WealthAlpha Equity Research Playbook

A Step-by-Step Guide for Beginners in Stock Market Investing

Prepared by Wealth Alpha —SEBI Registered Research Analyst

Part 1 — Identifying Undervalued Stocks

Why this matters: Many investors lose money because they chase “cheap” stocks that remain cheap or fall further. The right way is to identify quality businesses available at reasonable or undervalued prices. These businesses grow steadily and protect wealth even during difficult market periods.

Key Principles

1. Return on Capital Employed (ROCE): A strong company will consistently have ROCE above 15%. Example: Asian Paints has maintained ROCE above 20% for years.

2. Debt Management: Low debt means lower risk. A safe level is Debt-to-Equity ratio below 0.5. Example: Infosys has near-zero debt.

3. Cash Flow: A strong company should convert at least 80% of its profit after tax into cash flows.

4. Growth: Look for companies growing sales and profits by 10% or more annually for the last 3–5 years.

5. Valuation Pre-Screen: Compare P/E and EV/EBITDA ratios with sector averages.

6. Catalysts: Policy changes, capacity expansion, deleveraging, raw material softening, demand uptick.

Beginner’s Checklist

- ROCE ≥ 15%
- Debt-to-Equity ≤ 0.5
- Cash flow ≥ 80% of profit after tax
- Sales and Profit CAGR ≥ 10% over 3–5 years
- Valuation below or equal to peers
- Clear upcoming catalyst

Part 2 — Assessing Competitive Advantages (Moats)

Why this matters: A company may look good today, but without a durable advantage, competitors can easily copy its model. Competitive advantage, also called a “moat,” protects long-term profitability.

Types of Moats with Examples

1. Cost Advantage — Example: Maruti Suzuki produces cars at lower costs due to scale and vendor network.

2. Switching Costs — Example: TCS or Infosys software services are deeply embedded in client systems.

3. Network Effects — Example: Zomato grows stronger as more restaurants and customers join.

4. Brand and Intangibles — Example: HUL’s Surf Excel commands premium pricing.

5. Regulatory and Licensing Barriers — Example: Coal India benefits from government mining rights.

Beginner’s Checklist

- Moat type identified (Cost/Brand/Network/etc.)
- Evidence of moat in financials (ROCE, margins, market share)
- Sustainability of advantage ≥ 3–5 years
- Moat score ≥ 60/100

Part 3 — Dissecting Financial Statements

Why this matters: A company's story may sound good, but numbers tell the truth. By reading financial statements carefully, you can confirm if the company's profits are real and sustainable.

Income Statement Checks

• Revenue growth should come from volume, not just price hikes.

• Operating margins should be stable or improving.

• Remove one-off items like asset sales or extraordinary income.

Balance Sheet Checks

• Debt-to-Equity ≤ 0.5

• Interest coverage ratio ≥ 5×

• Receivables and inventory should not rise faster than sales.

• Promoter pledging should ideally be 0%.

Cash Flow Checks

• Cash from operations (CFO) ≥ 80% of profit after tax.

• Free cash flow should be positive except in expansion years.

• Capex should maintain or improve ROCE.

Beginner's Checklist

- CFO ≥ 80% of profit after tax
- Interest cover ≥ 5×
- Working capital days stable
- Free cash flow positive or justified capex
- No red flags (pledge, unusual liabilities)

Part 4 — Performing Company Valuations

Why this matters: Even the best company can be a poor investment if bought at too high a price. Valuation connects quality and price.

Valuation Methods

1. Price-to-Earnings (P/E) Band — Compare the current P/E with the last 5 years.

2. EV/EBITDA — Compare with peers; useful for capital-intensive sectors like cement.

3. Discounted Cash Flow (DCF) — Estimate future cash flows and apply a 25–30% margin of safety.

4. Reverse DCF — Calculate implied growth in the current price and check if it is realistic.

Beginner’s Checklist

- Current P/E compared with 5-year band
- EV/EBITDA compared with peers
- DCF value calculated with margin of safety
- Reverse DCF growth assumption realistic
- Upside potential ≥ 20–25% before entry

Final Step — Putting It All Together

Quality Score (QS) and Value Score (VS) allow structured decisions.

Quality Score Components

• Moat strength, governance, financial quality, stability, disclosure.

Value Score Components

• Valuation vs peers, growth vs price, cash yield, downside protection.

Decision Matrix

Quality Score	Value Score	Action
<55	Any	Avoid
55–64	60+	Starter (1–2% allocation)
≥65	60+	Core allocation (3–5%)
≥75	70+	High conviction (5–8%)

Example Case Study

BankCo Ltd (Illustrative):
• ROE = 16%, GNPA = 2%, CASA = 45%
• P/B = 2.2× vs peer 2.8×
• CFO stable and strong

Scores:
• Quality = 72/100
• Value = 66/100

Decision: Core allocation of 4–6% of portfolio, buy in 2 tranches, exit if ROE <13% or NPAs >4%.