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FOREWORD

This guide is designed to help candidates prepare for the NISM Series XV: Research Anlayst Certification Examination. The rapidly growing Indian financial industry, set to expand at 15% annually for the next five years, presents lucrative opportunities. Educational qualifications, especially NISM certifications, are crucial for securing roles in financial services. These certifications serve as prerequisites for various positions, assuring companies of a candidate's knowledge of the stock market. NISM certifications set a common knowledge benchmark, fostering quality market professionals and enhancing investor participation. They also offer structured career paths, allowing individuals to become traders, investors, analysts, advisors, or mutual fund distributors by clearing accredited NISM exams.

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CHAPTER 1

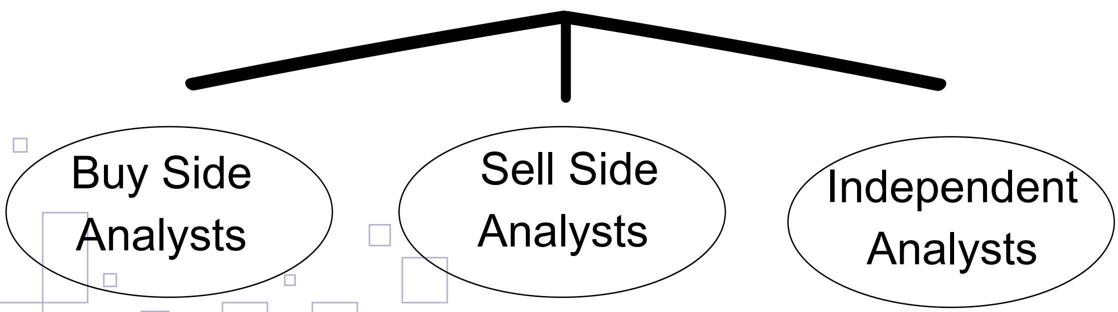
INTRODUCTION TO RESEARCH ANALYST PROFESSION

Role of Research Analyst

A research analyst is a professional who prepares investigative reports on securities after conducting proper due diligence for their clients. The report an analyst prepares entails the examination of financial records and documents of securities of companies or industries and often concludes with a "buy," "sell" or "hold" recommendation.

Imagine you've decided to buy a new car. What would be your process of selection? For the price range decided, you would shortlist a set of brands, compare various technical Specifications, and depending upon what factors are important to you - whether it's the mileage or the interior of the car, you take the decision. This process is very similar to Research Analysts. There is Research (collection of information from various sources) and then Analysis (processing of data to take decisions).

Research Analysts can be categorized in to three main classes, depending on the nature of analysis they do and whom they are serving to.



- **Sell-Side Analysts:** They typically publish research reports on the securities of companies or Industries with specific recommendations to buy, hold, or sell the same.
- **Buy-Side Analysts:** They generally work for Asset managers like mutual funds, hedge funds, pension funds, Alternative investment funds, Foreign Portfolio investors, or portfolio managers that purchase and sell securities for their investment accounts or on behalf of their investors/clients.
- **Independent Analysts:** They work for research firms separate from full-service investment firms and sell their research to others on a subscription basis. They also provide customized research reports on specific requests.

Primary Responsibilities of a Research Analyst

Research Analysts' primary role is to understand and evaluate the growth of industries and companies

- **Understanding economy:** Changes in various macroeconomic factors, Fiscal and Monetary Policies and their impact on the economy, flows from FDI and FPI, Savings and investment patterns, and Global factors based on imports and Exports.
- **Understanding Companies:** This includes analyzing companies based on their approach towards business. Based on their styles, product configurations, business models, customer segments, their financials the companies are studied by analysts in two dimensions - Qualitatively and Quantitatively.
- **Understanding industry:** Different industries face different challenges and opportunities. Their growth drivers could be significantly different. Accordingly, Research Analysts need to understand thoroughly the regulatory environment prevalent

in the industry, business models, competition, operating factors, sensitivity of demand to price changes, consumers' behavior etc.

Important Qualities of a Research Analyst

- Good with numbers
- Good Excel/spreadsheet and other data analytical tools
- Clarity in financial concepts
- Ability to read and comprehend financial statements and reports
- Ability to ask pertinent questions
- Attention to details
- Communication Skills – Written and Verbal

