



STOCK SELECTION PROCESS

RESEARCH METHODOLOGY

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INTRODUCTION

After spending 14 years in the stock market since 2001 and closely interacting with individual investors, we have realized that most investors do not have access to the right research to invest their hard-earned money. Many investors don't know where to turn, whom to trust, or what they must stop doing if they are to achieve superior investment performance.

To make money from the stock market, one should follow sound principles and proven rules and methods of investment.

StockAxis, founded in 2014, provides in-depth research and recommendations to help investors earn attractive returns from equity markets. We have built an investment advisory firm whose interests are aligned with investors' interests.

We believe that Investing should be a right – not a privilege. With that thinking, we provide free equity research tools such as Stock Trend, Stock Rating, Stock Analyzer, StockAxis Top50, Top 10 Industries, etc. This ensures our interests are always aligned with yours.

You have the freedom to opt into our paid advisory services if you wish. No longer will clients be forced to pay fees for services they can't or don't want to use.

1. STOCK SCREENING PROCESS

Expect nothing less than highly rigorous due diligence from StockAxis during each step of the investment process. We begin with using our in-house proprietary software systems to get a list of companies qualifying our screeners. We conduct thorough, in-depth analysis to select the best companies for investment. Ultimately, we recommend and monitor the selected companies continuously.

Every business is different and unique; this implies that the research carried out should be suitable to the business. The following are different research strategies applied for different businesses:

Cyclical / Non-cyclical Business

The terms 'cyclical' and 'non-cyclical' describe how highly correlated a company's operational performance is to economic fluctuations. Cyclical Industries and their companies have a direct relationship to the economy, while non-cyclicals repeatedly outperform the overall business environment when economic growth slows down.

Investors cannot influence the cycles of the economy, but we can adapt our investing practices to the best of our knowledge. Adapting to economic changes requires an understanding of how industries are aligned to the economy. It's important to know the fundamental difference between cyclical and non-cyclical companies to distinguish between sectors affected by economic changes and those that are more immune to it.

Cyclical stocks represent companies that manufacture and/or sell discretionary products and services that consumers buy when the economy is performing very well. People tend to avoid purchasing these products and services when times are tough. When people

stop/hold off buying because of a reduction in purchasing power, companies' revenues may start to fall. This, in turn, puts pressure on stock prices, which also start to drop. In the event of a long downturn, some of these companies may even go out of business.

We at a StockAxis look for companies whose businesses are non-cyclical/less cyclical and are hence, generally profitable regardless of economic trends. These companies' products and services are more related to non-discretionary consumption in our country. They are least dependent on macro-economic indicators and more dependent on domestic consumption trends. They provide great places to invest when the economic outlook is in downturn.

Non-cyclical businesses are also known as secular stories and are consistent over a period. We also look for industry tailwinds where there is increasing support from the government and a conducive business environment. These stocks generally outperform the market and post steady earnings.

2. BUSINESS MODEL

We believe a strong business model plays a very important role in the overall growth of the company. Basically, the primary component of the business model is the value proposition. This is a description of the goods or services that a company offers and why they are attractive to customers or clients, ideally stated in a way that distinguishes the product or service from its competitors.

We look for scalability in the business with visibility in its earnings over a longer duration. They should have high entry barriers, strong leadership in the market, the products should have been well accepted by consumers and strong brand recognition.

We look for a business model which has been resilient through a downfall, margins are stable or on an increasing trend and finally, we check for disruption. One bad cycle can easily impact a business. Hence, the product portfolio of the company should be resilient in a downfall during which margins are stable.

Here is a list of different business models:

Manufacturer Business Model

The manufacturing business model uses raw materials to create a product to sell in the market. This type of business model might also involve the fabrication of prefabricated components to make a new product, such as automobile manufacturing.

A manufacturing business can sell its products directly to customers (known as the business-to-consumer (B2C) model). We at StockAxis believe that this is a high margin

business which creates strong earnings visibility and demands high valuation in the stock market. We prefer and recommend this business model.

Another option involves outsourcing product sales to another company (known as the business-to-business or B2B model). Wholesale manufacturers typically sell products to retailers, who, in turn, sell directly to consumers. An example of this type of company might be a clothing manufacturer that sells merchandise to a retailer, who, in turn, sells to consumers. This business model is not margin lucrative and generally commands low valuations in the market.

Distributor Model (Trading Business)

A distribution company buys products directly from a manufacturing company and resells the products directly to consumers or to a retailer. The distributor often acts as one of the middle points between a manufacturer and the final consumer. Distributors are responsible for setting price points that will generate a profit while also utilizing effective promotion strategies that will secure strong sales. This kind of business model is also known as a trading business model which commands very low-price valuation in the market. We generally avoid recommending such business models.

