.52	0.25
ITI	1,660	1,195	0.72	5,518	0.30	0.22
JK Iind	2,078	479	0.23	2,337	0.89	0.20
Zuari	3,585	456	0.13	2,243	1.60	0.20
Surana Corp.	1,693	45	0.03	271	6.25	0.17
STC India	7,595	418	0.06	2,698	2.82	0.15
Uttam Galva	1,788	239	0.13	1,928	0.93	0.12
Ispat Ind	4,914	1,295	0.26	11,983	0.41	0.11
National Steel	1,911	61	0.03	787	2.43	0.08
Ruchi Soya	5,687	871	0.15	16,513	0.34	0.05
Vishal Exports	3,936	79	0.02	14,284	0.28	0.01

Source Data compiled from various magazines.

As one can further identify from Table 2.8, reputed companies like Tata Motors, Reliance, Crompton, and so on, have a reasonable MCAP/Assets ratio and can be studied further for picking up for value investment. The case of Ruchi Soya is an interesting one with low MCAP to assets in business and has been recommended for further investment by other research firms as well. One has to learn to analyze using these models and wait for investment recommendations from leading brokerages, research firms, and so on, and move in with more confidence when both our analysis and their recommendations match. It is generally seen that some companies are asset intensive, like Tata Steel, Reliance, and so on, whereas companies like ITC and HUL, and so on, are less asset intensive in nature. Generally, there are times when market conditions dictate or turn adverse, like in a bear phase. At such times, reputed companies are available at a discount and then this ratio can be used to acquire them at a cheaper price. One needs to wait patiently after acquiring these shares for appreciation in price. Target price for this type of model is difficult to state as one needs to weigh multiple factors such as profitability of the company, profitability growth trends, sales growth rate, and so on. But the approach suggested, as you can see, picks up only those shares that are safe buys. All these approaches work well when the fundamentals of the company are improving and therefore insulate your investments from vagaries of the market. However, care should be taken to exit the stock when fundamentals deteriorate; periodic booking of profits is a safer option.

Analysis of EPS and Assets Per Share Model 3

Generally, investors want to ensure that the companies they invest in have high earnings per share (EPS). To understand the drivers of EPS in the stock market, the following model depicts with clarity how to analyze the issue:

$$\begin{aligned} \text{EPS} &= \text{net profit/sales} \times \text{sales/number of shares} \\ &= \text{NPM} \times \text{sales per share} \end{aligned} \quad \ldots(5)$$

This simple formula gives the following insights:

- Increase in net profit margin can improve EPS.
- Growth in sales per share is another driver of EPS. This further can be analyzed as contributing to volume growth or pricing convenience in markets. One needs to investigate if pricing pressure in the market wherein the company is operating can adversely influence the same.

It is observed that volatility in earnings per share from quarter to quarter arises due to these two factors:

1. Fluctuations in NPM.
2. Fluctuations in sales per share due to fluctuations in
   (i) volume growth, and
   (ii) pricing parameters.

One conclusion that the author has drawn is that there are many companies in India that have a high sales per share figure. This is due to historical reasons such as following a conservative

bonus declaration policy. Sales have kept pace with market reality, but the equity has not grown proportionately.

Table 3.1 is an analysis of this model based on stocks in the Nifty index.

TABLE 3.1 Nifty Basket of Companies with EPS Details

Company	*EPS*	*NPM*	*Sales per Share*	*P/E Ratio*
Reliance Industries	63.1	0.1112	581	18.7
ONGC	61.3	0.2919	224	12.5
Bharti Airtel	10.5	0.178	59.22	42.3
TCS	26.8	0.2414	115	34.7
Infosys	40.4	0.2682	162.43	40.2
ICICI Bank	27.2	0.1346	210	27.4
Wipro	13.2	0.1954	71	34
BHEL	66.5	0.1247	549	29.9
ITC	5.7	0.2324	26	25.8
SBI	81.7	0.1019	822	16.2
SAIL	9.3	0.1415	68	7.4
L&T	29.3	0.0586	525	40.6
HLL	5.3	0.1197	50.20	32.2
HDFC	45.6	0.2826	171	29.6
Suzlon Energy	27.8	0.2167	132	37.5
HDFC Bank	26.9	0.1529	180.6	32
Tata Steel	58.7	0.2316	261	7.7
Satyam Computers	14.9	0.2186	71	24.5
Sterlite Industries	8.8	0.0689	131	34.3
Tata Motors	33.9	.068	526	20.6
Bajaj Auto	97.5	0.1393	740.06	23.0
GAIL	25.9	0.1413	193.5	10.4
Maruti Udyog	40.9	0.0996	416	18.5
Grasim	86	0.119	724	24.2
HCL TECH	15.1	0.1856	93	28.9
Sun Pharma	23	0.2676	88	34.6
Cipla	7.6	0.2122	37	26.3

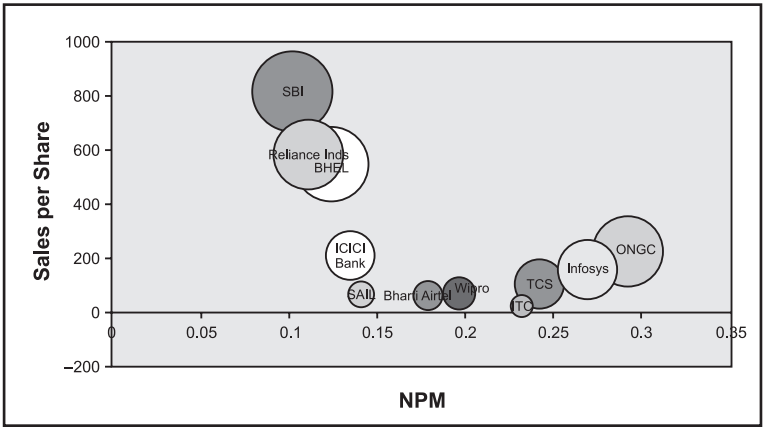
(*Table 3.1 contd*)

Siemens	21.4	0.0798	267	34.2
M&M	26.5	0.0858	325.6	24.1
Ambuja Cement	5.1	0.2196	23	22.2
Hindalco	13.6	0.1444	95.93	9.4
ABB	50.5	0.074	699	50
Nalco	23.2	0.3170	75.33	6.2
PNB	44.3	0.1295	352	10.2
ACC	20.5	0.097	168.5	22.9
Hero Honda	42.1	0.1028	436	16.5
Ranbaxy	3.4	0.048	96	47
Zee	1.3	0.083	17.68	213
VSNL	17.7	0.1377	133	23.2
Reliance Energy	29.4	0.1614	187	16.2
Dr Reddys	10.9	0.092	121	31.8
BPCL	7.7	0.0038	2092	8.4
Tata Power	22.7	0.1024	233	19.9
Glaxo Pharma	32.2	0.2081	174	27.4
IPCL	35.2	0.0988	363	7.1
MTNL	8.7	0.105	88.26	17.4
HPCL	11.6	0.00569	2107	5.9
Dabur	3.0	0.1393	23.39	37.4

Source *Capital Market*, 14 January 2007.

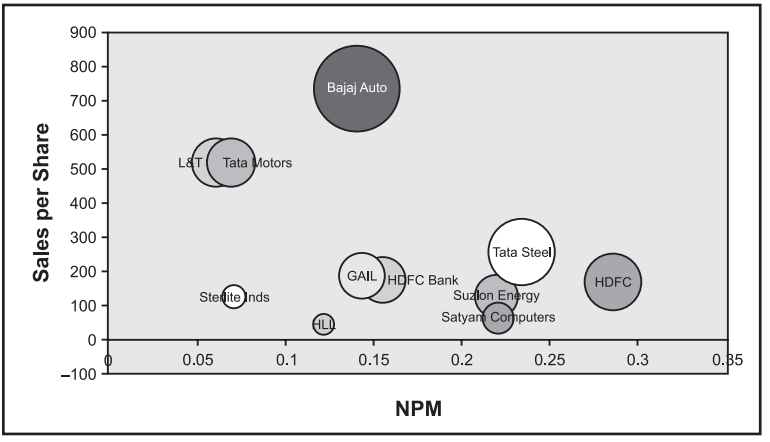
One can see that sales per share for the Nifty group of companies can vary from a figure as low as 17.68 to as high as 2107. Selecting companies that have high ratio ensures that their EPS is correspondingly high and one can look out for winners across this spectrum (provided they follow liberal dividend payout policy and bonus policy). This can be seen from the following bubble charts wherein NPM is on the X-axis and sales per share is on the Y-axis. The bubble size indicates earnings per share magnitude. Figures 3.1 and 3.2 show that SBI, BHEL, and Reliance Industries have very high sales per share and their equity has not grown in proportion with sales. They have more potential to reward investors with bonus shares.

FIGURE 3.1 NPM vs Sales per Share: Illustration 1



Source Created from data in Table 3.1.

FIGURE 3.2 NPM vs Sales per Share: Illustration 2



Source Created from data in Table 3.1.

DIVIDEND YIELD MODEL AND MCAP/SALES MODELS IN PRACTICE FOR PHARMA INDUSTRY

Table 3.2 analyzes companies in the ET-Lifex basket of companies sorted on the basis of dividend yield criteria in the descending order of dividend yield among pharma companies.

TABLE 3.2 ET-Lifex Basket of Companies

Company	*FV*	*CMP*	*DIV%*	*DIV Yield*	*MCAP*	*Sales*	*MCAP/Sales*
Novartis	10	323	200	6.19195	1033	525	1.967619048
Wyeth	10	494	250	5.060729	1123	286	3.926573427
Abbott	10	474	175	3.691983	687	507	1.355029586
Glaxo	10	1196	280	2.341137	10130	1470	6.891156463
Ranbaxy	5	390.75	170	2.175304	14570	3575	4.075524476
Unichem	5	255	100	1.960784	966	453	2.132450331
Cadila	5	321.6	120	1.865672	4039	1246	3.241573034
Alembic	2	56	50	1.785714	789	625	1.2624
Torrent	5	192	50	1.302083	1628	687	2.369723435
Aventis	10	1275	160	1.254902	2937	808	3.63490099
Wockhardt	5	399.6	100	1.251251	4371	960	4.553125
Pfizer	10	845	100	1.183432	2522	660	3.821212121
Orchid	10	262	30	1.145038	1756	873	2.011454754
Nicholas	2	269.2	150	1.114413	5625	1406	4.000711238
Cipla	2	204.95	100	0.975848	15931	2897	5.499137038
Lupin	10	707	65	0.919378	5680	1596	3.558897243
IPCA	10	619	55	0.88853	1548	769	2.013003901
Dr Reddys	5	663.45	100	0.753636	11476	217	52.88479263
Plethico	10	341	25	0.733138	1163	221	5.262443439
Astrazeneca	2	661	200	0.605144	1654	225	7.351111111
Matrix	2	198.85	60	0.60347	3062	667	4.590704648
Sun Pharma	5	977.3	110	0.562775	19100	1681	11.36228435
Biocon	5	459.5	50	0.54407	4595	687	6.688500728
Dabur Pharma	1	62	20	0.322581	974	255	3.819607843
Strides	5	316	20	0.316456	1108	318	3.48427673
Dishman	2	236	35	0.29661	1742	216	8.064814815
Divis	10	3853.2	100	0.259525	4975	266	18.70300752
Panacea Biotek	1	428	100	0.233645	2818	536	5.257462687
Aurobindo	5	690.45	30	0.21725	3683	1370	2.688321168
Glenmark	2	636.85	35	0.109916	7623	562	13.56405694

Source ET-Lifex, *The Economic Times*, 12 May 2007.
Note FV = Face Value, CMP = Current Market Price.