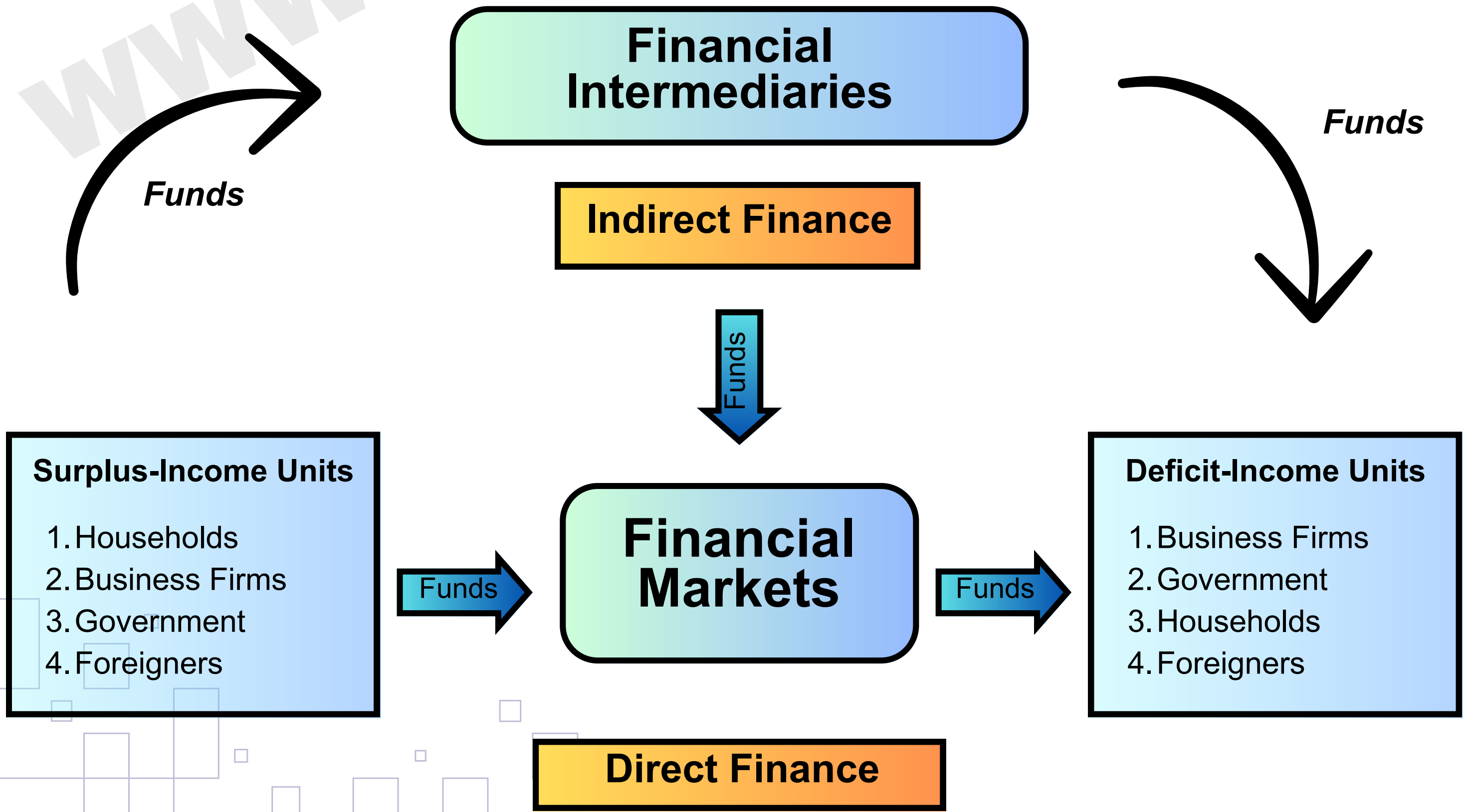
CHAPTER 2

INTRODUCTION TO SECURITIES MARKET

Securities are transferrable financial instruments or contracts that show evidence of indebtedness or ownership interest in assets of an incorporated entity. These include equity shares, preference shares, debentures, bonds, and other such instruments. These are issued by companies, financial institutions, or the government. They are purchased by investors who have money to invest.

Financial Market consists of:

- Investors/Providers of funds (buyers of securities)
- Borrowers/Seekers of funds (sellers of securities)
- Intermediaries (providing the infrastructure to facilitate transfer of funds and securities)
- Regulatory bodies (responsible for the orderly development of the market).



Product Definitions

- **Equity Shares:** Equity shares represent the form of fractional ownership in a business venture. Equity shareholders collectively own the company. They bear the risk and enjoy the rewards of ownership.

- **Debentures/Bonds/Notes:** Debentures/Bonds/Notes are instruments for raising long-term debt. Debentures are either unsecured or secured (backed by collateral support) in nature. There are a variety of debentures/bonds such as fully convertible, non-convertible, and partly convertible debentures. These could be in Domestic as well as Foreign currency.

1. Fully convertible debentures are fully convertible into ordinary shares of the issuing company. The terms of conversion are specified at the time of issue itself.
2. Partly convertible debentures (PCDs) are partly convertible into ordinary shares of the issuing company under specified terms and conditions as specified at the time of issue itself. The non-convertible part of these debentures is redeemed as happens in any other vanilla debenture.
3. Non-convertible debentures (NCDs) are pure debt instruments without a feature of conversion. The NCDs are repayable/redeemable on maturity.

- **Foreign currency bonds:** Foreign currency bonds are bonds issued by a company in a currency that is different from the currency of its home country. Companies in emerging markets may prefer to issue bonds in USD or currencies of other economically matured countries as they carry significantly lower interest rates.

- **External bonds / Masala bonds:** External bonds, also referred to as Euro bonds are bonds issued in a currency that is different from the currency of the country in which it is issued. External bonds denominated in Indian rupees (INR) are referred to as Masala bonds. These bonds are issued outside of India but are denominated in Indian Rupees.

- **Warrants and Convertible Warrants:** Warrants are options that entitle an investor to buy equity shares of the issuer company after a specified time at a pre-determined price. Only a few companies in the Indian Securities Market have issued warrants till now.

- **Indices:** An Index is a basket of securities of different backgrounds, which indicates the price trends of the underlying securities collectively to indicate overall market trends.

MARKET INDEX

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Securities of different sectors collectively indicating the overall market trend.

SECTORAL INDEX

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Securities belonging to the same sector but with diff. structures indicate the trend of that particular sector.

NIFTY/SENSEX

BANK NIFTY/NIFTY FINANCIALS

- **Mutual Fund Units:** Mutual Funds (MFs) are investment vehicles that pool together the money contributed by investors which the fund invests in a portfolio of securities that reflect the common investment objectives of the investors.

- **Exchange Traded Funds (ETFs):** An Exchange Traded Fund (ETF) is an investment vehicle that invests funds pooled by investors to track an index, a commodity (e.g. Gold), or a basket of assets. It is similar to an index fund in the sense that its portfolio reflects the index it tracks. But, unlike an index fund, the units of the ETF are listed and traded in demat form on a stock exchange, and their price changes continuously to reflect changes in the index or commodity prices.

