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How to select stocks for your long term portfolio :

A Thread ■■■

(i) Selecting the sectors
(ii) Selecting the companies
(iii) How to review and decide
(iv) Perfect time to exit/pyramiding

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(1/n)

(i) Selecting the sectors :

• Sectors which are unaffected due to any slowdown or in other words, non-cyclical sectors should be preferred.

• Which are having good demand of their products / tailwinds in their favour. IT/Pharma is the recent example.

(2/n)

• Govt. policies in favour of the sector by imposing any duties or providing incentives to the industry.

• Always check for proxy plays, Example :

- Realty boom - Building materials, Appliances, Cement (Proxy)

• Sector which is the need of the hour - Renewables.

(3/n)

(ii) Selecting the companies :

• 2 ways to select the companies :

- Based on past financials / historical data
- Estimating forward valuations

• By analysing past data, you can identify the company which performed the best, can be classified as the leader.

(4/n)

• Companies with consistent higher OPM, RoCE, RoE and OCF conversion are considered good for investing.

• For example, leaders in various sectors :

- Diagnostic - Dr Lal Pathlabs
- Amines - Alkyl Amines
- Cement - Shree Cement

(5/n)

• While analysing past data, we can use this formula :

- Sales Growth (5 years) > 15%
- RoCE > 15% or RoE > 12%
- Net Debt/Equity < 0.1

(6/n)

• Estimating forward valuations : This is a very tricky part of selecting the stocks.

• Based on recent quarterly earnings and management's guidance, you will have to project the future earnings.

• In this case, sectorial tailwinds must be in favour of the company.

(7/n)

• While forecasting the valuations, please keep a note on :

- OPM in improving trend (last few quarters)
- Avoid capital intensive sectors (such as metal)
- Management guidance and their execution
- Sectorial tailwinds in favour

(8/n)

(iii) How to review and decide :

• Check the quarterly earnings and attend con-calls.

• Review their Half-Yearly and Yearly results where company posts balance sheet along with CFO statement.

• Compare the guidance given with what they delivered.

(9/n)

• While checking B/S or CFO statement, Do check :

- Trade Receivables - Significant increase - Negative
- Cash + Investment Value - Increase - Positive
- OCF conversion from EBITDA - High - Positive
- Working capital cycle & management

(10/n)

- Higher CWIP - Capex - Positive in longer run
- Contingent liabilities - High - Negative
- Net fixed asset turnover (NFAT)
- RoIC and RoCE.

• Invest in the businesses which can generate higher RoCE and OCF from their businesses.

(11/n)

(iv) Perfect time to exit / pyramiding :

"Always remember : When everyone is greedy, be fearful and when everyone is fearful, be greedy."

Track the business, valuation metrics & decide.

I hope this thread will add some value to your analysis.

Thanks for reading■

(12/12)