Using the criterion of dividend yield in Table 3.2, one can find that the shares attractive for investment are the following ones:

- Novartis
- Wyeth
- Abbott

All are multinationals offering steady dividends to investors.

If we shortlist companies in Table 3.2 based on MCAP/Sales, the following companies are good for investment.

- Novartis
- Abbott
- Alembic

It can be seen that both dividend yield and MCAP/Sales recommend Novartis and Abbott as safe investment bets and accordingly one can plan.

Another approach for identifying companies is using more than one criterion for identification of companies for investment:

- Identify companies that have ROCE > 12 percent and also P/E ratio < 12.
- Identify companies that have price-to-book value ratio < 1.5 and dividend percent > 50 percent.
- Identify companies that have NPM > 10 percent and P/E ratio > 12.
- Identify companies that have sales above Rs 500 crore and P/E ratio < 12.
- List down companies that have sales and earnings growth rate > 20 percent.
- Identify companies that have sales above Rs 500 crore and P/E ratio < 10.
- Identify companies that have consistent increase in EPS for the last four quarters.

Developing these kinds of criteria would help the investors to identify and compare stocks that are inherently valuable and then proceed with investment depending upon market conditions. Learning to sift through data using multiple criteria filters out companies and helps us to see clearly who are likely to be winners in the capital market.

WHEN THESE FILTERS ARE APPLIED, HOW TO DECIDE WHEN TO EXIT?

Generally, whatever may be the criterion, it should have sound common sense and be intuitively obvious to anyone investing in the company. For example, if we are analyzing the company based on dividend yield or ROCE, and so on, then we should become alert when these metrics turn adverse or are likely to turn adverse for the company when results are expected or announced. Therefore, one should learn to revisit the investment decision whenever fresh evidence is available and one should take a call whether to continue to hold on to the investment or book profit/loss. This is the discipline that Warren Buffett has mastered and practices religiously. The author also has failed to practice this discipline at times and some of the decisions have turned adverse due to the fact that proper decisions were not taken when required.

Cash Earnings Per Share Model

Till now, one has seen the analysis involving EPS and how it can be used to judge the companies for investment purposes. However, there is another way to look at the investment opportunity and that is through analysis of cash earnings per share (CPS) and EPS. *Capital Market* magazine gives both these figures for all the companies listed in its scoreboard. To understand the essence of this approach one needs to define CPS:

CPS = operating cash flow/number of shares issued

To simplify the concept, CPS is nothing but EPS + depreciation per share. However, in essence, the CPS involves nothing but EPS plus amortization of goodwill and other intangible items. The advantage of using CPS is that this figure is not as susceptible to accounting manipulations as net income or EPS. The author proposes further research on the stocks wherein the difference between CPS and EPS is more than the dividend per share of

the company by a substantial margin. This may throw some light on future prospects of the companies and their growth plans. If one finds that the depreciation provided is good enough only to replace the existing assets without much increase in the productive capacity of assets, then one needs to be careful with such companies and look for other companies wherein there is scope for growth in the productive capacity and related assets. Table 3.3 analyzes the companies listed in *Capital Market* from this perspective.

TABLE 3.3 CPS Analysis of Select Stocks

Company	*CPS*	*EPS*	*CPS-EPS = Depn/Share*	*Face Value*	*Dividend %*	*Dividend per Share*
Carborandum Universal	7.3	5.5	1.8	2	75	1.5
Grindwell Norton	11.2	9.0	2.2	5	160	8
Wendt India	49.5	40.3	9.2	10	175	17.5
Madras Aluminium	89.9	80.6	9.3	10	120	12
Eicher Motors	32.2	17.7	14.5	10	290	29
Tata Motors	61.3	46.1	15.2	10	150	15

Source *Capital Market*, 21 April to 4 May 2008.

The above analysis throws open the growth opportunities available for productive capacity and related investments versus dividend declared to please the shareholders for their current investment. This perspective and further study of the company will give key answers about the company's management and its plans. Similarly, this analysis can be performed on other companies listed in *Capital Market* magazine to determine the opportunities available.

Assets Per Share Model

Another approach can be comparing the current stock price with assets per share of the company and then identifying companies

that are value buys if the current stock price is less than assets deployed in business per share. Table 3.4, which analyzes the companies based on this approach, has been prepared in the following steps:

1. First of all, companies that have declared a dividend of 100 percent are listed down for further analysis.
2. Then assets/share is calculated by reading the balance sheets of these companies in comparison to market price for better identification of valuable companies for investment.

TABLE 3.4 Analysis of Companies wherein Dividend is High and Assets Per Share is Low

Company	*Div %*	*Equity*	*Face Value*	*Assets*	*Assets/ Share*	*Current Market Price (CMP) as on 26 April 2007*	*Divi-dend Yield %*	*CMP/ Assets per Share*
Karur Vysya	100.00	18.00	10.00	7884.85	4380.47	267.00	3.75	0.060952
Aarti Inds	101.00	36.39	5.00	430.70	59.18	28.45	17.75	0.48075
Electro Steel	125.00	20.76	10.00	983.50	473.75	394.00	3.17	0.831666
Pricol	100.00	9.00	1.00	281.25	31.25	33.00	3.03	1.056
Ramco Industries	100.00	4.33	10.00	290.66	671.27	735.00	1.36	1.094939
Nippo Batteries	200.00	3.75	10.00	111.00	296.00	330.00	6.06	1.114865
Sundaram Fasteners	170.00	10.51	1.00	603.00	57.37	65.00	2.62	1.132919
IHP	150.00	4.85	10.00	167.13	344.60	450.00	3.33	1.30587
D link	160.00	6.00	2.00	160.00	53.33	74.00	4.32	1.3875
IBP	100.00	22.15	10.00	659.57	297.77	414.00	2.42	1.390315
Hindalco	200.00	115.89	1.00	11466.58	98.94	149.00	1.34	1.505908
Chemfab Alkalies	100.00	3.47	5.00	43.96	63.34	96.00	5.21	1.51556

(*Table 3.4 contd*)

Triton Valves	140.00	0.32	10.00	25.04	782.50	1190.00	1.18	1.520767
Tide Water	100.00	0.87	10.00	99.57	1144.48	1905.00	0.52	1.664507
TVS Motor	130.00	23.75	1.00	865.67	36.45	61.00	2.13	1.673559
Sundaram Brake	100.00	2.71	10.00	77.45	285.79	525.00	1.90	1.836992
Rajesh Exports	100.00	7.39	2.00	790.00	213.80	404.00	0.50	1.889595
Blue Star	100.00	17.99	10.00	185.70	103.22	220.00	4.55	2.131287
Ultra-marine	150.00	5.84	2.00	57.00	19.52	43.00	6.98	2.202807
Ashok Leyland	100.00	118.93	1.00	2048.28	17.22	39.70	2.52	2.305115
Rico Auto	100.00	12.28	1.00	241.47	19.66	48.00	2.08	2.441049
Mastek	150.00	6.97	5.00	165.00	118.36	306.00	2.45	2.585236
Clariant	110.00	11.93	10.00	107.86	90.41	270.00	4.07	2.986371
NRB Bearings	100.00	9.89	2.00	144.62	29.25	90.00	2.22	3.077375
Swaraj Engines	225.00	12.42	10.00	59.00	47.50	151.00	14.90	3.178678
Elgi	100.00	7.82	1.00	119.76	15.31	50.00	2.00	3.264863
GMM Pfaudler	100.00	2.83	2.00	59.00	41.70	138.00	1.45	3.309661
Madras Cement	100.00	12.08	10.00	1025.81	849.18	2924.00	0.34	3.44332
Godfrey Philips	220.00	10.40	10.00	389.25	374.28	1312.00	1.68	3.505408
HCL Tech.	800.00	64.00	2.00	2956.00	92.38	332.00	4.82	3.594046
Patel Engg.	100.00	5.00	1.00	435.00	87.00	355.00	0.28	4.08046
Kirloskar Oil	125.00	19.42	2.00	614.00	63.23	260.00	0.96	4.111726
BEML	100.00	36.74	10.00	810.00	220.47	971.00	1.03	4.404264
HCL Info	310.00	33.59	2.00	517.00	30.78	136.00	4.56	4.418027

(*Table 3.4 contd*)

Patni Computers	125.00	27.56	2.00	1345.00	97.61	432.00	0.58	4.425993
ZEE	100.00	41.25	1.00	2658.00	64.44	287.00	0.35	4.454007
Hercules Hoists	120.00	0.80	10.00	26.00	325.00	1450.00	0.83	4.461538
Bajaj Auto	250.00	101.18	10.00	5361.34	529.88	2436.90	1.03	4.598954
Manugraph	100.00	6.00	2.00	106.00	35.33	165.00	1.21	4.669811
Satyam	250.00	64.73	2.00	3226.00	99.68	466.00	1.07	4.675167
Siemens	140.00	33.14	10.00	783.00	236.27	1118.00	1.25	4.731867
Balaji Tele Films	800.00	13.04	2.00	213.00	32.67	168.00	9.52	5.142535
GG Dandekar	500.00	0.48	1.00	8.00	16.67	87.00	5.75	5.22
Carborandum	100.00	18.68	2.00	239.78	25.67	147.00	1.36	5.725999
M&M	130.00	236.08	10.00	3064.88	129.82	762.00	1.71	5.869494
Auto Axles	125.00	15.11	10.00	135.37	89.59	561.00	2.23	6.261882
Bosch Chassis	120.00	10.40	10.00	139.96	134.58	917.00	1.31	6.813947
Pidilite	100.00	25.24	1.00	418.41	16.58	116.00	0.86	6.997538
ITC	310.00	375.51	1.00	8140.97	21.68	162.00	1.91	7.472404
Hero Honda	1000.00	39.94	2.00	1695.14	84.88	687.00	2.91	8.093367
Bharat Forge	125.00	44.15	2.00	860.43	38.98	321.00	0.78	8.235504
BEL	112.00	80.00	10.00	1609.00	201.13	1657.00	0.68	8.238658
Motherson Sumi	100.00	23.48	1.00	244.35	10.41	111.00	0.90	10.66618
Wipro	250.00	284.33	2.00	4954.00	34.85	556.00	0.90	15.95554
Cummins	200.00	39.60	2.00	336.00	16.97	291.00	1.37	17.14821
Infosys	230.00	137.26	5.00	1569.00	57.15	2018.00	0.57	35.30793
Praj	108.00	16.22	2.00	43.00	5.30	485.00	0.45	91.47326
Iflex	100.00	385.05	5.00	1125.00	14.61	2430.00	0.21	166.3416
L&T	27.07	1375.00	2.00	5228.00	7.60	1688.00	0.03	221.9778

Source Compiled from various sources such as *Capital Market* magazine.

From Table 3.4 it can be seen that the following companies are value buys as their current market prices are very near to their assets deployed in business per share and are less than 1.5 times assets per share.

- Aarti Industries
- Electro Steel Castings
- Pricol
- Ramco Industries
- Nippo Batteries
- Sundaram Fasteners

From this list it can be seen that these companies have steady businesses that give reasonable returns and their managements are conservative in approach unlike the other companies. After the above shares are identified, usually one needs to verify how the profitability of the company is likely to vary and at what level is it at currently, and so on, and only then investment decisions need to be taken.