Retailer Model

A retailing business buys products from a wholesale or manufacturing company, then sells it directly to the public. Examples of retailers are DMART, V-MART, V2 RETAIL, TRENT, FUTURE RETAIL, RELIANCE RETAIL and many more. Retailers might be nationwide chains, or they could be independent shops operated by a single entity.

Retailers may either have physical outlets at different locations and/or sell online. This kind of business, we believe, will witness secular growth as it is related with India's

consumption. These companies have a sustainable business model and command high valuations in the stock market.

Online Model (E-commerce)

E-commerce has helped businesses establish a wider market presence by providing cheaper and more efficient distribution channels for their products or services. E-commerce, which can be conducted over computers, tablets, or smartphones, may be thought of as a digital version of mail-order catalogue shopping. Nearly every imaginable product and service is available through e-commerce transactions, including books, music, plane tickets, and financial services such as stock investing and online banking. As such, it is considered a very disruptive technology. This model is successful if the company uses sophisticated technology for its online E-commerce platform.

At StockAxis, we assess the business model of the company, its ability to bring visibility in the company's margins and its sustainability. This is one of the many parameters that we assess while analyzing a stock. Other parameters we consider include the industry group the company belongs to, its management, its performance and outlook as compared to its peers, among others.

3. RETURN RATIOS

Assessing a company's profitability is one of the key factors to consider while making an investment decision. One must use return ratios to do this. Return ratios indicate how efficiently a company is using its funds to generate profits. The two key return ratios are: Return on Equity and Return on Capital Employed. Let's understand both these ratios.

Return on Equity (ROE)

The return on equity ratio (ROE) is a profitability ratio that measures how effectively a company is able to use its equity capital to generate profits. A high ROE indicates that a company is using its own funds in a better way, and vice versa. However, one must compare the ROE of a company with other companies in the sector or industry group it belongs to.

StockAxis' Analysis of ROE

As mentioned earlier, a higher ROE is a positive indication of effective usage of capital. StockAxis combines this metric with DuPont analysis to further break down the ROE indicator. The DuPont analysis covers three key ratios i.e. operating margin, asset turnover and financial leverage. This analysis helps us pinpoint the specific reasons for a higher or lower ROE. For instance, a company can have a higher ROE due to its market leadership, sustainable growth, operational efficiency, and/or optimum utilization of equity capital. A caveat here is that one must compare companies in the same industry group since every industry has different levels of shareholders' fund and income.

Return on Capital

The Return on capital employed (ROCE) ratio indicates the level of profits a company has generated by deploying the sum of equity capital and borrowed funds, i.e. total capital of the company. This is, in effect, the sum of equity and debt on the company's books. A higher ROCE is considered to be good.

StockAxis' Analysis of ROCE

As mentioned earlier, a higher ROCE is a positive indication of effective usage of funds. It indicates that the company has been able to use its funds optimally. A company with a high ROCE could withstand challenging situations while sustaining profitability. A caveat here is that one must compare companies in the same industry group since every industry has different levels of funds and income.

4. OUTPERFORM

The term 'Outperform' implies being better than other stocks/the broad market. It implies looking for market leaders.

Market Leaders

A market leader can be defined as a company which has the highest market share in a given industry for a particular product or service. The market leader often enjoys the first mover advantage in new markets. Due to its leadership position, the stock often trades at a higher valuation than its peers. The company has the capability and technology to launch products that can add value to the customer.

StockAxis' Analysis of Outperformer

StockAxis looks for the market leader or the next best player in an industry group with potential to become a leader. Market leaders have the ability to grow on a sustained basis and offer consistently attractive returns. Our research team identifies companies which have a competitive edge over their peers, such as companies that have niche businesses, unique products, inimitable services or business products, first mover advantage, etc. We believe that companies which are market leaders in their respective industry group/sector, or which have the potential to become leaders, can outperform the broad market or their peers. Market leaders can survive and maintain business growth across different business cycles. Choosing leaders over laggards helps us to outperform the market, specifically when markets are in a downtrend.

5. MANAGEMENT QUALITY

Most investors tend to overlook assessing the management of a company. Even the best of companies may be run down if the management quality is below par. Management forms the backbone of any business. Senior managers, starting from the CEO downwards, are instrumental in the success of the business. They provide the vision, direction and strategies to overcome competition while ramping up growth, which reflects in the company's bottom-line. The management is responsible to run the company keeping the interests of the shareholders in perspective with the ultimate aim of creating value for shareholders.