- **Preference Shares:** a special kind of equity shares that have preference over common/ordinary equity shares at the time of dividend and at the time of repayment of capital in the event of winding up of the company. However, unlike common equity shares, preference shares do not carry voting rights or a right over the residual assets of the company, in case of winding up.

- **American Depositary Receipts (ADRs):** These depositary receipts issued and traded in the U.S.A. are issued by a non-US company. ADRs are one of the most popular depositary receipts and many companies across the world have issued ADRs. Some of the Indian companies that have issued ADR include Infosys, Wipro, ICICI Bank, and HDFC Bank.

- **Indian Depositary Receipts (IDR):** They are issued and traded in the Indian market by a non-Indian company referred to as IDR. Depositary receipts of Standard Chartered Bank are traded in the Indian stock market in the form of IDR.

- **Global Depositary Receipts (GDRs):** These refer to depositary receipts that are allowed to be traded in more than one country. Typically, GDRs are preferred to be issued in the European Union member states as the commonality of the regulations makes it easy for the issuing companies to comply with regulations across the region.

- **Foreign Currency Convertible Bonds (FCCBs):** FCCBs or Foreign Currency Convertible Bonds are foreign currency (usually dollar) denominated convertible debt papers issued by companies in international markets. These instruments are to be understood the way convertibles are with the only difference being that they are generally optionally convertible and issued offshore in different denominations under guidelines as defined by the Reserve Bank of India (RBI) from time to time. The payment of interest and repayment of principal (if happens) on these bonds is in foreign currency. However, once the conversion of the instrument happens in equity, the dividend is paid in Indian Rupees with conversion obligation (currency risk) lying with the investors.

- **Equity Linked Debentures (ELDs):** Equity Linked Debentures (ELDs) are floating-rate debt instruments whose interest is based on the returns of the underlying equity asset such as Nifty 50, S&P Sensex, individual stocks or any customized basket of individual stocks. The issuer of the bond invests a pre-determined part of the principal amount collected in fixed-income securities like bonds, which provide principal protection while the balance is used to buy options that provide exposure to returns of equity. Thus, these instruments are generally structured in a way to gives full capital protection with a provision for equity participation to the investors.

- **Mortgage Securities (MBS) and Asset-Backed Securities (ABS):** MBS and ABS are debt instruments issued by institutions against the receivables and cash flows from financial assets such as home loans (MBS), auto loans, rent receivable, credit card receivables, and others. The cash flows accruing from these assets are used to meet the interest and principal repayment obligations on the bonds issued. The issuer can create liquidity in an otherwise illiquid asset by securitizing it. The instruments are credit-rated and may be listed on stock exchanges.

- **REITs/InvITs:** Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) are investment vehicles that pool money from various investors and invest in revenue-generating real estate projects and infrastructure projects, respectively.

- **Commodities:** Commodities are basic materials or goods that are largely homogenous in nature. These goods are interchangeable with other goods of the same type. Thus, a bar of gold is a commodity while jewelry made of gold is not a commodity.

Structure of Securities Market

PRIMARY MARKET

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The primary market provides the channel for the sale of securities (equity, debt) by unlisted public companies directly to the public either Domestically or Internationally at face value or at a discount/premium.

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Through IPO/FPO

SECONDARY MARKET

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Secondary market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange.

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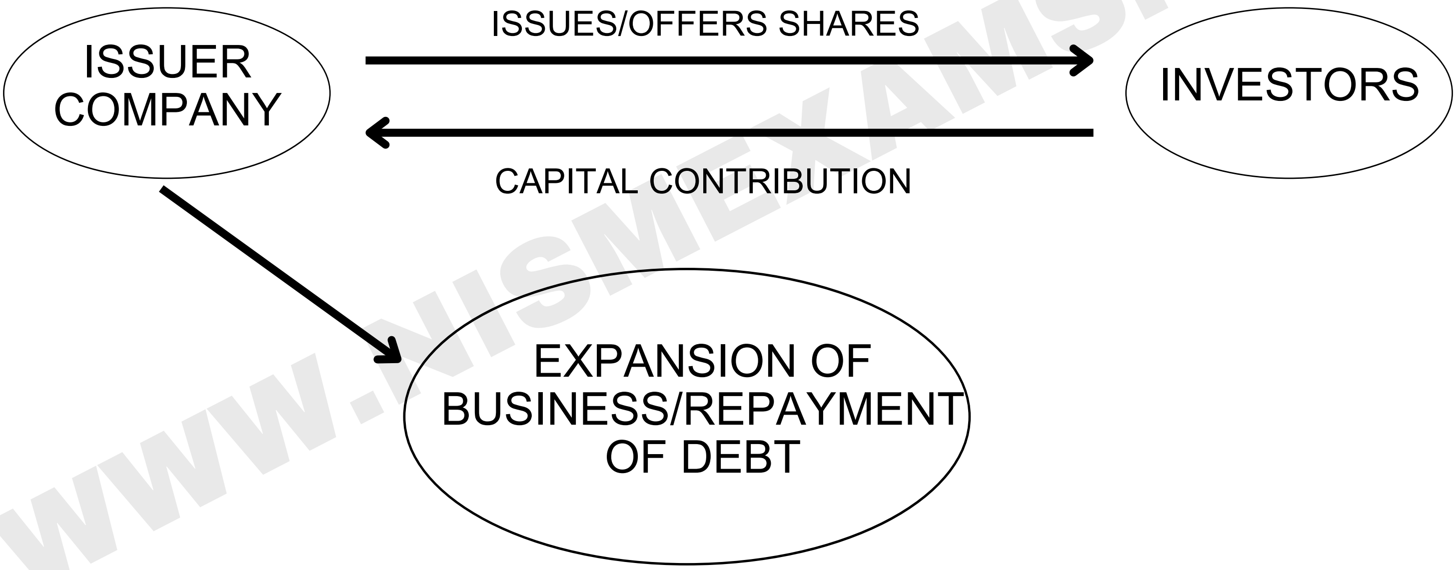
Through Trading & Investing

Primary Market

Most companies are usually started privately by their promoter(s). However, the promoters' capital and the borrowings from banks and financial institutions may not be sufficient for setting up or running the business over the long term. So companies seek funds from the public by inviting them to contribute towards the equity and issue shares to them accordingly. The way to invite share capital from the public is through a 'Public Issue'. Simply stated, a public issue is an offer to the public to subscribe to the share capital of a company. Once this is done, the company allots shares to the applicants as per the prescribed rules and regulations laid down by SEBI.