4 Assessing Indebtedness of a Company

This chapter shows an approach using the data published in *Business Standard* daily on how to calculate the debt employed by companies in their business.

Capital employed/net worth
= (price/book value) / (ROCE × P/E ratio) ...(6)
= (price/net worth per share) / (net profit/
capital employed × price/net profit per share)

On canceling the common terms, the above formula gives the ratio of capital employed by net worth of any company.

TABLE 4.1 Capital Employed/Net Worth Data

Company	*Price/Book Value*	*ROCE*	*P/E Ratio*	*Capital Employed/ Net Worth*
3i Infotech	4.16	0.0694	15.74	3.8
ABB	19.52	0.3881	46.21	1.08
ACC	4.96	0.4282	30.36	0.38
Aditya Birla Nuovo	5.00	0.0907	45.49	1.21
Amtek Auto	3.55	0.0804	25.72	1.72
Arvind Mills	0.61	0.08	11.26	0.67
Ashok Leyland	3.45	0.2359	12.98	1.13
BEML	4.03	0.3206	18.46	0.68

(*Table 4.1 contd*)

BEL	6.50	0.43	22.18	0.67
Bharat Forge	6.16	0.1714	28.69	1.24
BHEL	8.42	0.3337	28.87	0.87
Biocon	5.15	0.1801	24.97	1.14
BPCL	1.34	0.0281	10.65	4.47
Canara Bank	1.29	0.0625	6.80	2.99
Century Textiles	6.85	0.1392	27.85	1.76
Cipla	3.85	0.2972	29.81	0.43
CMC	7.30	0.2313	24.46	1.29
Crompton	14.77	0.2896	33.17	1.53
Cummins	7.28	0.3112	31.10	0.75
Dabur	19.59	0.4709	29.05	1.43
Divis	14.78	0.2275	72.95	0.89
Dr Reddys	2.30	0.0905	23.3	1.09
GE Shipping	1.28	0.2286	4.31	1.29
GAIL	2.15	0.2854	9.70	0.77
Glaxo Pharma	8.58	0.6169	18.61	0.74
Glenmark	17.79	0.0981	30.12	6.02
Grasim	3.73	0.1873	10.32	1.93
Gujarat Ambuja Cement	5.36	0.4488	11.24	1.06
HCC	2.89	0.0894	79.36	0.40
HCL Tech	8.76	0.2574	33.3	1.02
HDFC	7.79	0.0794	27.54	3.56
HDFC BANK	5.14	0.0611	28.76	2.92
Hero Honda	5.49	0.6447	15.80	0.53
Hind Zinc	3.76	0.5710	6.45	1.02
Hindalco	1.25	0.1606	11.50	0.67
HLL	15.81	0.7827	22.73	0.88
Idea Cellular	22.42	0.0934	60.72	3.95
I-flex	8.00	0.2095	50.65	0.75
India Cements	3.26	0.0825	9.24	4.27
Indian Hotels	4.72	0.1375	33.68	1.02
Infosys	10.16	0.3721	29.35	0.93
IPCL	1.68	0.2819	7.72	0.77
ITC	6.88	0.3558	27.05	0.71
IVRCL	7.3	0.1215	39.02	1.54

(*Table 4.1 contd*)

JSW Steel	1.90	0.1971	7.41	1.3
KPIT Cummins	5.41	0.1403	20.51	1.88
L&T	5.13	0.2564	39.96	0.50
Lupin	6.41	0.1674	18.45	2.07
M&M	5.87	0.2982	12.76	1.54
Mahindra Gesco	3.41	0.0683	124.96	0.72
Maruti Udyog	3.44	0.3205	14.83	0.72
Moser Baer	2.29	0.0268	61.64	1.38
Mphasis BFL	9.74	0.1544	45.29	1.39
Nagarjuna Constructions	1.89	0.1119	34.7	0.49
Nalco	2.75	0.4179	6.91	0.95
NIIT Tech	9.68	0.2471	31.3	1.25
NTPC	2.91	0.1237	22.4	1.05
ONGC	2.40	0.3281	12.63	0.58
Polaris	2.97	0.0394	24.9	3.02
Punj Lloyd	17.48	0.079	85.94	2.57
Rajesh Exports	7.35	0.0708	20.95	4.95
Ranbaxy	6.26	0.0907	25.54	2.7
Rei Agro	2.03	0.1310	10.13	1.52
Reliance Capital	4.22	0.1381	31.70	0.96
Reliance Energy	1.35	0.086	13.95	1.12
Reliance Industries	5.2	0.1728	25	0.88
SAIL	4.61	0.3653	14.29	0.88
Satyam	5.22	0.2728	21.5	0.88
Sesa Goa	4.13	0.7407	10.28	0.54
SCI	1.37	0.2082	5.55	1.18
Siemens	19.12	0.4922	53.01	0.73
Sun Pharma	12.84	0.1557	27.97	2.94
Suzlon Energy	8.82	0.3031	37.8	0.76
Tata Motors	5.22	0.2782	16.75	1.12
Tata Power	2.35	0.1179	18.42	1.08
Tata Steel	3.39	0.4407	8.66	0.88
Tata Tea	4.12	0.1787	11.13	2.07
TCS	15.16	0.5147	28.80	1.02
Tech Mahindra	20.63	0.4025	29.57	1.73
Titan	14.38	0.2232	42.16	1.52

(*Table 4.1 contd*)

Unitech	15.72	0.1590	523.28	0.188
United Phosphorus	4.84	0.1130	21.16	2.02
Voltas	8.23	0.3063	15.53	1.73
VSNL	2.15	0.1118	186.36	0.10
Welspun Gujarat	3.28	0.1102	14.88	2.00
Wipro	8.53	0.3621	27.15	0.86
Zee	7.83	0.0566	49.82	2.77

Source *Business Standard.*

WHEN TO APPLY THIS CRITERIA?

It should be borne in one's mind that this is not a primary criteria for investment, but only identifies and segregates companies that have a high debt content and those with low debt content. Then how do we decide when to invest in the companies? The higher this ratio, the higher the debt content for that company, as against any other company with a lower ratio (and therefore) having lower debt content. Therefore, one should avoid investing in companies that have a high ratio of this parameter, and in addition, one should be careful in making investments in such companies when interest rates are likely to go up. Then the safe bet when interest rates are going up are the ones with low debt content. If this principle is kept in mind then sound investments can be made using the above criteria; irrespective of bull market or bear market one can invest in the company.

The author has presented this ratio as the data for the aforementioned formula is readily available in *Business Standard* newspaper. In the usual case, if debt–equity ratio is to be calculated, one needs to go through the balance sheet of the company and then calculate, which is more time consuming and involves more effort. Therefore, the idea in presenting this concept to the reader is to make use of the data given in the *Business Standard* newspaper to identify companies with high and low debt contents rather than looking for individual companies' annual reports, which is time consuming. After the initial screening of companies using this approach, one can selectively look for annual reports of companies that are identified using this approach.

Capital employed/net worth is a ratio that reflects the debt employed by the company. The data from *Business Standard* for 200 companies published on Fridays helps one to analyze companies and identify which companies have less debt and are thus less risky to invest in. Thus, the earlier analysis (Table 4.1) identifies the following companies for our consideration based on very low ratio of capital employed by net worth, that is, less than 2:

- ACC
- Arvind Mills
- BEML
- BEL
- BHEL
- Cipla

Further profitability analysis and outlook analysis for the company can be done to identify which of these companies is good for investment using any of the criteria suggested in this book.

5 Identifying Companies Based on Quarterly Results

One can purchase the *Capital Market* fortnightly magazine and then analyze the data of companies as described next.

Identify companies that have improved their current quarter's operating profit margin (OPM) when compared to previous financial year's OPM. From this set of companies identify those companies wherein sales growth in current quarter is more than previous year's growth rate. These two filters would give a set of companies wherein investment for this quarter can be beneficial to the investor till the next set of quarterly results are out. These criteria assume that past performance is an indicator of the future and thus one has to learn to shuffle the portfolio depending on how quarterly results compare for different companies using this approach. Generally, the company's stock price adjusts to the results announced over time and if quick and proper judgment of the market is done, the investor can benefit. These criteria generally identify solid companies wherein capital gains appreciation is assured for the investor. The investor can then further narrow down choices to invest by adding additional criteria such as whether the company is a market leader in its category or not, and so on. This type of analysis can be done using the data in *Capital Market* magazine published fortnightly and available in market.

Time horizon for investment using this approach is one quarter only and the investment decision needs to be reviewed particularly in the context of fresh evidence in terms of its most

recent quarterly results. The author advocates this technique as short-term trading technique depending on how you optimize your returns based on the quarterly results. The assumption for investment is that the better the results are for a company in a quarter, the better it is to invest in that company irrespective of its P/E ratio or any other parameter for that quarter in the company, so that one can capitalize on the positive developments of the company. In the case of bear market, the returns are likely to be muted and small as compared to bull market, where the swing in prices can be more and better returns can be achieved. However, one should be careful to invest in companies wherein not one but both the parameters indicated in Table 5.1 improve.

TABLE 5.1 Analysis of OPMs of Select Companies

Company	*Previous Year's Sales Growth Rate*	*Previous Year's OPM*	*Current Quarter Sales Growth*	*Current Quarter OPM*
Reliance	23	17.7	37 ↑	16 ↓
TCS	39	29.1	47 ↑	29.2 ↓
Infosys	32	32.3	51 ↑	32.2
ICICI Bank	45	64.5	59 ↑	68.1 ↑
Wipro	41	24.3	47 ↑	23.9 ↓
SBI	9	56.8	8 ↓	67.2 ↑
HDFC Bank	49	49.2	58	56.5 ↓
Tata Motors	19	10.7	37 ↑	11.3 ↑
Bajaj Auto	30	15.4	30 ↑	15 ↓
Maruti	10	13.6	13 ↑	13.9 ↑
Sun Pharma	40	24.8	29	24.7
Ambuja Cement	34	32.3	52	36.1
M&M	22	8.5	30	14.8
PNB	4	57.3	14	71.8
Hindalco	19	20.5	74	21.3
ACC	–19	16	37	27
Nalco	18	53.2	38	60.7
Cipla	33	20.7	33	25.4

(*Table 5.1 contd*)

Ranbaxy	–4	2.3	34	17.7
BPCL	31	1.2	56	6.5
Hero Honda	17	15.6	3	12.7
Dr Reddys	29	13.9	78	36.3
HPCL	18	1.1	45	6.8
Glaxo	8	26.9	4	31.7

Source *Capital Market*, 1–14 January 2007 for Nifty basket of companies.

It can be seen that companies like ICICI bank, HDFC Bank, and Tata Motors have improved OPM margins in the current quarter when compared to the last financial year and can be held till future quarter results are out. If this trend sustains, the shares can further be held for more quarters.

