Investment writing:
Clarity is the key

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Business Line

Investment writing

- Impress clients with your arguments, not with your Shakespearean language.
- Don’t dwell on methodology. Dwell on the conclusions instead.
- Tread lightly on the adjectives. Let numbers do the talking.
- Don’t make assertions without facts. The aim of research is to persuade the reader to act, not to offer gratuitous gyan.
- Know your arguments before you begin to write

Language: Learn to go short

Rule # 1: Cut out superfluous words. Keep it crisp.

MACRO RESEARCH

What they wrote

The strengthening case of US QE tapering and narrowing global excess liquidity, thanks to the decline in ECB's base money and decrease in US money multiplier, continues to support our thesis of the tapering global liquidity cycle. The centrality of US monetary policy actions will increasingly determine actions of global central banks, including advanced and emerging economies. The explicit ramification reflects in the sharp INR depreciation and aggressive tightening by the RBI.

What it means

Global liquidity may tighten on US QE tapering. US monetary policy will now decide what other central banks do. This is what shows up in the sharp rupee depreciation and RBI's tight money policy.

Language: Learn to go short

Rule # 2 Never use a long word where a short one will do.

MACRO RESEARCH

What they wrote

EMs flows vulnerable to tapering and "reverse decoupling":

Historically, portfolio flows into emerging and developing markets are inversely correlated with change in US rate cycle. In our view, Fed's tapering plan is a significant risk for EMs given:

a) reverse de-coupling, i.e., deceleration in EMs' GDP and earnings growth vs. strengthening growth outlook for the US, a converse scenario to 2007-08 consensus view and

b) disproportionately large portfolio flows into emerging Asia & Lat Am markets during the 2009-13 mega boom.

What it means

Historically, portfolio flows into emerging markets have fallen when US rates rose. Fed's tapering plan is a big risk to EMs because:

a) There is now a trend of slowing earnings and GDP growth in the EMs compared to improving growth outlook for the US. This is a contrast to 2007-08.

b) 2009-13 saw disproportionately large flows into emerging Asia and LatAm countries

Don’t use jargon when plain English will do

Superfluous words: Vulnerable to tapering, reverse decoupling, deceleration, converse to consensus, mega boom

Why say vulnerable to tapering when you can say risk of outflows

Why say reverse decoupling when you can say divergence

Why say consensus scenario when you can say market view

Why say mega boom when you can say bull market or rally

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Why say visibility when you mean certainty about growth

Why say deceleration when you mean slowdown

Why say de-growth when you mean decline

Why say granularity or color when you mean details

Keep the conclusions long, methodology short

STRATEGY RESEARCH

Introduction: Whilst the current scenario makes us wonder whether we are fast approaching a financial market apocalypse as massive capitulation has led to the cratering of stock prices. The current NPA crisis, slowing infrastructure investment, policy paralysis (and the list goes on) being some of the key contributing factor which has led to flight of capital besides current account stress is reflecting on currency devaluation. Whilst we crystal gaze and try to build the bear case scenario into our coverage universe we pick one of our favorite tools from our analytic ammo to predict Sensex levels over the 3M, 6M and 12M time frame. In the following text we build our analysis around market returns and the yield gap to predict the 'Bear Case' levels in Sensex using what we call our 'Yield Predictability' model and cross check it with 'Sensex Dividend Discount Model'.

Six pages later……Yawnnn…..

Conclusion : In our bear case we get a Sensex range of 18,002 – 22,883. In our base case we get Sensex range of 18,392 - 22,883. At current Sensex level of 18,246 we may be closer to the lower end of the Sensex range indicating a possibility of Sensex taking a 'U-Turn'

Isn't that what we all wanted to know?

Lighten up on adjectives, let numbers do the talking

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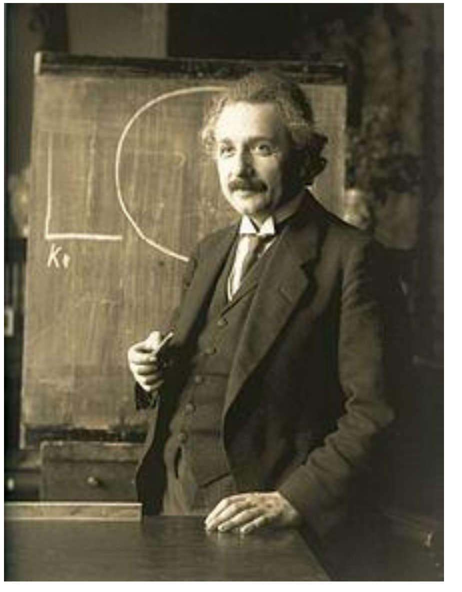
Can't we just say….

Stock prices have declined 12 per cent in the last six months with rising NPAs, slowing investments, and the risk of capital flight. We try to see how low the Sensex can go over the next 3, 6 and 12 months using the gap between 10 year bond yields and earnings yields. We also cross check the results using the Dividend Discount Model.