IPO- Initial Public Offer

When an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.



- **Follow-on Public Offer (FPO):** When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called FPO.

- **Private Placement:** It refers to issuing large quantities of shares to a select set of investors. According to the Companies Act 2013, the number of investors to whom shares are issued under private placement should not exceed fifty. Private placements can be in the form of qualified institutional placements (QIP) or preferential allotment.

- **Qualified Institutional Placements (QIPs):** Qualified Institutional Placement (QIP) is a private placement of shares made by a listed company to certain identified categories of investors known as Qualified Institutional Buyers (QIBs). QIBs include financial institutions, mutual funds, and banks among others.
- **Preferential Issue:** Preferential issue means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis.
- **Rights and Bonus Issues:** Securities are issued to existing shareholders of the company on a specific cut-off date, enabling them to buy more securities at a specific price (in case of rights) or without any consideration (in case of bonus). Both rights and bonus shares are offered in a particular ratio to the number of securities held by investors as of the record date.
- **Onshore and Offshore Offerings:** While raising capital, issuers can either issue the securities in the domestic market and raise capital or approach investors outside the country. If capital is raised from the domestic market, it is called an onshore offering and if capital is raised from investors outside the country, it is termed an offshore offering.
- **Offer for Sale (OFS):** An Offer for Sale (OFS) is a form of share sale where the shares offered in an IPO or FPO are not fresh shares issued by the company, but an offer by existing shareholders to sell shares that have already been allotted to them. An OFS does not increase the share capital of the company since there is no fresh issuance of shares.
- **Sweat Equity:** A company may issue shares to its employees, promoters, technocrats, or others as a reward for their

contribution to the company. These shares are referred to as sweat equity. The purpose of issuing the share is to motivate employees and top management or any other recipient to work in the interest of the company.

- **Employee Stock Option Scheme (ESOPs):** ESOPs are instruments given by a company to its employees that give them an option to buy the shares of the company at a pre-determined price after a period (referred to as a vesting period). Typically, the vesting period is more than one year and companies may stipulate additional conditions for vesting.

Secondary Market

A secondary market refers to a market where securities are traded after being initially offered to the public in the primary market by providing an efficient platform for trading securities. The majority of the trading is done in the secondary market with the help of various market intermediaries.

- **Over-The-Counter Market (OTC Market):** OTC markets are the markets where trades are directly negotiated between two or more counterparties. In this type of market, the securities are traded and settled over the counter among the counterparties directly.
- **Exchange Traded Markets:** The other option of trading in securities is through the stock exchange route, where trading and settlement are done through the stock exchanges. The trades executed on the exchange are settled through the clearing corporation, which acts as a counterparty and guarantees the settlement of the trades to both buyers and sellers.

- **Trading:** A formal contract to buy/sell securities is termed trading. As defined above, trading can be done either in the Over-The-Counter (OTC) market or the Exchange Traded Market. Stock exchanges in India feature an electronic order-matching system that facilitates efficient and speedy execution of trades.
- **Clearing and Settlement:** Clearing and settlement are post-trading activities that constitute the core part of the equity trade life cycle. Clearing activity is all about ascertaining the net obligations of buyers and sellers for a specific period. And, settlement is the next step of settling obligations by delivering shares (by the seller) and paying money (by the buyer).
- **Risk Management:** In OTC transactions, counterparties are expected to take care of the credit risk on their own. In the exchange-traded world, the clearing corporation, as defined above, gives a settlement guarantee of trades to the counterparties (all buyers and sellers). This exposes the clearing corporation to the risk of default by the buyers and sellers. To handle this risk, the clearing corporation charges various kinds of margins, most prominent among these margins are Initial or upfront margin, Peak Margin, and mark-to-market (MTM) margins.

Various Market Participants

Market Participants in the Securities Market include buyers, sellers, and various intermediaries between the buyers and sellers.

- **Stock Exchanges:** Stock Exchanges provide a trading platform where buyers and sellers can transact in already issued securities. Stock markets such as NSE, BSE, and MSEI are nationwide exchanges. Trading happens on these exchanges through electronic trading terminals which feature anonymous order matching.

- **Depository:** A depository is like a bank wherein the deposits are securities (viz. shares, debentures, bonds, government securities, units, etc.) in dematerialized form. In India only 2 Depositories are operative which are:

NSDL

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National Securities Depository Ltd.

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Promoted by NSE

CDSL

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Central Depository Services (India) Ltd.

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Promoted by BSE

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Listed on NSE

- **DEPOSITORY PARTICIPANT:** A Depository Participant (DP) is an Agent of the depository that acts as an intermediary between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act and it must be registered as such with SEBI. Most Brokers also function as DP.

- **Trading Members:** Trading members or Stock Brokers are registered members of a Stock Exchange. They facilitate buy and sell transactions of investors on stock exchanges. All secondary market transactions on stock exchanges have to be essentially conducted through registered brokers of the stock exchange.