While using the above approaches one should take care to follow all these guidelines, which are a must for a fresher. Some general guidelines to keep in mind in finalizing the investments are the following:

- You should invest only in top-200 traded shares, which are listed in financial dailies.
- One should be careful to invest only in market leaders of the respective sectors, which these criteria throw light on. This is simple—identify the companies by looking at the capital market results as to which is the company which has highest sales in each sector of the classification given by *Capital Market* magazine and then see if its OPM and sales have improved both over the last quarter and last financial year.
- One should have the patience to wait for identification of value and for the market to realize the potential of the company identified by these criteria. Invariably, one finds that these systematic analyses identify multi-baggers before others provided one is consistent and regular in investments. Using this approach, the author identified IVRCL in the year 2001/2002 at a price of Rs 50 when its order book position was several crores. However, the author after listening to the advice of his stock broker avoided building

a position in the stock as it trades in small volumes and is illiquid in nature. But the market realized the stock's worth later on and the upward journey of the stock began, thus forcing the author to regret his decision. This approach if applied consistently brings out and discovers multi-baggers (as Peter Lynch, the Wall Street investor, calls them) much before the market unearths them. One needs to be patient and wait for their turn to unfold to book profits.

Sector-wise Profitability Analysis 6

How do we identify which sectors have a better potential for investment? Table 6.1 analyzes the sectors as per classification done in the *Capital Market* fortnightly magazine and lists down the number companies that are competing in each sector.

TABLE 6.1 Number of Companies in Key Sectors in India

Sector	*Number of Companies*
Tea	17
Finance: Term Lending	5
Transport: Airlines	4
Diamond Cutting/Jewellery	18
Cement: South India	13
Breweries	18
Automobiles: Tractors	5
Telecom Equipment	17
Textiles: Composite	14
Textiles Manmade	20
Leather	11
Pharma-Bulk: Indian & Formulations	43
Finance and Investment	137
Computers: Software Converts	10
Refineries	10
Cement: North India	18
Pharma: Indian Formulations	31

(*Table 6.1 contd*)

Pesticide-Agro: MNC	15
Dyes & Pigments	11
Diversified: Medium/Small	10
Photographic	1
Diversified: Large	4
Diversified: Mega	5
Computers: Hardware	18
Petrochemicals	16
Construction	90
Fasteners	4
Textiles: Spinning—Synthetic/Blended	12
Solvent Extraction	17
Telecom: Service Provider	11
Steel: Large	22
Cables: Power	10
Electronics Components	21
Electrode: Graphites	3
Packaging	35
Tyres	11
Engines	4
Mining/Minerals	31
Textiles: Jute	4
Castings & Forgings	31
Banks: Public Sector	22
Fertilizers	20
Electrodes: Welding	5
Personal Care: MNC	6
Auto Ancillaries	76
Plastics Products	32
Textiles: Silk	5
Textiles: Processing	31
Steel: Medium	52
Oil Drilling	10
Paints	7
Food Processing: Indian	37
Personal Care: Indian	9

(*Table 6.1 contd*)

Banks: Private Sector	18
Textile Products	59
Air Conditioners	4
Entertainment	55
Paper	31
Pharma: MNC	10
Glass & Glass Products	11
Pharma: Indian Bulk	26
Chloro Alkalies	9
Compressors/Drilling Equipment	5
Bearings	9
Computers: Education	7
Automobiles: Scooters	6
Automobiles: LCV/HCV	5
Chemicals	79
Engineering	67
Finance: Housing	10
Aluminium	16
Textile Machinery	5
Automobiles: Cars	2
Computers-Software: Medium/Small	130
Textiles: Cotton Blended	58
Cigarettes	4
Cables: Telephone	10
Computers-Software: Large	10
Power Generation	15
Transmission Lines	4
Engineering Turnkey	18
Healthcare	13
Ceramic Tiles	14
Abrasives	4
Steel: Sponge Iron	10
Trading	45
Cement Products	7
Dry Cells	5
Steel: Pig Iron	4

(*Table 6.1 contd*)

Refractories	3
Electric Equipment	41
Pumps	7
Cycles	2
Pesticides-Agro: Indian	15
Shipping	11
Travel Agencies	3
Food Processing: MNC	3
Automobiles: Motorcycles	4
Miscellaneous	101
Hotels	33
Sugar	38
Couriers	2
Detergents	3
Moulded Luggage	1
Printing & Stationery	11
Domestic Appliances	10
Electronics: Consumer	7
Aquaculture	3

Source *Capital Market*, 22 December 2006.

TABLE 6.2 OPM Analysis of Key Sectors

Sector	*MCAP**	*Sales*	*MCAP/ Sales*	*OPM of Previous Year (A)*	*OPM of Current Quarter (B)*	*Ratio of OPMS (B)/(A)*
Tea	8573	3368	2.55	2.5	28.7	11.48
Finance: Term Lending	860	2049	0.42	31	86.2	2.780645
Transport: Airlines	7319	7358	0.99	6.3	16.8	2.666667
Diamond Cutting/ Jewellery	6410	12938	0.50	2	4.3	2.15
Cement: South India	14149	4392	3.22	15.7	33.3	2.121019

(*Table 6.2 contd*)

Breweries	15779	5067	3.11	7.4	15.3	2.067568
Automobiles: Tractors	27318	11033	2.48	7.6	13.8	1.815789
Telecom Equipment	4654	3713	1.25	–1.9	–3.2	1.684211
Textiles: Composite	2424	2366	1.02	7.6	12.4	1.631579
Textiles Manmade	14457	10271	1.41	9.5	15.3	1.610526
Leather	2374	2040	1.16	6.5	9.7	1.492308
Pharma-Bulk: Indian & Formulations	107280	23387	4.59	15.1	22.3	1.476821
Finance & Investment	53139	14458	3.68	34.8	51.2	1.471264
Computers: Software Converts	1922	1354	1.42	10.2	15	1.470588
Refineries	266734	455677	0.59	5.7	8.1	1.421053
Cement: North India	66915	16217	4.13	20	28.1	1.405
Pharma: Indian Formulations	5469	2647	2.07	13.3	18.52	1.392481
Pesticide-Agro: MNC	3220	1775	1.81	12.6	17.5	1.388889
Dyes & Pigments	827	1761	0.47	7.4	10.2	1.378378
Diversified: Medium/ Small	13578	2014	6.74	11.8	15.9	1.347458
Photographic	111	381	0.29	7	9.3	1.328571
Diversified: Large	4213	3754	1.12	12.8	17	1.328125
Diversified: Mega	38924	15032	2.59	13.9	18.4	1.323741
Computers: Hardware	9579	7349	1.30	9.4	12.2	1.297872

(*Table 6.2 contd*)

Petro-chemicals	18154	19922	0.91	13.2	17.1	1.295455
Construction	122601	21202	5.78	13.8	17.7	1.282609
Fasteners	2250	1477	1.52	12.1	15.4	1.272727
Textiles-Spinning: Synthetic/ Blended	2010	2900	0.69	10	12.7	1.27
Solvent Extraction	3525	11454	0.31	3.5	4.4	1.257143
Telecom: Service Provider	236215	21975	10.75	26.1	32.8	1.256705
Steel: Large	96132	97249	0.99	19	23.7	1.247368
Cables: Power	1212	1562	0.78	9.1	11.3	1.241758
Electronics Components	34304	11113	3.09	13	16.1	1.238462
Electrode: Graphites	1595	1143	1.40	17.9	22	1.22905
Packaging	9007	6372	1.41	10.8	13.2	1.222222
Tyres	6208	12720	0.49	6.5	7.9	1.215385
Engines	9989	4088	2.44	11.7	14.2	1.213675
Mining/ Minerals	81107	21887	3.71	32.4	39	1.203704
Textiles: Jute	227	438	0.52	11.3	13.6	1.20354
Castings & Forgings	11452	5879	1.95	13.4	16.1	1.201493
Banks: Public Sector	160166	138623	1.16	60.2	71.5	1.187708
Fertilizers	18286	33680	0.54	8.7	10.3	1.183908
Electrodes: Welding	954	626	1.52	17.3	20.1	1.16185
Personal Care: MNC	59540	13547	4.40	13.6	15.8	1.161765
Auto Ancillaries	36722	21579	1.70	12.4	14.4	1.16129
Plastics Products	4280	4094	1.05	9.1	10.4	1.142857

(*Table 6.2 contd*)

Textiles: Silk	1776	847	2.10	17.8	20.3	1.140449
Textiles: Processing	7670	6972	1.10	12.9	14.7	1.139535
Steel: Medium	4326	3963	1.09	9.1	10.3	1.131868
Oil Drilling	192054	49188	3.90	44	49.5	1.125
Paints	12115	5771	2.10	12	13.5	1.125
Food Processing: Indian	3956	5613	0.70	10	11.2	1.12
Personal Care: Indian	16833	3653	4.61	15.9	17.8	1.119497
Banks: Private Sector	155588	42253	3.68	60	67	1.116667
Textile Products	4552	11466	0.40	11.2	12.5	1.116071
Air Conditioners	2605	2054	1.27	7.8	8.7	1.115385
Entertainment	42307	5305	7.97	19.6	21.8	1.112245
Paper	4581	7272	0.63	16.1	17.7	1.099379
Pharma: MNC	20778	5155	4.03	23.4	25.7	1.098291
Glass & Glass Products	4739	1719	2.76	13.6	14.8	1.088235
Pharma: Indian Bulk	14494	5831	2.49	17	18.5	1.088235
Chloro Alkalies	3536	2934	1.21	26.6	28.9	1.086466
Compressors/ Drilling Equipment	3825	1749	2.19	11.7	12.7	1.08547
Bearings	4233	2058	2.06	16	17.3	1.08125
Computers: Education	3147	601	5.24	17.5	18.7	1.068571
Automobiles: Scooters	26871	8232	3.26	13.3	14.1	1.06015
Automobiles: LCV/HCV	40578	28783	1.41	9.5	9.9	1.042105

(*Table 6.2 contd*)

Chemicals	32023	35042	0.91	5.1	5.3	1.039216
Engineering	28062	11360	2.47	12.8	13.2	1.03125
Finance: Housing	42210	6248	6.76	91.7	94.1	1.026172
Aluminium	34749	17286	2.01	29	29.7	1.024138
Textile Machinery	8432	1473	5.72	15.4	15.7	1.019481
Automobiles: Cars	27256	12472	2.19	12.9	13.1	1.015504
Computers-Software: Medium/ Small	52052	9859	5.28	22.6	22.9	1.013274
Textiles: Cotton Blended	9720	13559	0.72	15.2	15.4	1.013158
Cigarettes	66373	10965	6.05	31.8	32.2	1.012579
Cables: Telephone	3768	2115	1.78	12.1	12.2	1.008264
Computers-Software: Large	406879	42063	9.67	27.2	27.3	1.003676
Power Generation	161678	44404	3.64	25.3	25.3	1
Transmission Lines	4983	3452	1.44	12.6	12.6	1
Engineering Turnkey	48708	17755	2.74	8.6	8.5	0.988372
Healthcare	3134	1298	2.41	15.4	15.1	0.980519
Ceramic Tiles	1999	1983	1.01	17.3	16.9	0.976879
Abrasives	2553	895	2.85	17.7	17	0.960452
Steel: Sponge Iron	7920	4846	1.63	27	25.7	0.951852
Trading	25104	45579	0.55	1.5	1.4	0.933333
Cement Products	2502	2074	1.21	18.1	16.8	0.928177

(*Table 6.2 contd*)

Dry Cells	1234	1546	0.80	10.3	9.4	0.912621
Steel: Pig Iron	963	1408	0.68	11.9	10.8	0.907563
Refractories	785	402	1.95	20.2	18.2	0.90099
Electric Equipment	127766	28847	4.43	15.9	14.3	0.899371
Pumps	5579	1477	3.78	13.8	12.3	0.891304
Cycles	1325	1913	0.69	9.7	8.5	0.876289
Pesticides-Agro: Indian	6478	3270	1.98	13.1	11.3	0.862595
Shipping	12062	7715	1.56	40.1	34.5	0.860349
Travel Agencies	919	240	3.83	25.4	21.8	0.858268
Food Processing: MNC	15586	5613	2.78	16.54	14	0.846433
Automobiles: Motorcycles	17078	12186	1.40	12.6	10.2	0.809524
Miscellaneous	76809	37282	2.06	19.1	15.4	0.806283
Hotels	22508	3773	5.97	33.5	27	0.80597
Sugar	12919	15017	0.86	17	13.6	0.8
Couriers	1939	871	2.23	13.4	9.9	0.738806
Detergents	3003	2732	1.10	19.1	13.8	0.722513
Moulded Luggage	346	620	0.56	5.5	3.9	0.709091
Printing & Stationery	3125	2651	1.18	12	7.6	0.633333
Domestic Appliances	1343	5147	0.26	5.9	3.7	0.627119
Electronics: Consumer	10936	10641	1.03	11.6	5.1	0.439655
Aquaculture	57	223	0.26	4	1.2	0.3
Grand Total	3455593	1693652	2.04	16.18	18.59	1.148881
			P/E	12.60	10.97	

Source *Capital Market*, 22 December 2006.
Notes Figures for MCAP and sales are in Rupees (crores).
* as on 22 December 2006.