We, at StockAxis, use our market intelligence to look for management with integrity, intelligence and passion to run their businesses efficiently. Some of the factors we consider while evaluating the management include:

- 1) Promoters'/ management's background and competence.
- 2) Salary of KMP (Key managerial persons).
- 3) How efficiently capital has been allocated.
- 4) Insider trading activity, if any.
- 5) Frauds/ scams, if any.
- 6) Related party transactions.
- 7) Past track record of stakeholders' value creation.

At StockAxis, we prefer aligning our clients' investments with proven management which has won the trust and admiration of stakeholders.

6. CORPORATE GOVERNANCE

The general idea of 'corporate governance' is processes and practices through which businesses are operated and controlled; in other words, it is, 'the governance of corporations'.

Corporate governance is therefore about rules framed and implemented by the company's board of directors in order to establish the values the company must abide by.

There have been some recent amendments by SEBI, which we believe are in the right direction. Some key ones are as follows:

- 1) Debarring of erring auditors
- 2) Each member of the board of directors should limit his directorships in companies to the maximum stipulated limit
- 3) Tightening rules related to CSR (Corporate Social Responsibility)
- 4) Directors to make declarations to the board on an ongoing basis regarding their independence
- 5) Half yearly statement of cash flows.

We at StockAxis believe that the most important pillars of corporate governance are fairness, transparency and accountability. All these factors are critical in successfully running a company.

Transparency

Transparency is a critical component of corporate governance because it ensures that all of a company's actions can be checked at any given time by an outside observer. In simplest terms, transparency means having nothing to hide. For a company, this means it allows its processes and transactions to be observable to outsiders. It also makes necessary disclosures, informs everyone affected about its decisions, and complies with legal requirements.

Accountability

Accountability, which can also mean answerability or liability, is in fact, more than that. It's about having ownership over one's actions, whether the consequences of those actions are good or bad. When the idea of accountability is approached with this positive outlook, people will be more open to it as a means to improve their performance. This applies across the organization - from the staff all the way up to the corporate board. Some questions that pertain to accountability include - How's the level of accountability in the corporate board? Are directors there to simply fill in a seat, or are they actively engaged in decisions and strategies for the company?

Fairness

Fairness refers to equal treatment; for example, all shareholders should receive equal consideration for whatever shareholdings they hold. In addition to shareholders, there should also be fairness in the treatment of all stakeholders including employees, communities and public officials.

For many company boards, being fair is a very difficult thing. There are big decisions to be made on which a normal person or group with some interest (financial or otherwise) cannot

just be fair; for instance, in transactions such as mergers or acquisitions. For this reason, many companies are turning to what is known as fairness opinions. This involves calling in an independent knowledgeable entity to assess a particular transaction and give their opinion on its fairness.

Taken together, fairness, transparency and accountability define a company's integrity.

In the last few years, we have witnessed increasing frequency of corporate frauds and governance failures.

At StockAxis, one of our top priorities is to look for companies with good governance and ensure that such practices continue.

We check for:

- 1) Change of auditors / very high auditors remuneration.
- 2) Representation of independent directors.
- 3) Directorships in other companies of key managerial persons.
- 4) Remuneration payable to executive / non-executive directors.
- 5) Credit rating report.
- 6) Board's approach to corporate social responsibility.
- 7) Promoters' control and succession planning.
- 8) True independence of independent directors.

7. GROWTH POTENTIAL

The key intent of investing in equity is capital appreciation. This is achieved by investing in 'growth' stocks. We at Stock Axis look for growth stocks in trending sectors or rapidly expanding industries, where new technologies and services are evolving. 'Growth' companies usually reinvest their earnings back into the business, rather than pay a minimal dividend to shareholders. We look for stocks with tremendous growth potential which will translate into growth in earnings and revenues, and, in turn, higher stock valuations in future.

Growth stocks usually trade at high prices relative to their fundamentals (e.g. book value, revenue, cash flow and dividends). These stocks quote at high valuations due to high earnings expectations and their growth rates are considerably higher than the market averages. These stocks are popular in the market due to their potential to launch innovative products and capitalize on market opportunities. We expect attractive returns from investing in growth stocks as their market value grows with expansion of their profitability and business.

We look for businesses with strong visibility in earnings. We assess the sector/industry group the business belongs to in terms of its potential to grow and the opportunity size. We generally prefer investing in companies whose earnings are expected to increase at an above-average rate compared to their industry sector or the overall market. Growth investing is profitable because buying stocks of emerging companies can provide impressive returns if the companies are successful.

We at StockAxis evaluate stocks in trending sectors. A megatrend is a major development that has huge implications for majority of the stocks in that particular sector. Thus, we identify a company that's poised to address the opportunities that such trends reveal. A fundamentally strong company in a growing industry is a fitting recipe for success.