- **Authorized Person:** Authorised person is any person (individual, partnership firm, LLP, or body corporate), who is appointed by a stock broker or trading member as an agent to reach out to the investors scattered across the country. A stock broker may appoint one or more authorized person(s) after obtaining specific prior approval from the stock exchange concerned for each such person.

- **Custodians:** A Custodian is an entity that is charged with the responsibility of holding funds and securities of its large clients, typically institutions such as banks, insurance companies, and foreign portfolio investors.

- **Clearing Corporation:** Clearing Corporations play an important role in safeguarding the interest of investors in the Securities Market. Clearing agencies ensure that members of the Stock Exchange meet their obligations to deliver funds or securities. These agencies act as legal counterparties to all trades and guarantee the settlement of all transactions on the Stock Exchanges.

- **Clearing Banks:** Clearing Bank acts as an important intermediary between clearing members and the clearing corporation. Every clearing member needs to maintain an account with the clearing bank. It is the clearing member's responsibility to make sure that the funds are available in its account with the clearing bank on the day of pay-in to meet the obligations arising out of trades executed on the stock exchange.

- **Merchant Bankers:** Merchant bankers are entities registered with SEBI and act as issue managers, investment bankers, or lead managers. They help an issuer access the security market with the issuance of securities. They are single-point contacts for issuers during a new issue of securities.

- **Underwriters:** Underwriters are intermediaries in the primary market who undertake to subscribe to any portion of a public offer of securities that may not be bought by investors. They serve an important function in the primary market, providing the issuer the comfort that if the securities being offered to the public do not elicit the desired demand from investors, they (underwriters) will step in and buy the securities. When the underwriters make their commitments at the initial stages of the IPO, it is called hard underwriting. Soft underwriting is the commitment given once the pricing is determined.

Institutional Participants

Institutional Investors comprise domestic financial institutions, Banks, Insurance Companies, Mutual Funds, and Foreign Portfolio Investors. Some of them are defined here in brief:

- **Foreign Portfolio Investors (FPIs):** A Foreign Portfolio investor (FPI) is an entity established or incorporated outside India that proposes to make investments in India. These international investors must register with the regulator - the Securities and Exchange Board of India (SEBI) to participate in the Indian Securities Market.

- **P-Note Participants:** Participatory Notes (P-Notes or PNs) are instruments issued by SEBI-registered foreign portfolio investors to overseas investors, who wish to invest in the Indian stock markets without registering themselves with the market regulator.

- **Mutual Funds:** A mutual fund is a professionally managed collective investment scheme that pools money from many investors to purchase securities on their behalf. Mutual fund companies invest the pooled money in stocks, bonds, and other securities, depending upon the investment objective of the scheme which is stated upfront.

- **Insurance Companies:** Insurance companies' core business is to ensure assets. Depending on the type of assets that are insured, there are various insurance companies like life insurance and general insurance, etc. These companies have huge corpus and they are one of the most important investors in the Indian economy by investing in equity investments, government securities, and other bonds.

- **Pension Funds:** A fund established to facilitate and organize the investment of the retirement funds contributed by the employees and employers or even only the employees in some cases.

- **Venture Capital Funds:** A venture capital fund refers to a pooled investment vehicle like a mutual fund but with the mandate to invest money in enterprises that are in the early stage of development but with the potential for long-term growth.

- **Private Equity Firms:** Private equity is a term used to define funding available to companies in the early stages of growth, expansion, or buyouts. Investee companies may be privately held or publicly traded companies. The term private equity includes venture capital firms. The money in the fund is contributed by investors, called limited partners, and invested and managed by the general partner(s).

- **Hedge Funds:** A hedge fund is an investment vehicle that pools capital from several investors and invests that across the assets, across the products, and the geographies. These fund managers generally have a very wide mandate to generate a return on the invested capital.

- **Alternative Investment Funds:** These are privately pooled investment schemes that invest in various asset classes such as real estate, private companies, commodities, and such other alternative investment assets. SEBI categorizes AIFs into three categories:

1. Category I AIF: These refer to AIFs that invest in start-up or early-stage ventures or social ventures SMEs infrastructure or other sectors or areas that the government or regulators consider as socially or economically desirable.
2. Category III AIF: These refer to those that use complex

investment strategies including the use of leverage and derivatives. Hedge funds, PIPE Funds, etc. are registered as Category III AIFs.

3. Category II AIF: AIFs that do not fall in Category I and III and that do not undertake leverage or borrowing (other than to meet day-to-day operational requirements) are categorized under Category II AIFs. Various types of funds such as real estate funds, private equity funds, funds for distressed assets, etc. are registered as Category II AIFs.

- **Investment Advisers:** Investment advisers work with investors to help them decide on asset allocation and make a choice of investments based on an assessment of their needs, time horizon return expectation, and ability to bear risk. They may also be involved in creating financial plans for investors, where they help investors define their financial goals and propose appropriate saving and investment strategies to meet these goals.

- **Employee Provident Fund (EPF):** EPF is a scheme that is used to provide retirement benefits in the form of defined benefit schemes to employees of covered organizations. Every employer is obligated to provide 12% of basic salary as a contribution to the scheme and an equal amount is deducted from the employee's salary. The funds are deposited with the Employees' Provident Fund Organisation (EPFO) which administers and manages the funds.

- **National Pension Scheme (NPS):** This is a government-sponsored retirement scheme. Subscribers contribute regularly to the scheme and on maturity, the funds accumulated in the scheme can be used to buy annuity products. Subscribers will also have the option to partially withdraw the funds at maturity.

Kinds of Transactions

- **Cash trades:** The trades where settlement (payment and delivery) occurs on the same trading day (T+0, where 0 defines the time gap in days between trade day and settlement day).