It can be seen that in Table 6.2, the tea sector has dramatically improved profitability. Other sectors that have improved profitability are the following:

- Finance: Term Lending
- Transport: Airlines
- Diamond Cutting/Jewellery
- Cement: South India
- Breweries
- Automobiles: Tractors
- Telecom Equipment
- Textiles: Composite
- Textiles Manmade
- Leather

As a conservative investor, one has to wait and watch the figures and then move in a decisive way. However, other forms of investing also can be tried out, but this approach considers the lag effect of information flow and thus is a sure shot for further investment opportunity in many of the sectors. This ensures that reasonable returns are generated, but not ambitious returns like other approaches project.

It can be seen that the following sectors have very less MCAP/Sales ratio, but simultaneously improved profitability:

- Diamond Cutting
- Refineries
- Dyes & Pigments
- Textiles-Spinning: Synthetic/Blended
- Solvent Extraction
- Cables: Power

All these sectors have also improved profitability in the current quarter under study. The next question that comes to mind is how to identify companies in these sectors. After identifying the sectors, one should investigate the market leader (the company that has maximum sales in that sector according to the *Capital Market* magazine) in that sector for possible investment criteria.

Analysis done by the author has identified many companies at an early stage itself. It should be borne in mind that some sectors have less investor fancy than other sectors. Therefore, the price movements of stocks in these sectors tend to be in a narrow range. However, the value in the following shares identified by the author much before they caught the fancy of the bull market and these companies have delivered good returns:

- IVRCL
- Baja Hindustan
- Havell's India
- Rei Agro
- Rajesh Exports

All these shares were identified much before the market discovered their merit, before the bull market of 2003.

One comment that should be made is that the overall MCAP to sales ratio is around 2.04 and the P/E ratio based on operating profit works out to 12.6 for the last financial year and 10.97 for the current quarter. This suggests that the market is not overheated and has the potential to go up still as P/E is attractively placed and fundamentals justify the risk. However, one needs to worry as and when the fundamentals go out of balance. MCAP to sales ratio is thus one barometer for assessing the health of stock markets in the overall context. From Table 6.2 one can identify the sectors that have low MCAP/Sales ratio and then analyze the leading company in each sector as a probable candidate for investment. This will ensure that we invest in market leaders provided the sectors are attractive to invest. For example, *Capital Market* dated 21 April–04 May 2008 gives an overall summary of how to assess the overheatedness of the market. Table 6.3 gives a summary of parameters to judge overall heatedness of the stock market and whether the market in aggregate is overvalued or not can be judged by looking at the various parameters summarized in this table.

TABLE 6.3 Summary of Parameters to Judge Overall Heatedness of the Stock Market

Metric	*For Full Year*	*TTM*
OPM %	20.9	22.8
PBDT Margin %	15.2	16.1
P/C Ratio	18.2	15.4
P/E Ratio	23.4	18.8
Dividend Yield %	1.3	
Price/Book Value Ratio	4.1	
Total Market Capitalization of 2200 Companies	Rs 5302039 crore	

Source *Capital Market*, 21 April–04 May 2008, p. 65.

It can be seen that the OPM has improved in the current year over the previous financial year figures and the trend is encouraging. Similarly this got reflected in the P/E ratio after the correction in the market in January 2008 and the P/E ratio is reasonable and not overheated. Dividend yield is at 1.3 percent, which is less, and the price/book value ratio is only 4.1.

FII HOLDINGS: AN INDICATOR

Every Thursday, *Business Standard* gives the list of Foreign Institutional Investor (FII) investment into the top-200 traded companies of the previous day. This can be used to analyze how the FIIs are increasing their holding in Indian companies and then one can track the price movement if substantial purchases are done by FII since this is one of the driving forces for a company's stock price to go up in the Indian markets. The data captured at various periods of time are presented for sample companies so that the reader can also track the same. Table 6.4 gives a snapshot of how FII holdings in different companies have varied over a period of time as compiled from *Business Standard* daily statistics.

TABLE 6.4 Variation in FII Holdings Status

Company	*FII Holding*			
	24/11/2005	*8/12/2005*	*23/3/2006*	*1/5/2008*
3i Infotech	4.45	4.45	3.59	5.53
Abanlioyd			13.42	16.62
ABB	16.4	16.4	16.16	15.79
ACC	20.52	20.52	23.74	15.12
Aditya Birla Nuovo				17.94
Adlabs	10.48	10.48	10.47	5.8
Aftek	16.81	16.81	14.89	
AIA Engg.			5.7	
Allahabad Bank	14.65	14.65	12.63	18.52
Alok	28.47	28.47		29.86
Alstom Projects			0.83	2.84
Amar Remedies	11.9	11.9	14.75	
Amtek Auto	36.39	36.39*	36.77	45.79
Amtek India		9.99		

Source *Business Standard*, 24 November 2005.

If one periodically monitors FII holdings in companies, one can predict and follow their judgment and unearth good shares for better returns.

Mutual Funds 7

INTRODUCTION TO MUTUAL FUNDS AND MUTUAL FUNDS IN INDIA

The origin of mutual funds, though started with UTI (Unit Trust of India) in 1963, took firm and concrete shape in 1993 with the government allowing the private sector and foreign institutions to set up mutual funds in India.

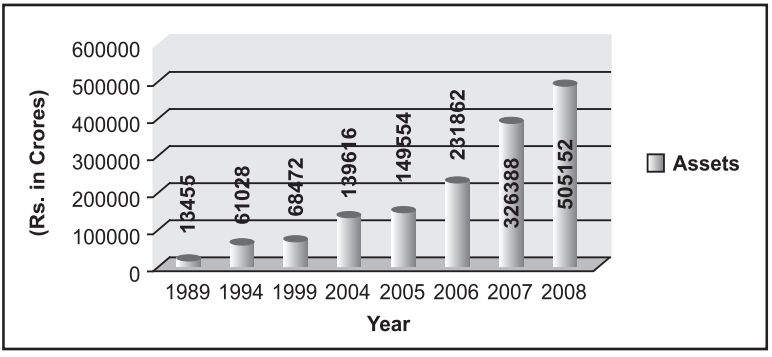
According to a Study on the Indian Mutual Fund Industry (IMFI) undertaken by the Associated Chambers of Commerce and Industry of India (ASSOCHAM), it is highlighted that IMFI, which owned assets worth around Rs 5 lakh crore until about September 2007, may end up notching assets of about Rs 6 lakh crore by March 2008, as it has started expanding by penetrating into smaller towns with vigorous speed. According to the ASSOCHAM Study, Asset Under Management (AUM) as percentage of GDP in India is 4.12 percent as against Australia, 88.22 percent; Germany, 10.54 percent; Japan, 7.57 percent; UK, 18.81 percent; USA, 61.27 percent; Canada, 34.33 percent; France, 59.63 percent; Hong Kong, 101.085 percent; and Brazil, 19.95 percent.

Figure 7.1 depicts the growth of this nascent industry in India by tracing the growth of assets of mutual funds.

Figure 7.2 shows the number of mutual fund schemes registered with SEBI.

Though the assets have grown at a fast pace, the Indian mutual fund industry is still in its infancy when compared to developed

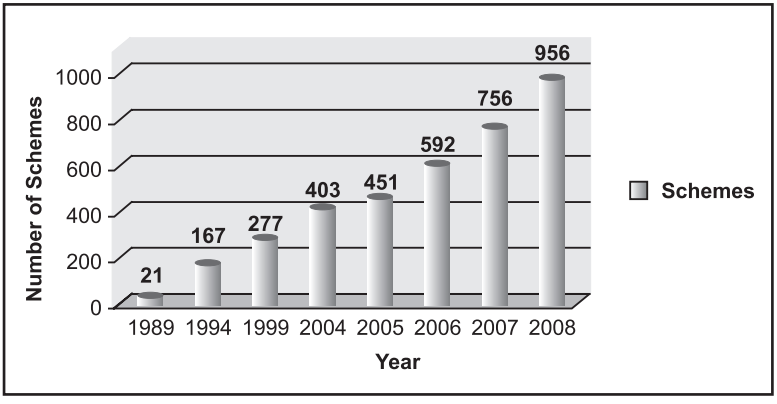
FIGURE 7.1 Growth of Mutual Funds Industry in India



Source AMFI booklet on mutual funds, 'Investor's Concise Guide', available at www.amfiindia.com (accessed on 9 December 2009).

Note This fast growing industry is regulated by the Securities and Exchange Board of India (SEBI).

FIGURE 7.2 Number of Schemes of Mutual Funds



Source AMFI booklet on mutual funds, 'Investor's Concise Guide', available at www.amfiindia.com (accessed on 9 December 2009).

financial markets like USA. As on March 2008, the US mutual fund industry is estimated to be operating with 8,064 mutual funds with an asset base of US$ 11.734 trillion.

Classification of mutual funds into two main categories as open-ended and close-ended schemes by way of structure is the most frequently used classification of funds.

An open-ended fund has the key advantage of offering liquidity, conveniently offering to buy and sell units at net asset value (NAV)-related prices. These funds do not have fixed maturity period. As compared to open-ended funds, close-ended funds have fixed maturity period varying from 2 to 15 years depending on the scheme objectives. One can invest in the scheme at the time of the initial issue and then buy or sell at the stock exchange where it is listed, depending on terms and conditions of issue.

As one gains experience, one can see that the risk exposed when directly investing through the equity route in the market is greater than investing through mutual funds. Mutual funds offer reasonable returns depending on the philosophy of investing and stated practices.

SOME TERMS EXPLAINED

As per the definition of AMFI (Association of Mutual Funds of India) website, www.amfiindia.com, the following terms need to be defined for a better understanding.

Net Asset Value (NAV)

NAV is the market value of the assets of the scheme minus its liabilities. The per unit NAV is the net asset value of the scheme divided by the number of units outstanding on the valuation date.

Sale Price

Sale price is the price you pay when you invest in a scheme. Also called Offer Price, it may include a sales load.

Repurchase Price

Repurchase price is the price at which units under open-ended schemes are repurchased by the mutual fund. Such prices are NAV-related.

