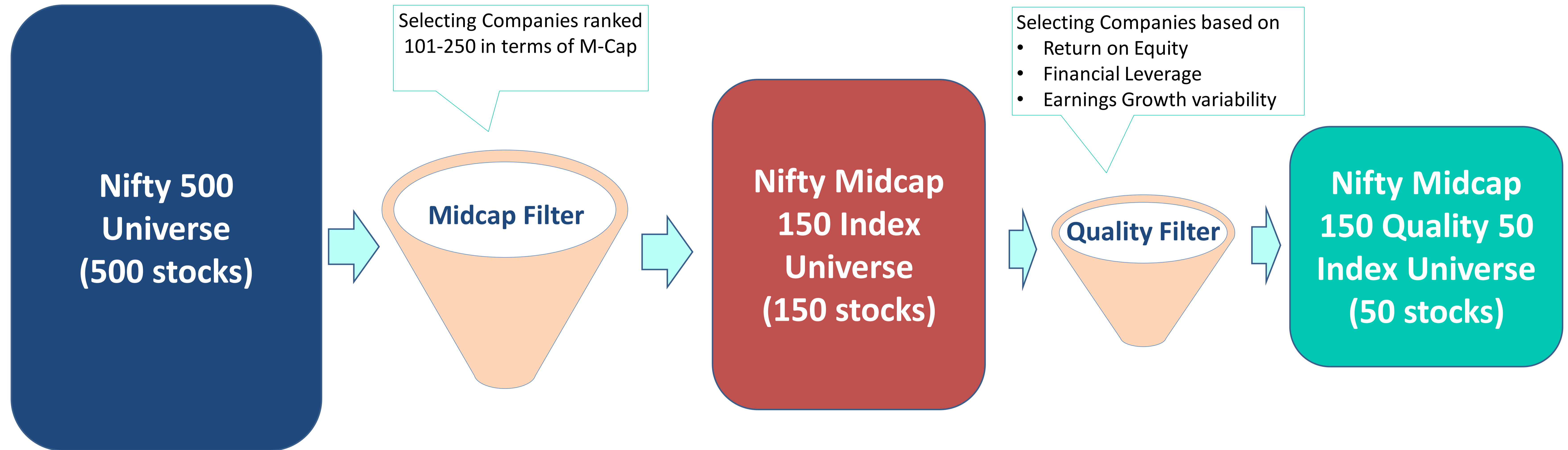


GETTING SMARTER SERIES

Understanding Nifty Midcap 150 Quality 50 Index

DSP

Nifty Midcap 150 Quality 50 Index - Derivation



What are the 'Quality' filters?

Return on Equity

Measures a company's **financial performance**

Indicates how **effectively a company is utilizing its capital**

Rising ROE indicates a company is able to generate higher profit without needing as much capital

Debt to Equity

Indicator of **Financial leverage**

High leverage could mean **higher fixed costs & greater susceptibility to bankruptcy**

Not considered for financial services companies

EPS Growth Variability

Reflects **Earnings Quality** of a company

Consistent EPS growth reflects healthy earnings quality and vice versa

Stocks with **negative EPS in any of the previous 6 fiscal years** are not considered for selection

Balance sheet + P&L

Balance sheet

Profit & Loss

Comprehensive assessment of financial statements

How are companies selected using the 'Quality' filter?

Z Score is calculated for each of the Quality parameter of every stock

Z score of each parameter for each security is calculated as per the following formula

$$(x - \mu) / \sigma$$

Where;
x is parameter value of the stock
 μ is mean value of the parameter
 σ is std. deviation of parameter.



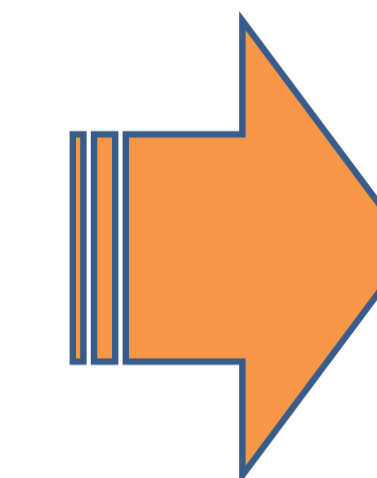
Weighted Average Z-score is calculated for each stock

For Non-Financial Service sector company:

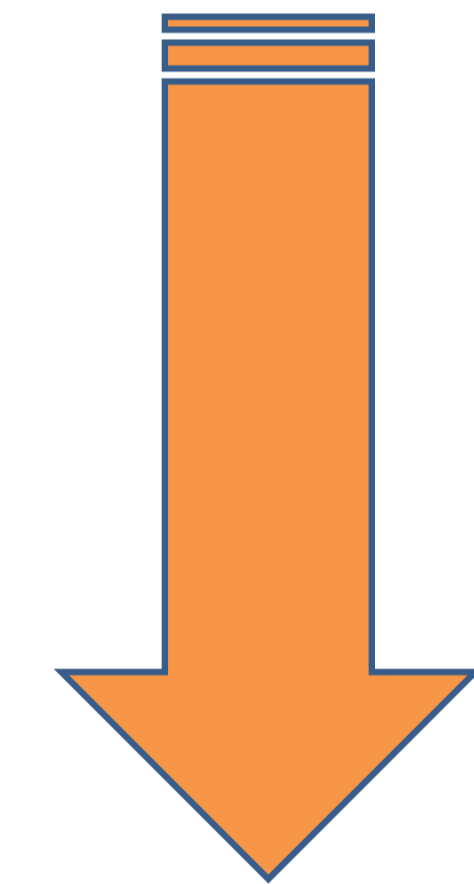
Weighted Z score = $0.33 * \text{Z score of ROE} + 0.33 * - (\text{Z score of D/E}) + 0.33 * - (\text{Z score of EPS growth variability})$

For Financial Service sector company:

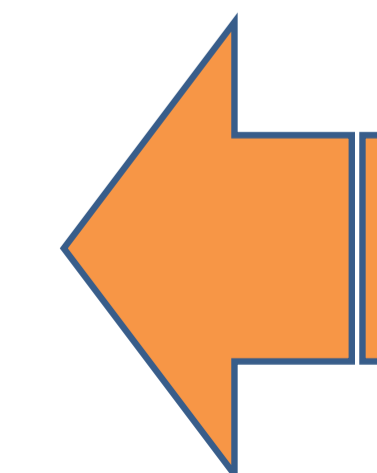
Weighted Z score = $0.5 * \text{Z score of ROE} + 0.5 * - (\text{Z score of EPS growth variability})$



Quality score is calculated for all eligible securities from the weighted average Z score



Top 50 stocks based on Quality score are selected



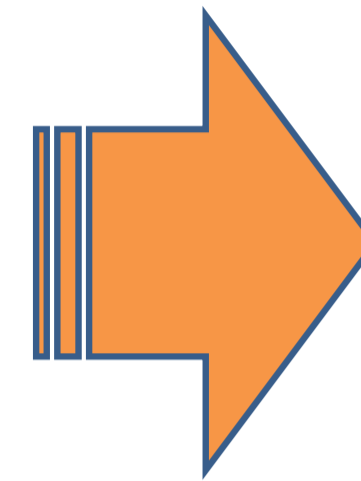
Quality Score = $(1 + \text{Average Z score})$ if Avg. Z score > 0

Quality Score = $(1 - \text{Average Z score})^{-1}$ if Avg. Z score < 0

How are stock weightages determined?

Weight of stock =

$$\text{Z score} * \sqrt{\text{Free-float M-Cap}}$$



Stock Weights are capped at lower of :