- **Tom trades:** The trades where settlement (payment and delivery) occurs on the day next to the trading day (T+1, where 1 defines the time gap in days between trade and settlement day).

- **Spot trades:** The trades where settlement (payment and delivery) occurs on the spot date, which is normally two business days after the trade date. Equity markets in India offer Spot trades.

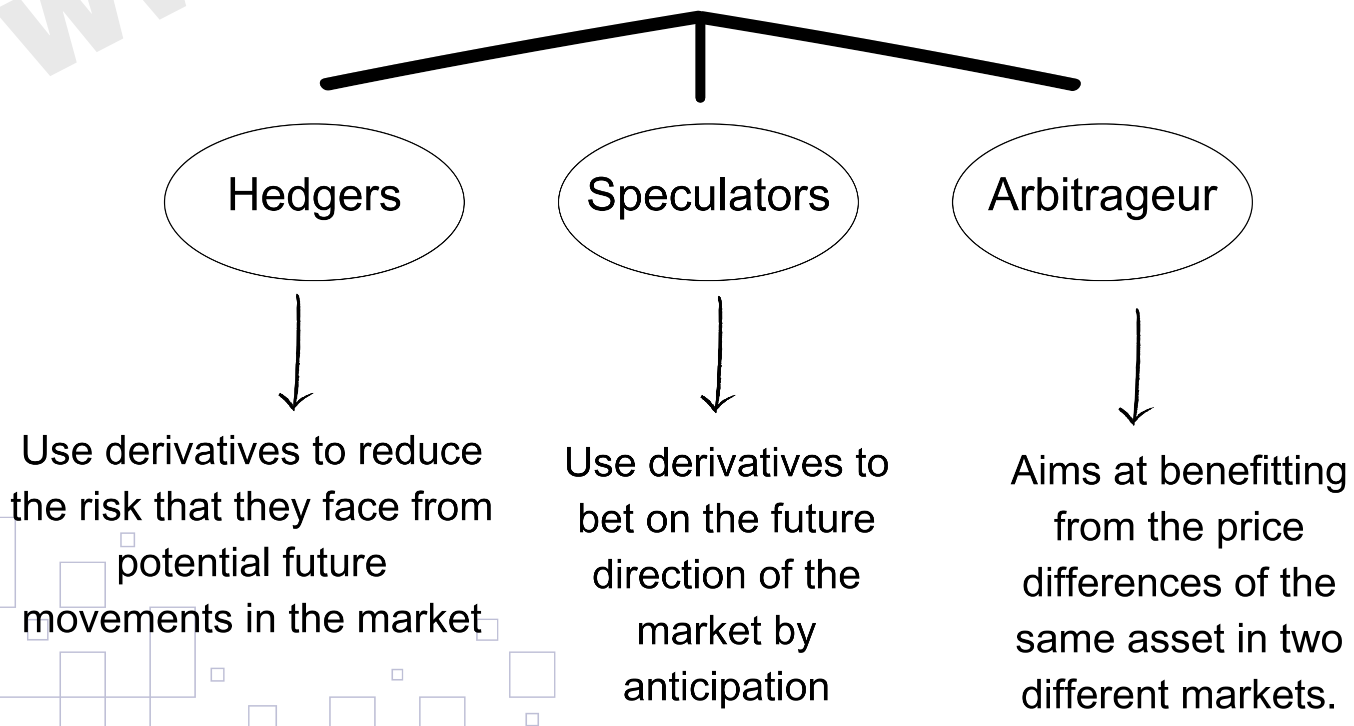
- **Forwards:** It is a contract between two parties to buy/sell an underlying asset at a certain future date for a price that is pre-decided on the date of the contract. Both parties are obliged to honor the transaction irrespective of the price of the underlying asset at the time of delivery.

- **Futures:** A futures contract is similar to a forward, except that the deal is made through an organized and regulated exchange rather than being negotiated directly between two parties. Indeed, we may say futures are exchange-traded forward contracts.

- **Options:** It is a contract that gives the right, but not the obligation, to buy or sell the underlying at a stated date and price. The buyer of the option pays the premium for the right, and the seller of the option receives the premium with the obligation to sell/ buy the underlying if the buyer exercises his right.

- **Swaps:** A swap is an agreement made between two parties to exchange cash flows in the future according to a prearranged formula. Swaps help market participants manage risk associated with volatile interest rates, currency exchange rates and commodity prices.

Trading, Hedging, Arbitrage



Dematerialization and Rematerialization of securities

- **Dematerialization:** Dematerialization is the process of converting securities held in physical form into holdings in book entry (electronic) form. In demat form, one investor's shares are not distinguished from another investor's shares and these shares do not have any distinctive number, folio number, or certificate number.

- **Rematerialization:** Rematerialization is the reverse of dematerialization and is the process of converting securities held in electronic form into physical form. On request of investors, Securities on rematerialization are allotted in physical form with distinctive numbers, in place of the securities held electronically in book-entry form with a depository.

CHAPTER 3

TERMINOLOGY IN EQUITY AND DEBT MARKETS

Two broad types of securities are issued by seekers of capital from investors: Equity and Debt. When a business needs capital to fund its operations and expansion, it chooses between these two types of securities.

Equity	Debt
Equity capital is available for the company to use as long as it is needed.	Debt capital will have to be returned after the specified time.
Equity investors do not enjoy any fixed return or return of principal invested.	Debt investors earn a fixed rate of interest and return on principal at maturity.
Equity investors are owners of the Business.	Debt investors are lenders to the Business.
Equity investors participate in the management of the business	Debt investors do not
Residual profits of the business belong to the equity investors	Debt investors' claim is restricted to the periodic fixed coupons and principal principal repayment on maturity.