Redemption Price

Redemption price is the price at which close-ended schemes redeem their units on maturity. Such prices are NAV-related.

Sales Load

Sales load, also called 'Front-end' load, is a charge collected by a scheme when it sells the units. Schemes that do not charge a load are called 'No Load' schemes.

Repurchase or 'Back-end' Load

Repurchase or 'Back-end' load is a charge collected by a scheme when it buys back the units from the unit holders.

The data for Table 7.1 has been extracted and compiled from Diversified Mutual Funds, as reported in Daily MF Performance Alert, around 30 October 2006, as reported in the IDBI Paisa Builder website (daily mutual fund performance indicator excel sheet) and modified in the following manner for the benefit of investors (www.idbipaisabuilder.in):

- Data has been analyzed and mutual funds are presented in decreasing order of return from inception/NAV criteria. In Table 7.1, the last column gives the aforementioned values. The justification of the ratio is that it is a measure of return/cost to the individual buyer of the mutual fund and thus is a good indicator of efficiency of management of funds by the fund house.

- Among the larger funds size category, Birla Top 100 Fund–Growth and Fidelity Equity Fund–Growth appear promising for investment by this criteria.

TABLE 7.1 Mutual Fund Schemes in India

Scheme Name	*Fund Size (Rs crores)*	*NAV Date*	*NAV*	*Return Since Inception (A)*	*(A)/NAV*
Principal Large Cap Fund – Growth	297.44	10/12/2006	15.51	55.1	3.552547
ABN AMRO Opportunities Fund – Growth	138.99	10/12/2006	18.117	56.68	3.128553
Birla Top 100 Fund – Growth	573.99	10/12/2006	14.6797	44.73	3.047065
Fidelity Equity Fund – Growth	2558.64	10/12/2006	18.576	55.23	2.973191
SBI Magnum Multi Cap Fund – Growth	1432.94	10/12/2006	14.46	41.1	2.842324
SBI Magnum COMMA Fund – Growth	573.4	10/12/2006	15.07	42.68	2.832117
Reliance Equity Opportunities Fund – Growth	2029.15	10/12/2006	19.0049	51.97	2.734558
Franklin India Flexi Cap Fund – Growth	3227.64	10/12/2006	19.49	51.21	2.627501
UTI Dividend Yield Fund – Growth	518.27	10/12/2006	15.04	34.47	2.291888
UTI Opportunities Fund – Growth	618.09	10/12/2006	13.99	31.38	2.243031
Kotak Opportunities Fund – Growth	301.1	10/12/2006	25.8	57.37	2.223643
HDFC Core & Satellite Fund – Growth	769.14	10/12/2006	24.39	53.88	2.209102

(*Table 7.1 contd*)

Standard Chartered Classic Equity Fund – Growth	491.25	10/12/2006	14.0041	30.68	2.190787
ABN AMRO Equity Fund – Growth	211.71	10/12/2006	24.13	52.19	2.162868
Prudential ICICI Discovery Fund – Growth	1209.48	10/12/2006	26.49	56.94	2.14949
Sundaram India Leadership Fund – Growth	300.42	10/12/2006	26.8554	54.25	2.020078
DSP ML Tiger Fund – Growth	1131.3	10/12/2006	28.79	57.22	1.987496
Sahara Wealth Plus Fund - FP – Growth	19.77	10/12/2006	13.2872	26.04	1.959781
Tata Equity P/E Fund – Growth	92.21	10/12/2006	23.1531	44.34	1.915078
Tata Dividend Yield Fund – Growth	191.67	10/12/2006	16.9282	32.16	1.899789
Chola Global Advantage Fund – Growth	23.48	10/12/2006	13.75	24.14	1.755636
PRINCIPAL Dividend Yield Fund – Growth	208.23	10/12/2006	16.05	26.81	1.670405
ING Vysya L.I.O.N Fund – Growth	135.58	10/12/2006	11.9	19	1.596639
Kotak Global India – Growth	126.23	10/12/2006	23.404	37	1.580926
BOB Growth Fund – Growth	13.21	10/12/2006	27.93	39.51	1.414608
Tata Contra Fund – Growth	361.3	10/12/2006	11.634	16.34	1.404504
Canequity Diversified – Growth	86.92	10/12/2006	27.68	38.5	1.390896
Quantum Long-Term Equity Fund – Growth	23.81	10/12/2006	11.5	15	1.304348

(*Table 7.1 contd*)

Standard Chartered Premier Equity Fund – Growth	218.74	10/12/2006	11.434	13.7	1.198181
Birla Dividend Yield Plus – Growth	579.85	10/12/2006	41.38	47.23	1.141373
DSP ML Top 100 Equity Fund – Growth	282.71	10/12/2006	51.18	57.5	1.123486
DWS Alpha Equity Fund – Growth	162.21	10/12/2006	47.43	51.86	1.093401
Sahara Growth Fund – Growth	6.08	10/12/2006	45	44.02	0.978222
Prudential ICICI Dynamic Plan – Growth	1252.36	10/12/2006	56.5324	55.03	0.973424
HSBC Equity Fund – Growth	1027.94	10/12/2006	63.9265	62.09	0.971272
SBI Magnum Sector Umbrella - Contra – Growth	1316.25	10/12/2006	34.6	33.13	0.957514
ING Vysya Dividend Yield Fund – Growth	101.55	10/12/2006	11.07	10.52	0.950316
Reliance Equity Fund – Growth	5502.32	10/12/2006	10.78	7.8	0.723562
DSP ML Equity Fund	634.6	10/12/2006	40.49	27.75	0.685354
SBI Magnum Equity Fund	258.99	10/12/2006	24.53	16.11	0.656747
PRINCIPAL Growth Fund – Growth	345.52	10/12/2006	46.26	29.26	0.632512
HDFC Growth Fund – Growth	331.39	10/12/2006	44.089	27.6	0.626006
Franklin India Growth Fund		10/12/2006	26.49	16.56	0.625142
Tata Pure Equity Fund – Growth	306.81	10/12/2006	55.7548	34.54	0.619498
DSP ML Opportunities Fund – Growth	1228.59	10/12/2006	50.15	28.6	0.570289

(*Table 7.1 contd*)

ING Vysya Select Stocks Fund – Growth	50.5	10/12/2006	25.74	13.55	0.526418
UTI Growth & Value Fund – Growth	161.08	10/12/2006	52.1	26.76	0.513628
Kotak 30 – Growth	377.1	10/12/2006	62.154	31.37	0.504714
Taurus Starshare	160.36	10/12/2006	35.61	16.57	0.465319
Tata Equity Opportunity Fund – Growth	420.72	10/12/2006	52.3934	24.23	0.462463
ABN AMRO Dividend Yield Fund – Growth	58.49	10/12/2006	10.542	4.84	0.459116
UTI Mastershare – Growth	1851.96	10/12/2006	31.7	13.64	0.430284
UTI Equity Fund – Growth	1521.26	10/12/2006	31	10.92	0.352258
Prudential ICICI Growth Plan – Cumulative	393.67	10/12/2006	85.24	29.6	0.347255
UTI Master Growth – Growth	350.43	10/12/2006	40.95	14.04	0.342857
Templeton India Growth Fund – Growth	332.81	10/12/2006	61.96	21.18	0.341833
SBI Magnum Multiplier Plus 93 – Growth	719.48	10/12/2006	47.51	15.47	0.325616
HDFC Top 200 – Growth	1484.87	10/12/2006	102.098	28.3	0.277185
Franklin India Bluechip – Growth	2419.79	10/12/2006	119.79	31.99	0.267051
Birla SunLife Equity Fund – Growth	405.98	10/12/2006	161.2	40.76	0.252854
HDFC Capital Builder Fund – Growth	790.88	10/12/2006	58.532	14.77	0.252341
JM Emerging Leaders Fund – Growth	57.18	10/12/2006	10.36	2.58	0.249035

(*Table 7.1 contd*)

Prudential ICICI Power – Growth	1430.63	10/12/2006	73.53	18.03	0.245206
Birla Advantage Fund – Growth	476.94	10/12/2006	113.81	25.24	0.221773
Franklin India Prima Plus – Growth	704.99	10/12/2006	122.72	23.14	0.188559
HDFC Equity Fund – Growth	3498.54	10/12/2006	136.262	24.66	0.180975
Reliance Vision – Growth	1960.26	10/12/2006	163.14	28.84	0.176781
Average				**32.38**	

Source Daily MF Performance Alert at *www.idbipaisabuilder.in* (extracted on 30 September 2006).

Similarly, the same analysis can be performed for different categories of mutual funds, such as sector funds, mid cap funds, MIP funds, balanced funds, ELSS funds, and so on.

It can be seen that Reliance Growth and Franklin India Prima Fund are doing very well and recommended for further study by this criterion.

Among the balanced funds, using the above approach, analyzing the same reflects the best performing funds. These are organized and sorted out in increasing order of Return/NAV in Table 7.2. Return/NAV is largest for Unit Scheme 2002 growth scheme, BOB Balanced fund growth option is second highest and Kotak Balance Fund is the third best performing fund.

TABLE 7.2 Balanced Funds Analyzed

Scheme Name	*Fund Size (Rs crores)*	*NAV Date*	*NAV*	*Return Since Inception*	*Return/ NAV*
Birla Balance Fund – Growth	133.92	6/1/2006	22.84	13.24	0.5796848
Birla SunLife 95 – Growth	129.23	6/1/2006	147.33	26.85	0.1822439
LIC Balanced – Plan C (Growth)	28.86	6/1/2006	37.0544	7.75	0.2091519

(*Table 7.2 contd*)

HDFC Prudence Fund – Growth	1688.87	6/1/2006	88.997	21.7	0.2438284
Tata Balanced Fund – Growth	155.81	6/1/2006	41.108	17.55	0.4269242
ING Vysya Balanced Fund – Growth	12.14	6/1/2006	15.83	7.79	0.4921036
DSP ML Balanced Fund – Growth	350.09	6/1/2006	31.23	17.61	0.5638809
PRINCIPAL Balanced Fund – Growth	37.74	6/1/2006	19.67	11.18	0.5683782
Prudential ICICI Balanced – Growth	432.02	6/1/2006	28.7	17.38	0.6055749
FT India Balanced Fund – Growth	237.11	6/1/2006	26.1446	15.99	0.6115986
Franklin India Balanced Fund – Growth		6/1/2006	28.24	17.38	0.6154391
Sundaram Balanced Fund – Growth	42.26	6/1/2006	27.7897	18.47	0.6646347
SBI Magnum Balanced Fund – Growth	218.29	6/1/2006	29.43	20.01	0.6799185
HDFC Balanced Fund – Growth	116.73	6/1/2006	26.458	18.53	0.7003553
Escorts Balanced Fund – Growth	6.28	6/1/2006	39.7222	30.69	0.7726158
JM Balanced – Growth	11.5	6/1/2006	18.87	17.07	0.9046105
Kotak Balance – Growth	106.61	6/1/2006	21.766	22.24	1.0217771
BOB Balance Fund – Growth	1.02	6/1/2006	20.47	30.12	1.4714216
Unit Scheme 2002 – Growth	629.77	6/1/2006	12.36	25.34	2.0501618

Source Daily Performance Alert at *www.idbipaisabuilder.in* (as extracted on 30 September 2006 and modified to suit the criteria).