Einstein said

"If you can't explain it to a six-year old,
you don't understand it yourself"



Don’t make assertions. Offer arguments based on facts.

Assertion: We believe market valuations are cheap.

Argument: At a price earnings multiple of 14 times estimated FY14 earnings, Sensex valuations are at the lower end of their historical band of 12-20 times in the last five years.

Assertion: Record low levels of INR against the dollar imply sustained upward risks to inflation. Notwithstanding the weak pricing power, both WPI inflation (4.9% in Jun’13) and CPI (9.6% in Jul’13) have reversed the declining trend seen in the earlier months. High CPI inflation, sustenance of high food inflation, along with prospects of continued cost pressures (oil, coal and power), keep inflationary pressures intact.

Argument: Commodities with a 28 % weight in WPI and 15% weight in CPI are pegged to import prices. With food prices also picking up and the cost of fuel rising by 11 per cent year on year, inflation is likely to remain high.

Assertion: Recent measures to control gold imports will not cool the CAD.

Argument: Gold is 10 per cent of the import bill, while energy accounts for 30 per cent. The 50 % forecast decline in gold imports can only reduce CAD to the extent of 0.5% of GDP.

Know your arguments before you write

Know what you want to say before you begin to type.
Plan out your report in advance.

What are the four reasons why I am recommending a buy on ITC:

- * Recent 15 % decline has made valuations (18 X FY15) attractive. Valuations at discount to Dabur, HUL.
- * Volume growth in cigarette defies FMCG slowdown. 6-7 % volume growth Vs 3-4 % for FMCGs
- * Agri biz (13 % of revenues) to benefit from strong monsoon, strong global prices, weak rupee
- * Hotels, paper turning around

Know your arguments before you write

SECTIONS

Investment recommendation- Whether it is a buy, sell or a hold

Valuation- Why do we recommend this

Industry overview- Where the industry stands, where this company figures in it

Business description- Core business captured in a few lines

Financial analysis- Trends in numbers

Investment risks- What could go wrong

Everything you say in the report must support your argument. Don't give out random, irrelevant facts.

The reader is interested in your conclusions, not in the number-crunching you did and the false starts you made.

Know your argument before you write

- For 1QFY2014 Britannia Industries (Britannia) posted a strong 98.8% yoy growth in bottom-line to Rs 86 cr, which is ahead of our estimate. The robust performance on the bottom-line front was led by a 300bp yoy expansion in OPM due to higher gross margin and reduction in other expenses. The company's 1QFY2014 OPM is the highest in the last 15 quarters.

- Topline was driven by superior product mix and higher price realizations. Volume growth is expected to be in low to mid single digits.

- The OPM rose by 299 bps to 8.3% Gross margin rose 234bp yoy aided by softening prices of inputs. However, advertising costs as a percentage of sales rose by 94 bps.

- Outlook and valuation: We expect Britannia to post a revenue and bottom-line CAGR of ~15.1% and 24.4% respectively over FY2013-15. This is higher than industry average.

At the current market price, the stock is trading at 25.1x FY2015E EPS; we have a Neutral rating on the stock.

Huh? Why, isn't everything great? Top-line, profits, growth!

Investment writing

Most important,

Clear thinking leads to clear writing.

Your report reflects your conviction in your recommendation.

"There's a clarity that comes with great ideas: You can explain why something's a great business, how and why it's cheap, why it's cheap for temporary reasons and how, on a normal basis, it should be trading at a much higher level. You're never sitting there on the 40th page of your spreadsheet, as Buffett would say, agonizing over whether you should buy or not." - Joel Greenblatt

Seven habits of highly annoying research reports

- Starting every para with ‘we believe’, ‘we think’, ‘we crystal-gaze’.

We know you believe in your report. Just state the facts.

- Taking sides with the company: ‘Our’ profits have slipped because of foreign currency pressures

Whom do you work for?

- Talking down to your client/reader.

“Pessimism is at its worst, investors are in sell mode and there is blood on the street. We think it is a good time to buy. ”

We know all about the blood on the street. We saw it. Just get to the ‘why’ part.

- Showing off how much effort went into the report

“We ran a screener on 5000 BSE listed companies and put them through tests on debt service coverage, Z score, blah blah. We met managements of 60 pharma companies in and around AP. ”

Okay, but isn’t that your job?

Seven habits of highly annoying research reports

- Peppering it with proverbs and cliches- "When the going gets tough, the tough get going'.

This is a report, not a three-act play. Just get to the point.

- Being smug. "We predicted in 2008 that Educomp's fair value was at Rs 20. This has come true last week."

If you must refer to a previous recommendation, do it in the footnotes or in the margin. And do remember that everyone in this business does go wrong.

- Risk factors that invalidate the entire argument.

"We believe JSW Steel is a high conviction bet. But downside risks to the Rupee, continuation of the mining ban, and environmental issues could pose a risk to our earnings estimates and TP. "

!!!! Can you tell me why it is rated a Buy, once again?

Thank You