Equity represents a risky, long-term, growth-oriented investment that can, show a high volatility in performance depending on how the underlying business is performing. There is no assurance of return to the equity investor.	Debt represents a relatively lower risk steady, income-oriented investment. It generates a steady rate of return, provided the business remains profitable and does not default on its payments.

Terminology in Equity Market

- **Face Value (FV):** The nominal price of a share is known as its face value. The equity capital of the company is calculated by multiplying the number of shares issued by its face value. The face value of a share is important for calculating the dividend payable on a share. When the dividend is mentioned as a percentage, that percentage is reckoned as the face value. For example, if a company with a Face value of Rs. 10 declares a 30% dividend, it means a dividend of Rs. 3 per share.

- **Book Value:** Book Value of a company is the net worth of the company. To compute book value per share, the net worth of the company is divided by the number of outstanding shares. In simple terms, book value per share means the theoretical amount of money each share would get in case the company was to wind up.

- **Market Value:** This is the market price of a share. The market value of the entire equity of a company is termed market capitalization and is computed as the market price per share multiplied by the total number of outstanding shares.

- **Replacement Value:** This refers to the market value of all the assets of a company at any point in time. If a new company were to set up with all the infrastructure/plants, that an already existing company has, then the cost that it would have to bear today is known as the 'Replacement Value' of the existing firm.

- **Intrinsic Value:** The intrinsic value of an equity share is the discounted value of its future benefits to the investors. Investing in equity is about estimating this intrinsic value and paying a price today to earn the future value.

- **Market Capitalization (Market Cap):** It is the amount of money required to buy out an entire company at its current market price. It is computed as the market price per share of the company multiplied by the total number of outstanding shares.

- **Enterprise Value:** Enterprise Value (EV) refers to the overall value of the business. Since the business is funded by various sources of capital, it is computed as the sum of the value of total capital employed in the business.

EV = Value of common equity + value of non-controlling interest + Value of preferred capital + Debt – cash, cash equivalents and financial investments

- **Earnings - Historical, Trailing, and Forward:** Earnings are profits in a business. Earnings can be defined at various levels. For example, net profits are the profits available to the equity owners. Earnings before Interest and Taxes (EBIT) are available to serve both equity and debt holders. Earnings before Interest Tax Depreciation and Amortization (EBITDA) are the earnings available to a business to replace its assets over some time and to serve both equity and debt holders. Earnings of previous years are called historical earnings. Trailing, earnings refer to the earnings of the latest four quarters, calculated on a rolling basis. Earnings computed based on future projections are called forward earnings.

- **Earnings Per Share (EPS):** Net profits of the company belong to the shareholders. Earnings per share is the net profit divided by the number of shares. It indicates the amount of profit that the company has earned, for every share it has issued.

- **Dividend Per Share (DPS):** A dividend is generally declared as a percentage of the face value of the shares.

- **Price to Earnings Ratio (PE Ratio):** Price to Earnings Ratio or the PE Ratio measures the price that the market is willing to pay for the earnings of a company.

Formula: $\dfrac{\text{Market Price of a share}}{\text{Earning Per share}}$

PE is referred to as a multiple of per rupee of earnings. When one refers to a stock trading at a PE multiple of 12x, it means the stock is trading at twelve times its earnings.

- **Price-to-Sales Ratio (P/S):** Price to Sales ratio is a valuation ratio that measures the price investors are willing to pay for each rupee of sales.

$$\textbf{Formula:} \quad \frac{\text{Market Price of a share}}{\text{Annual Net Sales Per share}}$$

A company with a lower P/S ratio relative to its peers indicates that the stock is relatively undervalued.

- **Price-to-Book Value Ratio (P/BV):** Price to price-to-book value Ratio is one of the most widely used ratios to find price relative to the value. The P/BV measures a company's current market price (CMP) vis a vis its book value.

$$\textbf{Formula:} \quad \frac{\text{Market Price of a share}}{\text{Book Value}}$$

$$\text{where Book Value is;} \quad \frac{\text{Net Worth}}{\text{Number of Shares}}$$

$$\text{Networth} = \text{Capital plus reserves}$$

- **Differential Voting Rights (DVR):** A DVR is just like a normal share of a company, except that it carries less than 1 voting right per share, unlike a common share. Such an instrument is useful for issuers who wish to raise capital without diluting voting rights. Investors who wish to invest only for dividends and capital appreciation and are not bothered about voting rights find these shares attractive.

Terminology in Debt Market

A debt security denotes a contract between the issuer (company) and the lender (investor) which allows the issuer to borrow a sum of money at pre-determined terms. These terms are referred to as the features of a debt security and include the principal, coupon, the maturity of the security, and the security, if any, provided for the lending.

- **Face Value:** This is the nominal or par value of the debt paper and interest, throughout the term of the paper, is paid as a percentage of this amount.
- **Coupon Rate:** Interest paid on the bond/debt security is known as the Coupon rate, expressed as a percentage of its face value.
- **Maturity:** Every loan will have a tenure. This is known as 'tenor' or 'maturity' or 'term to maturity' in bond markets.
- **Principal:** This is the amount of borrowing of the issuer represented by the security. This is the initial investment that an investor makes when the bond is issued and is represented by face value.
- **Redemption of a Bond:** When a bond matures, the investor 'redeems' the bond, which essentially means that the contract between the issuer and the investor is over. The issuer of the bond repays the principal and also makes the final coupon payment and then the bond ceases to exist.
- **Holding Period Returns (HPR):** Holding Period Return (HPR) is the return earned on an investment during a specific period when it was bought and held by the investor.
- **Yield to Maturity (YTM):** It takes into consideration all future cash flows coming from the bond (coupons plus the principal repayment) and equates the present values of these cash flows to the prevailing market price of the bond. The rate that equates the present outflow (the price of the bond that the investor needs to pay to purchase the bond) with the present

value of future inflows (coupons plus principal) is known as YTM.