If the same criterion is used for mid caps, Table 7.3 recommends the following mutual funds:

- SBI Magnum Midcap Growth option
- ING Vysya bank Midcap Growth option
- Prudential ICICI Emerging STAR Growth option

TABLE 7.3 Mid Cap Funds Analyzed

Scheme Name	*Fund Size (Rs crores)*	*NAV Date*	*NAV*	*Return Since Inception*	*Return/NAV*
SBI Magnum Mid cap Fund – Growth	532.35	6/1/2006	16.4992	62.18	3.768668
ING Vysya Mid cap Fund – Growth	391.18	6/1/2006	17.64	65.78	3.729025
Prudential ICICI Emerging STAR Fund – Growth	69.85	6/1/2006	15.03	50.13	3.335329
Kotak Mid cap Fund – Growth	785.01	6/1/2006	22.6	66.9	2.960177
SBI Magnum Sector Umbrella - Emerging Businesses – Growth	403.51	6/1/2006	17.207	50.86	2.955774
Sundaram SMILE Fund – Growth	483.38	6/1/2006	25.12	73.14	2.911624
Sahara Mid cap Fund – Growth	292.76	6/1/2006	15.8267	42.73	2.699868
Chola Mid cap Fund – Growth	16.87	6/1/2006	16.1722	40.41	2.498732
UTI Thematic Mid Cap Fund – Growth	61.06	6/1/2006	21.72	53.47	2.461786
Can Emerging Equities – Growth	86.03	6/1/2006	21.51	49.19	2.286843
Tata Mid cap Fund – Growth	21.46	6/1/2006	13.65	30.49	2.2337
Sundaram Select Mid cap – Growth	292.88	6/1/2006	12.2371	22.37	1.828047

(*Table 7.3 contd*)

SBI Magnum Global Fund 94 – Growth	745.37	6/1/2006	79.1065	71.33	0.901696
Reliance Growth – Growth	692.1	6/1/2006	34.59	15.55	0.449552
Franklin India Prima Fund – Growth	2813.19	6/1/2006	215.11	33.38	0.155176

Source Daily MF Performance Report at *www.idbipaisabuilder.in* (as extracted on 30 September 2006).

Similar analysis can be done for other categories of mutual funds, if required.

Mutual funds have two broad options–dividend and growth options. The ratio of the NAVs of these two options is one measure of the amount of dividend they have declared from their inception. Therefore, it is better to invest in such funds which have more of this ratio (NAV of growth option/NAV of dividend option). The higher the ratio, the better the performance and the assumption that one can expect the fund to repeat the same performance in future is the basis of investing in the fund. Same level of performance, if continued, can generate dividends in the same proportion. Table 7.4 gives some of the leading funds analyzed in this fashion. Before one understands Table 7.4, one needs to explain the two options–the dividend option and the growth option of mutual funds. Dividend option implies that the fund gives regular cash as dividend or reinvested in the fund as dividend reinvestment option. Please note that when dividend is declared, the NAV comes down by the extent of the dividend amount. This option is preferable for investors who want regular cash at periodic intervals. On the contrary, under the growth option, the declared dividend adds onto your investment and more units are added and investment compounds itself.

TABLE 7.4 Mutual Funds Analysis—Dividend and Growth Options

Scheme	*NAV – Div*	*NAV – Growth*	*Ratio*
Sundaram Select Mid cap	14.5	84.62	5.835862
Reliance Growth	46.1	249.99	5.422777

(*Table 7.4 contd*)

Sundaram Select focus	11.95	54.92	4.595816
Franklin Prima Plus	29.92	133.46	4.460561
HDFC Prudence	26.23	110.32	4.205871
Prudential Tax plan	19.91	82.91	4.164239
Prudential growth	20.76	84.77	4.083333
Franklin Tax shield	30.62	120.91	3.948726
Reliance vision	41.9	164.13	3.917184
HDFC Equity	37.84	144.18	3.810254
Prudential Power	20.18	74.48	3.690783
Franklin Prima	52.51	188.6	3.591697
Franklin Bluechip	35.7	123.86	3.469468
HDFC Top 200	34.83	105.02	3.015217
Tata Equ Oppor	18.33	52.44	2.860884
JM Income	10.16	28.72	2.826772
HDFC Cap Builder	21.3	59.74	2.804695
Franklin pension	16.51	42.95	2.601454
DSP Top 100 Equity	22.14	55.6	2.511292
Franklin Income	10.48	25.62	2.444656
HSBC Equity	28.48	68.72	2.412921
HDFC Tax Saver	56.65	134.89	2.381112
HDFC LT ADV	37.46	86.04	2.29685
JM Equity	15.06	33.51	2.2251
DSP Opportunity	23.84	52.64	2.208054
Reliance Banking	16.93	36.52	2.157118

Source *Business Line* newspaper.

As one can see, Sundaram Select Mid cap leads all the mutual funds in this analysis. This is one way to analyze and plan investments that are sound and risk free.

Another way to plan your investments is as follows: if you have excess funds from which you want to generate returns that are attractive but at the same time you want to avoid the risks associated with investing in shares, probably you can think of putting the money in fixed deposits with the option of monthly interest being credited to your savings account. This monthly interest can still be invested in Systematic Investment Plans (SIP)

of mutual funds in the aforementioned manner, and thus, the investor protects his/her original investment in fixed deposit and can get further returns by investing in mutual funds also using the interest as option to invest in funds. This ensures that his/her capital is protected and he/she ensures reasonable returns based on his/her investment in mutual funds. To give a simple calculation, say investing in fixed deposit gives a 9 percent return. Reinvesting that interest in an SIP of a mutual fund that gives a return of 20 percent enhances the return to 1.09 × 1.20, which is nothing but 1.308. This means that the investment has the potential to appreciate and give 30 percent return by safeguarding your original investment in fixed deposit. The principal is thus safe but you have been able to capitalize and improve your returns by such multiple investments and proper routing of investments. Similarly, if you have made profits in equity investing and are thinking of booking the same, you can book it and invest in fixed deposits to safeguard, or invest in debt instruments in mutual funds such as income schemes, so that the money rotates and your assets can grow at a faster pace.

8 Unconventional Ratios for Identifying Stocks

One comparison is to shortlist the companies that have returns greater than P/E ratio and then analyze them for identifying value in buying them. The following data is analyzed to identify companies for investment based on details in *Business Standard* dated 21 September 2006. The premise is to invest in companies that have high ratio of ROCE to P/E ratio as they are better companies to place your bets on in the uncertain market. This ratio gives a clue to which companies are better placed for further investment.

TABLE 8.1 ROCE vs P/E Ratio of Select Companies

Company	*ROCE*	*P/E*	*ROCE/P/E*
SAIL	62.58	5.56	11.26
Sesa Goa	93.23	10.53	8.85
GTC	223.18	26.56	8.40
SCI	24.74	3.64	6.80
Tata Steel	56.02	9.9	5.66
Harrisons Malayalam	18.55	3.67	5.05
JSW Steel	28.99	5.75	5.04
KEC Infra	17.48	3.5	4.99
IPCL	30.28	7.05	4.30
Gujarat Alkalies	30.42	7.7	3.95
Dhampur Sugar	23.59	6	3.93

(*Table 8.1 contd*)

GE Shipping	21.49	5.59	3.84
Hero Honda	71.92	19.09	3.77
Nalco	41.41	13.35	3.10
Glaxo	70.09	23.69	2.96
GNFC	24.71	8.5	2.91
GAIL	28.29	10.31	2.74
ONGC	34.71	14.49	2.40
BEL	43.56	18.86	2.31
HCL Info	30.28	13.79	2.20
Jindal Stainless	19.24	8.77	2.19
HPCL	17.59	8.42	2.09
TCS	70.04	33.76	2.07
Escorts	15.41	7.95	1.94
Colgate	70.66	40.54	1.74
HUL	72.88	45.02	1.62
Hinduja TMT	15.25	9.48	1.61
Satyam	33.38	21.87	1.53
Dwarikesh	18.82	13.45	1.40
Indian Oil	15.1	11.42	1.32
Maruti	28.51	22.26	1.28
Grasim	23.95	18.88	1.27
Triveni Engg.	25.08	20.29	1.24
BOC India	17.12	14.08	1.22
BEML	33.92	28.15	1.20
Mangalam Cement	18.78	15.64	1.20
Hind zinc	35.06	29.23	1.20
ITC	39.19	34.03	1.15
Reliance	18.66	16.45	1.13
Infosys	39.68	36.38	1.09
Tata Motors	28.34	26.9	1.05
Aftek Infosys	13.37	12.72	1.05
Dabur India	43.04	41.09	1.05

Source *Business Standard*, 21 September 2006.

From the Table 8.1 we can see that companies like (*a*) SAIL, (*b*) Sesa Goa, (*c*) GTC, (*d*) SCI, and (*e*) Tata Steel have value in buying them as per the logic discussed. This is one indicator of trying to assess which companies are attractively placed for investment.

Table 8.2 analyzes the sales growth rates of companies along with their P/E ratios. One can then try to identify by the ratio of growth to P/E ratio those companies that are available at cheaper valuations but simultaneously have high growth rates. This ratio gives dispassionate judgment of ratio of growth rates to P/E ratio and objectively identifies companies that are better placed. The premise to follow is that the higher the ratio, the better it is to invest in that company.

TABLE 8.2 Growth Rates Data of Select Companies

Company	*MCAP*	*Sales*	*Growth Rate*	*P/E*	*Growth Rate/P/E*
HCL Tech	13322	1447	99	22.7	4.361233
Hindalco	17629	3657	45	10.7	4.205607
Glaxo	8240	1470	55	14.8	3.716216
ICICI	44479	18767	54	17.5	3.085714
Jet	5217	5693	35	11.5	3.043478
Nalco	13112	4888	25	8.4	2.97619
Cipla	15417	2985	63	25.7	2.451362
Wipro	59952	10247	69	29.7	2.323232
Tata Power	8508	3942	31	13.9	2.230216
HDFC Bank	21600	5689	55	24.9	2.208835
Satyam	19546	4634	32	15.6	2.051282
Gujarat Ambuja Cements	11865	2600	39	19.6	1.989796
BHEL	42178	9516	45	25.1	1.792829
Tata Chem.	4232	2982	21	12	1.75
M&M	12861	6509	25	15.2	1.644737
PNB	11469	11092	13	8	1.625
Tata Motors	27583	20602	29	18	1.611111
TCS	80632	11230	45	29.7	1.515152
Bajaj Auto	24040	7668	33	21.8	1.513761

(*Table 8.2 contd*)

Oriental	3897	4676	10	7	1.428571
VSNL	8725	3303	16	11.4	1.403509
HPCL	7898	71037	27	19.5	1.384615
HDFC	27692	4278	30	22	1.363636
ITC	55450	9790	28	24.8	1.129032
ACC	13093	3160	19	17	1.117647
Hero Honda	14696	7418	16	15.1	1.059603
Tata Steel	23525	15139	7	6.7	1.044776
Sun Pharma	12646	1215	28	27.4	1.021898
Infosys	74225	9028	31	30.7	1.009772
SBI	40441	43183	8	9.2	0.869565
ABB	9325	2963	32	38.5	0.831169
Tata Tea	3599	886	16	19.3	0.829016
Dr Reddys	9082	1550	29	43	0.674419
Grasim	14430	6655	11	16.7	0.658683
BPCL	9540	72395	34	73.4	0.463215
Maruti	20747	12052	8	17.5	0.457143
HUL	45091	11080	12	28.2	0.425532
Zee	8873	834	50	120.1	0.41632
ONGC	136811	46366	3	9	0.333333
L&T	25858	14763	8	25.8	0.310078
Dabur	6440	1369	6	34	0.176471
GAIL	18575	14459	1	8	0.125
Ranbaxy	12764	3408	2	62	0.032258
SCI	3587	3396	0	2.8	0
SAIL	26455	28778	–2	6.6	–0.30303
MTNL	9025	5249	–7	15.6	–0.44872
Bharti	62245	11228	–59	30.9	–1.90939
Reliance Energy	8009	3976	–29	12.3	–2.35772
IPCL	5378	8469	–13	5.4	–2.40741

Source *Business Standard* and *Capital Market* magazines.