- 5% or
- 5 times the weight of the stock in Nifty Midcap 150 Index



Higher Z Score

Better Quality Parameters

Higher Weightage

Higher Free float M-cap

Less promoter holding

Higher Weightage

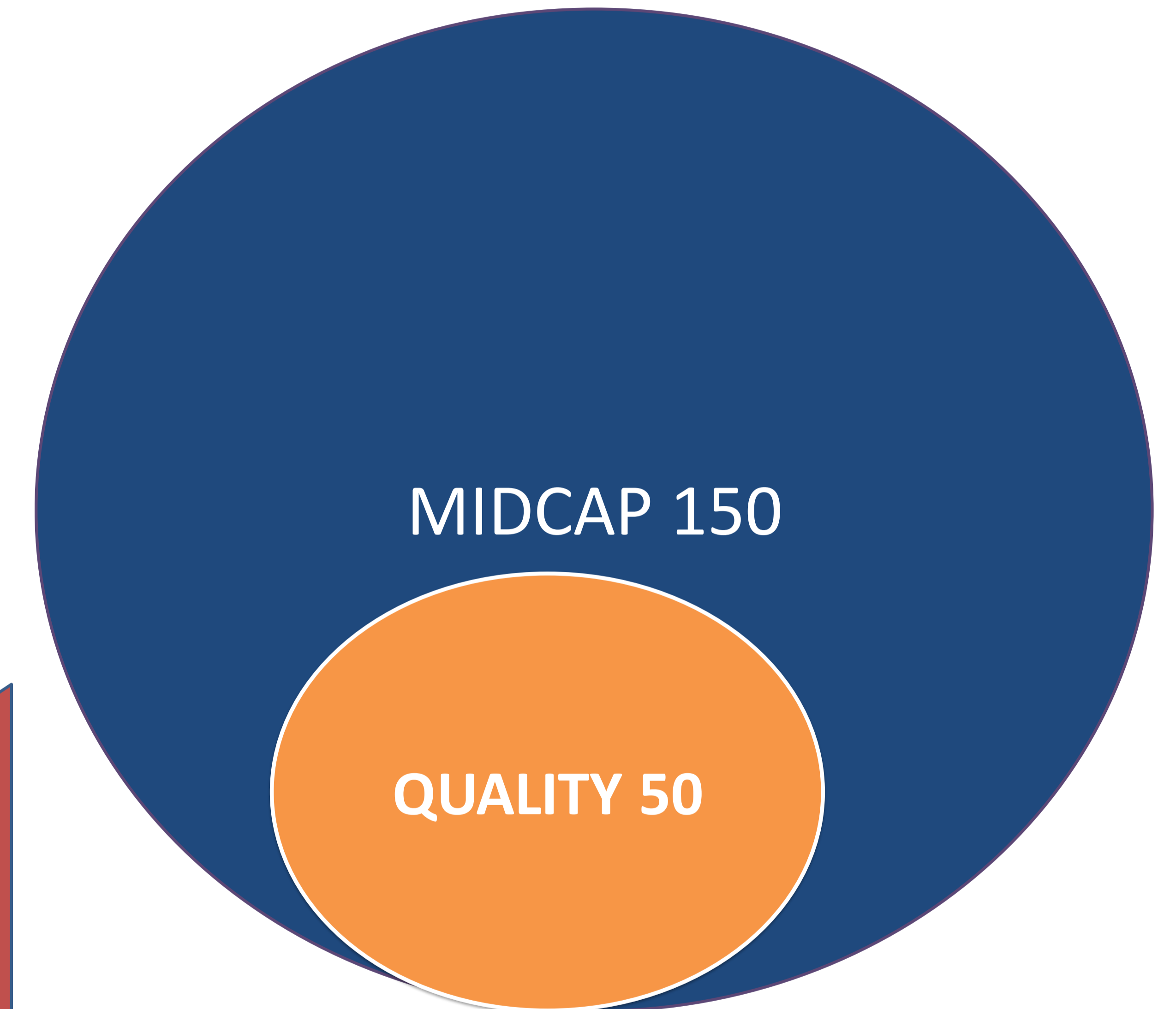
Illustration

PARAMETER	CALCULATION	INTERPRETATION	Example	
			Stock A	Stock B
Return on Equity (ROE)	$\frac{\text{Net Income}}{\text{Shareholder's Equity}}$	Higher ROE , better prospect of selection	9%	12%
Debt to Equity ratio	$\frac{\text{Total Debt}}{\text{Shareholder's equity}}$	Lower D/E , better prospect of selection	2.5	0.9
EPS Growth Variability	$\frac{\text{Total earning}}{\text{Outstanding shares}}$	Lower earning variability, better prospect of selection	1.5	2.2

Quality score of Stock B will be higher than that of Stock A. Thus, Stock B will have higher chance of being selected in Nifty Midcap 150 Quality 50 Index and will also have a higher weight compared to Stock A

Other Features

- **Constituents should have a minimum listing history of 1 year**
- **Companies ranked based on quality score that are**
 - **Top 25 – compulsorily included**
 - **Beyond 75 – compulsorily excluded**
- **Reconstitution and re-capping of weights in June and December**
- **EPS growth variability is not calculated for stocks with negative EPS in any of the previous 6 fiscal years. Such stocks are not considered for selection**



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