We look for companies that have established a strong niche, are consistently profitable and have a strong brand or familiar identity. To evaluate a company's financial condition, we assess the company's balance sheet, income statement, cash flow, and other operational data, along with external factors such as the company's market position, industry and economic prospects. The company should have consistent earnings, low debt and a commanding position in the marketplace.

Valuation (Price)

The price at which a stock is available is a critical parameter to consider while making an investment decision. We at StockAxis look for great businesses available at a fair price. Value stocks are those that are priced lower than the intrinsic value of the company and its assets. We identify a value stock by analyzing the company's fundamentals and evaluating some key financial ratios. If the stock's price is lower than the company's intrinsic value, it is considered to be a value stock.

We look for companies following robust risk management processes, which consist of identifying, assessing and controlling threats to an organization's capital and earnings. These threats, or risks, could stem from a wide variety of sources including financial uncertainty, legal liabilities, strategic management errors, accidents and natural disasters. Risk management helps organizations prepare for the unexpected by minimizing risks and incidental costs before they occur.

By executing a risk management plan and considering the various probable risks or events before they occur, an organization can save substantial amounts. A robust risk management plan will help a company establish procedures to avoid potential threats, minimize their impact should they occur and cope with the results.

To assess a company's valuation, we consider the following ratios:

Price-to-Earnings Ratio

The price-to-earnings ratio is a financial metric that compares the company's stock price with its earnings per share (EPS). The P/E ratio is important since the comparison of earnings with stock price represents the investor's perception about the company's ability to generate attractive earnings going forward. Stocks with a low P/E ratio could be characterized as value stocks while stocks with a high P/E ratio could be termed as growth stocks. However, there could be exceptions to this. For instance, a low P/E stock may be the result of the company's business going through a down cycle, under-performing its peers, etc. Similarly, a high P/E stock may be the result of unwarranted positive sentiment, low floating stock, etc. A high P/E may also indicate expectations of high earnings going forward, and vice versa.

Price-to-Book Ratio

This ratio is a financial metric of the company's price to its book value per share. It is primarily used in case of banking and financial institutions. It assesses whether the entity's stock price is high or low as compared to its book value. A higher market price may indicate that investors are optimistic about the entity's ability to generate attractive returns going forward. A low P/B ratio may indicate problems regarding the fundamental strengths of the entity.

Price-to-Cash Flow

Cash flow generated by a company is an important parameter in assessing its valuation. A robust price-to-cash ratio indicates that the company has good potential to generate sufficient cash. It measures the prospects that investors assign to the company's future health from a financial point of view. Generally, stocks with a low P/C ratio are characterized as value stocks and stocks with a high P/C ratio are characterized as growth stocks. The P/C ratio is considered as an additional multiple of the P/E since both ratios give indications regarding the firm's current and future performance. This ratio is used to assess the market price a stock will attain based on the level of cash generated by the company.

ADVISORY AS PER YOUR NEED

When it comes to investing, the risk you are prepared to take is really a matter of personal choice – there's no 'one size fits all' approach.

You may want to take very little risk because your priority is to conserve your capital. In this case, our Blue-chip service is suitable for you. On the other hand, you might be prepared to take greater risks with your money if it means the possibility of achieving much higher returns. For you, our Multi-bagger service is appropriate.

To keep things simple, it makes sense to think about three types of risk:

- You could lose some or all of your investment - there's no guarantee that your investment will increase in value, so you should be prepared for the possibility that you end up with less than you started with.
- Your investment may not perform as well as expected - even if your investment grows in value, there's no guarantee it will perform to your expectations. And you can't rely on an investment's past performance to be repeated in the future.
- The investment journey may be volatile - the value of investments can go down as well as up, and the riskier the investment, the more unpredictable its return is likely to be.

Why StockAxis?

Our relationship with our clients is more important than anything else. So, here are our promises we are determined to keep.

1. We'll always remember that it's your money. This means we work for you, so if you want to talk to the research analyst, you can. Just call your assigned relationship manager.
2. We'll never treat you like just another client. We don't use call centers and we don't have recorded messages telling you "how important your call is". Our Client Relations team is frequently praised by our customers for the help and attention they give.
3. We'll always keep asking for your valuable feedback and trying to improve.
4. We'll keep putting you first.

Giving us feedback

Outstanding customer service is at the heart of everything we do. But that doesn't mean we get it right every time. If you're not happy with the service we give you, please tell us. We'll listen to your complaint and where possible, we'll try to improve things, so it doesn't happen again.

If you have any query, email: research@stockaxis.com, call us on +91 22 66393000 or visit to us at: Opulent Investment Adviser Private Limited, 113/114, Bajaj Bhavan, Nariman Point, Mumbai – 400 021 and we'll get back to you at the earliest.