The following companies can be looked at for further investment opportunities:

- HCL Technologies
- Hindalco
- Glaxo Pharma

- ICICI Bank
- Jet Airways
- Reliance
- Nalco
- Cipla
- Wipro
- Tata Power
- HDFC Bank
- Satyam

ASSUMPTIONS BEHIND THE USE OF RATIOS DISCUSSED FOR INVESTMENT DECISIONS

The one thing that needs to be ascertained is whether these growth rates, ROCE, and so on, achieved by the companies are likely to be sustained in the ensuing years and whether these companies have sustainable business models or not. These criteria are only a first screener to identify the attractiveness of a stock to be invested in. Usual profitability analysis needs to be coupled with the above approach to yield better and consistent results. If one's analysis identifies a company that is also recommended by another research firm in the securities market, then one knows that one is on the right track. What is needed is to keep a sharp eye on the market and visit as many websites of investment firms as possible and update one's investment research with that of the firm and proceed further with decisions. The unusual ratios presented in this chapter cannot give target prices for investments but only act as a filtering agent for identifying companies and listing them for future analysis and monitoring for investments.

9 General Suggestions Compiled from the Available Literature

Whenever inflation rate is higher than interest rates, there will be pressure for interest rates to rise. When inflation rate is lower, then interest rates may remain stable barring other considerations of law of supply and demand applicable in money markets.

Some hints which are compiled from reading various books on investment and also those pitfalls which should be avoided, for the benefit of readers, are summarized as follows:

- Invest in companies that have dividend yield of more than half the savings bank interest rate.
- If you are an investor, you should learn to keep pace with current events and their implications on stocks. This single most reason can distinguish between a successful investor and an unsuccessful one.
- Invest in companies that have net profit margin more than twice the bank interest rate.
- For those companies that have higher ROCE, you can expect them to have higher MCAP/Sales ratio of 3 or more.
- One should invest only in companies that are growing at a rate equal to inflation + interest rate.
- Avoid companies that have ROE of less than 12 percent.
- One should be changing the criteria smartly depending on stock market conditions.
- Remember that high P/E companies will decline faster in a bear market.

- Sell off low dividend yield company stocks in a bear market to avoid further losses.
- Avoid companies wherein the ratio of earnings yield to dividend yield is more than 3.
- One of the reasons why some stocks keep going up and the reasons advocated on TV is the value of real estate owned by the company. If this value per share owned is more than the share price of the company, then it is automatically a candidate for fresh investments and someone will surely discover its value and then the upward journey for the stock starts. One should ensure that these real estates are not owned by resorting to undue borrowings by the company. This analysis is not reflected in the balance sheet or the P&L account of the company and needs to be gathered by studying the company in great detail.
- One needs to be careful about investing into cyclical products (copper, aluminum, steel, autos, paper, and so on) by looking at price to earnings ratio (which may be cheap). One should carefully study the cycle of the industry and only then invest into them. Investing in cyclicals when in a recession has proved to be better than when the economy recovers.
- If a stock disappoints with results in a quarter, immediately sell it as it would take a quarter to fix it. Though this book advises investing for long term, it is always prudent to keep checking and reviewing the prospects every quarter about the assumptions behind your investment decision. Whether there has been a fundamental change in the scenario is the question that one needs to determine before taking further decisions on the portfolio. One should verify if the stock is attractively priced relative to its earnings and also verify if the earnings of the company are going up or not. After verifying the facts, one can decide if the prospects have improved, and only then one may think of increasing one's holding. In case the prospects have worsened, then one can think of moving into another stock or reducing one's holding. Alternately, if the company is stable, then one can

decide whether one wants to stick on with one's investment considering other alternate opportunities for one's money.

- Generally, as these approaches are followed, one will identify a plethora of stocks for investment as creativity is the root of successful investing value wise. One can decide to hold on if long-term implications are there in these identified stocks, and periodical monitoring of fundamentals to check whether they are in place or not is essential for realizing better returns. However, it is difficult to predict at what price to sell the stock, as there are many factors which affect a stock price of the particular company you have invested in. Therefore, it is better to adopt the strategy of 'a bird in hand is better than two in the bush' and keep periodically booking profits after you have invested, depending on your actual needs. Keeping a target profit in mind and then selling off or rotating your money may be a better option.
- If you want to invest in small caps, invest only after they turn in the profits. Do not invest in anticipation of profits.
- None can predict the movement of interest rates, future of economy, or stock market. Instead focus on your investments and their businesses and what is happening to them. Keep reading a great deal about the businesses you have invested in.
- One should learn to study companies and their prospects from all the available information one can gather. If one studies these parameters as described in the book, one may master the science of investment; otherwise it will be like a game of poker for the investor and his/her returns. In case one does not have the time to do the homework suggested for companies, then one can turn into investing in mutual funds.
- One should learn to avoid the pitfall of buying a company with cheap valuation but mediocre prospects. This is a sure way to lose money. Therefore, one should learn to analyze the prospects of the business one is likely to invest in.
- Periodical checkup and screening on a quarterly basis identifies which companies have to be pruned and which

companies have to be rotated for investments and this definitely improves one's results. One should be careful and not get attached to stocks emotionally when prices are beyond the line of reality; one should sell it and come out. Stock market is a place of immense potential for alternatives to exist and this should be capitalized. One should be careful to learn from mistakes and avoid repeating the same by keeping a cool head and good temperament.

- Remember that in the stock market, the profit in hand is worth twice the profit in the bush. This helps you to book profits at reasonable periods of time to stay afloat in the market.
- Remember that the art of investment teaches that a bargain P/E ratio of Tata Steel is not the same as bargain P/E ratio for Reliance Industries. They are different and learning to judge this intricacy is the key to successful investing.
- Remember the thumb rule that a company with its P/E ratio at half its earnings growth rate is worth looking at for investment and those companies wherein the P/E ratio is twice its earnings growth rate are candidates for disinvestment.
- It is always better to read carefully the annual reports of the company you plan to invest in for important indicators like the cash position of the company, net of debt as well as value of its subsidiaries and other related group companies. You may be able to discover that the company may be available for a bargain and is undervalued so that the market discovers the same and share price then shoots up.
- Peter Lynch in his book *One Up on Wall Street* recommends analyzing a company on the following lines. If a company's long-term growth rate is 20 percent and the dividend yield is 5 percent, we need to add both of them and then divide the sum by actual P/E ratio of the company. He suggests that if this ratio is <1, the company is a poor candidate for investment; if the ratio is $+1.5$, the company is okay for investment; and a ratio of >2 means that the company is a potential candidate for investment.

Table 9.1 enlists some important points to note about Bull and Bear phases of a stock market.

TABLE 9.1 Bull Market vs Bear Market

Bull Market	*Bear Market*
Bull markets tend to last longer.	Greater amount of losses in a short timeframe is the hallmark of the bear market. For example, the January 2008 crash of Indian markets and the market behavior in the subsequent months.
High P/E ratio and low dividend yields characterize this phase.	Falling P/E ratio is the hallmark and high dividend yields are common.
Generally, prices are going up.	Generally, prices keep going down even after good news flows in.
Volume of shares traded is high.	Volume of shares trades is low.
Number of companies raising capital through public route is high.	Companies are afraid to raise capital in the public domain due to adverse market sentiment.
Generally, economy is on a recovery mood or in boom and all indices show positive growth signs. Investor psychology is upbeat.	Generally, accompanied by slowdown of economy, rising unemployment, rising inflation, and so on.
In a bull market, there is less supply of securities and high demand for the stocks. This results in a rising trend of the prices in the market due to imbalance in supply–demand equation. As a result, share prices soar as investors compete to buy the available equity.	In contrast, a bear market has more sellers and lesser number of buyers.

Source Author.

ADDITIONAL BOOKS TO READ TO MASTER THE ART OF INVESTMENT

The readers of this book are further advised to read the following bestsellers on investments to understand the market better and thus hone their skill set. Some of the books are easy to read while

some are complex and require in-depth study; a cursory glance is not enough to pick up the finer points or logic of investments.

- Graham, Benjamin. 1949. *The Intelligent Investor*. New York: Collins.
- Graham and Dodd. 2008. *Security Analysis: Principles and Technique*, 6E. New Jersey: McGraw-Hill Professional.
- Lynch, Peter. 1989. *One Up on Wall Street: How to Use What You Already Know to Make Money in the Market*. New York: Simon & Schuster.
- Lynch, Peter. 1993. *Beating the Street*. New York: Simon & Schuster.
- Murphy, Joseph E Jr. 1994. *Stock Market Probability*, 2nd edition. New Jersey: McGraw Hill.
- Pardoe, James. 2005. *How Buffett Does It*. New Jersey: McGrawHill.
- Train, John. 2003. *The Midas Touch: The Strategies that Have Made Warren Buffett the World's Most Successful Investor*. Hampshire: Harriman House Classics.
- Lefevre, Edward. 2006. *Reminiscences of a Stock Operator*, Revised Edition. New Jersey: John Wiley and Sons.
- Fischer, Kenneth L. 1990. *Super Stocks*. New Jersey: McGraw Hill.
- Fischer, Philip A. 1996. *Common Stocks and Uncommon Trends*. New Jersey: John Wiley and Sons.
- O'Neill, William, J. 2002. *How to Make Money in Stocks: A Winning System in Good Times Or Bad*. New Jersey: McGraw-Hill.
- Cawkwell, Simon. 1995. *Profit of the Plunge: How to Win at Short Selling*. Leighton Buzzard: Rushmere Wynn.

It is advisable to pay our respects to investors who have practiced the Ben Graham theory of value investing. Some of them who practice the value investing philosophy at leading firms (like Franklin Templeton) are:

- William J. Ruane
- Irving Kahn
- Charles Brandes

- Charlie Munger
- Mario Gabelli
- Prof. Roger Murray
- Max Heine
- Micheal F. Price
- Seth Klarman
- Martin J. Whitman
- Joel Greenblatt
- Charles de Vaulx
- Jean-Marie Eveillard

Some of the aforementioned have worked for reputed mutual funds and have established such well known performance standards that are the envy of stock market pundits.

Finally, this book pays respects to all those who have mastered the art of investment with their unconventional thinking and created wealth.

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He has written several articles on varied topics on Management in *The Hindu Business Line, Hindustan Times, Pharma Bio World, Express Pharma, Indian Management, The Chartered Accountant Student, Materials Management Review,* and so on. He has authored a book titled *Corporate Performance Improvement: A Practitioner's Perspective*, which describes a unique approach at improving return on assets of any company.

His hobbies are investing in stock markets and doing data analysis. Identifying companies for investment with fundamental analysis is his forte. He can be reached at gbrkprasad@gmail.com.