- **Duration:** Duration measures the sensitivity of the price of a bond to changes in interest rates. Bonds with high duration experience greater increases in value when interest rates decline and greater losses in value when rates increase, compared to bonds with lower duration.

Types of Bonds

Bonds are securities that represent a loan.

- **Zero Coupon Bonds:** Bonds that do not pay coupons in their entire term are known as Zero Coupon Bonds or simply 'Zeroes'. Such bonds are issued at a discount to their face values and are redeemed at par. Thus, the return on these bonds is not in the form of periodic payment of interest but in the form of the difference between the issue price and redemption value.

- **Floating Rate Bonds:** These are bonds whose coupon is not fixed, as in the case of vanilla bonds, but is reset periodically concerning a defined benchmark. Resetting the coupon periodically ensures that these bonds pay interest that reflects current market rates.

- **Convertible Bonds:** A convertible bond or debenture is generally issued as a debt instrument with the option to investors to convert the amount invested into equity of the issuer company later.

- **Principal Protected Note PPN:** is a relatively complex debt in such a way that it matures to the principal amount on the expiry of the term of the note. The remaining portion of the original investment is invested in equity, derivatives, commodities, and other products which have the potential to generate high returns.

- **Inflation Protected Securities:** These bonds have a fixed real coupon rate which is applied to the inflation-adjusted principal on each interest payment date. On maturity, the higher the face value or inflation-adjusted principal is paid out to the investors. Thus, the coupon income as well as the principal is adjusted for inflation.

- **Foreign Currency Bonds:** Foreign currency bonds are bonds issued by a company in a currency that is different from the currency of its home country. Companies in emerging markets may prefer to issue bonds in USD or currencies of other economically matured countries as they carry significantly lower interest rates.

- **External Bonds:** External bonds, also referred to as Euro bonds, are bonds issued in a currency that is different from the currency of the country in which it is issued. For example, if a company issues a US dollar-denominated bond in Kuwait, it would be referred to as a Euro bond as the currency of the bond (USD) is different from the currency of the country in which it is issued (Kuwaiti Dinar). External bonds denominated Indian rupees (INR) are referred to as Masala bonds. These bonds are issued outside of India but are denominated in

Indian Rupees.

- **Perpetual Bonds:** Perpetual bonds are bonds that do not have a stated maturity date. Thus, the issuer of perpetual bonds does not have any obligation to redeem it. The investors are entitled to periodic coupon.

CHAPTER 4
FUNDAMENTALS OF RESEARCH

Investment

Investing is the process of acquiring assets that increase in value over time and generates wealth.

Active Investing

It involves constant evaluation of every security in the investment portfolio so that investors can sell securities that are priced above their fair value. Similarly, while buying securities, investors look to identify securities that are priced below their fair value.

Passive Investing

Passive investing involves investing in a broad set of securities that fairly represent the asset class the investor needs to invest. A passive investor does not decide upon individual securities to buy or sell but rather their analysis is limited to the broader asset class.

Trading

Buying & Selling in securities for a shorter time duration, generally considered trading.

INVESTING VS. TRADING

BASIS	INVESTING	TRADING	
Duration	Long-term	Swing/Positional In	Intraday
Time	For more than 12 months	For more than a day but less than 12 months	Buying & Selling on the same day
Purpose	Generation of wealth	Regular income	Quick income
Approach	Fundamental approach	Fundamental and technical	Only technical approach
Analysis	Balance sheet, Financial Ratios etc.	Chart patterns and impact of news and events	Only chart patterns
Asset	Creation of asset is possible	No asset is created	No asset is created

The role of research in investment activity

The role of a fundamental research analyst comprises of two parts (i) Research and (ii) Analysis.

While analysis involves analyzing all the available information to conclude, research involves obtaining all the necessary information. For instance, a company's annual report may be a treasure trove of information about a company.

- **Insider information vs Mosaic analysis**

a. Insider information is material non-public information that when published would immediately affect an investor's decision to buy or sell the security. Whether information can be considered insider depends on the source of the information (how reliable it is), its impact, and its certainty.

b. Often analysts collate information from different sources, which individually may not be significant but when put together with other public or non-public information may provide critical insight to the information. These are called mosaic analysis. Such mosaic analysis is acceptable.

Technical Analysis

It is focused on forecasting the direction of prices through the study of patterns in historical market data through price and volume. There are three essential elements in understanding price behavior:

- The history of past prices provides indications of the underlying trend and its direction.
- The volume of trading that accompanies price movements provides important inputs on the underlying strength of the trend.
- The period over which price and volume are observed factors in the impact of long-term factors that influence prices over a period of time.

Fundamental Analysis

Its premise is that since equity shares reflect part ownership of a company, in the long term, its value should be driven by the returns generated by a company on its share capital. Fundamental analysis involves comprehensive study on the company's business as well as its governance style to understand the expected returns and reward for the shareholder.

Quantitative Research

In the context of quantitative research, analysts look for financial and operational metrics of the company. Theoretically, some of these metrics either independently or together with other metrics may serve as a leading indicator for the company's performance. At the simplest level, time series analysis and regression of historical data can help extrapolate future earnings. Quantitative analysts may use more sophisticated econometric approaches to refine their output.

Behavioral Approach to Equity Investing

Very often the investment decisions are influenced by behavioural biases in the decision maker, which leads to less than optimal choices being made. Thinking behind proponents of this philosophy is that securities prices go away from their fair values either upside or downside because of the fear and greed of the market participants

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