

# The Cash Flow Compounder

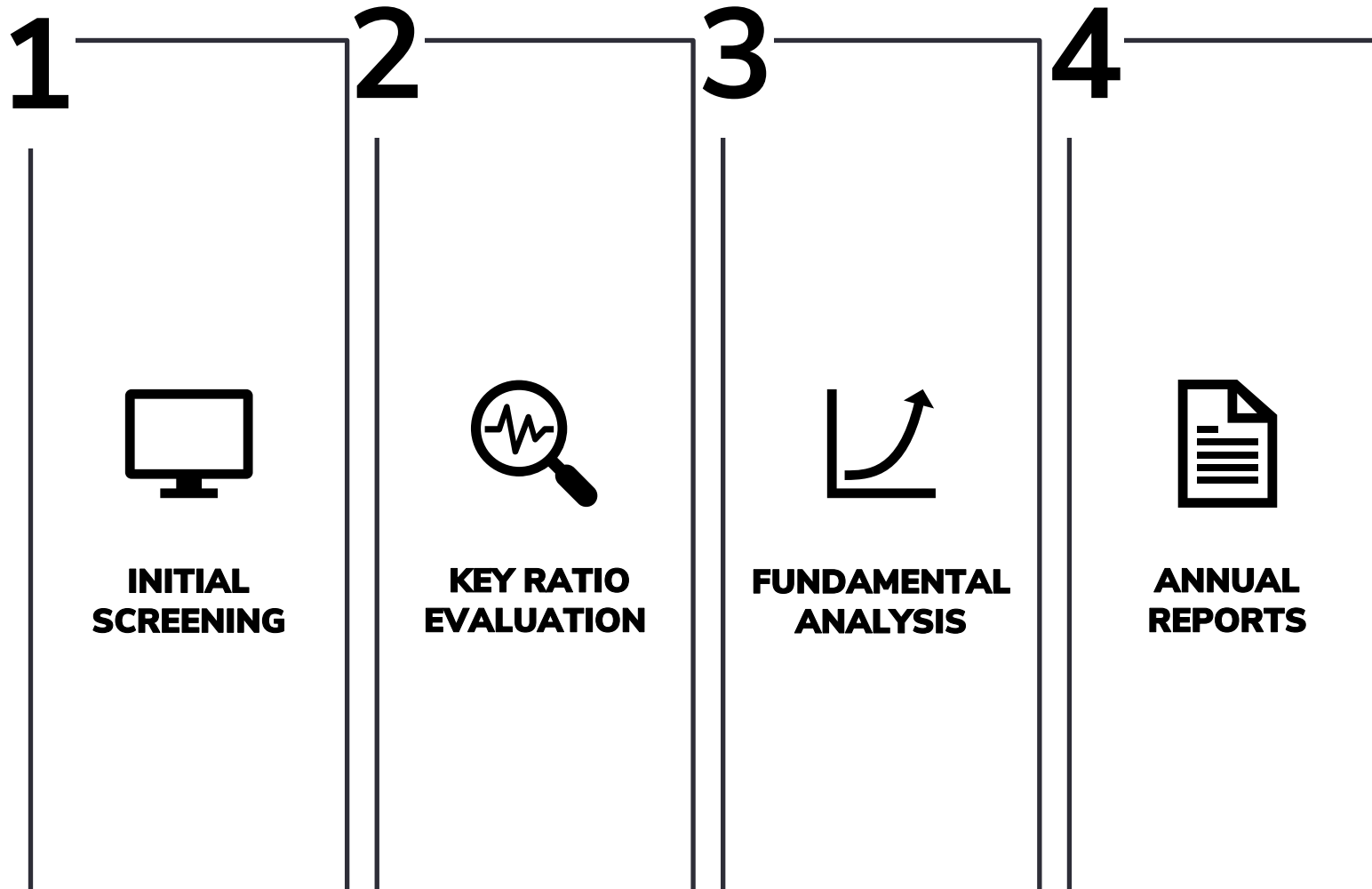
Investing Guidebook

Prepared for



# The stock research process typically involves screening stocks, evaluating their key ratios and their fundamentals, and analyzing their annual reports

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- 1** Generate a stock list based on criteria like margins, earnings growth, or leverage
- 2** Understand a company's attractiveness through ratios like ROCE, interest coverage, cash conversion and others
- 3** Deep dive into a company's historic growth, cash flow consistency, and existing moat
- 4** Examine the detailed financial performance, operations and potential risks



# Step 1 consists of screening stocks based on different parameters to obtain a more manageable number of stocks to further analyze



## Stock Screening

- The NASDAQ and the NYSE have approximately **3,600** and **2,400** listed **stocks**, respectively
- Screening is used as an initial filter to analyze a **more manageable** number of stocks
- We exclude companies from the **Real Estate, Utilities, and Financial** sectors because their metrics have distinct importance and attractive thresholds.

FINVIZ Stock Screener

No.	Ticker	Market Cap	ROI	Curr R	Profit M	Price	Change
1	MSFT	2967.49B	26.01%	1.24	36.43%	399.37	-0.72%
2	NVDA	2204.39B	56.62%	4.17	48.85%	881.76	0.48%
3	INTU	178.21B	11.87%	1.17	18.35%	636.51	-0.29%
4	ANET	83.17B	28.74%	4.39	35.62%	265.19	0.58%
5	SNPS	82.24B	19.41%	1.29	22.92%	539.15	-1.03%
6	WDAY	65.21B	12.23%	1.92	19.18%	246.99	-0.72%
7	SMCI	52.72B	23.06%	2.43	7.92%	900.50	1.14%
8	GRMN	27.96B	18.10%	3.39	24.67%	145.59	0.28%
9	FSLR	19.15B	11.53%	3.55	25.03%	178.93	-1.05%
10	MANH	12.80B	65.74%	1.17	19.91%	207.94	-0.90%
11	PCTY	8.79B	16.14%	1.09	12.96%	156.05	-1.05%
12	APPF	8.41B	20.14%	5.47	11.38%	236.07	-0.83%
13	QLYS	6.14B	39.37%	1.53	27.49%	166.29	-1.18%
14	BMI	5.52B	18.98%	3.46	13.81%	187.79	1.09%
15	EXLS	4.89B	17.04%	2.07	11.32%	29.47	-0.03%
16	DLO	4.21B	32.20%	1.66	24.07%	14.23	-2.20%
17	ACLS	3.43B	26.36%	3.79	21.78%	105.21	0.35%
18	AGYS	2.29B	34.19%	2.01	37.54%	83.82	0.97%
19	ODD	1.86B	19.89%	2.05	11.60%	32.73	0.55%
20	PAYO	1.86B	13.32%	1.09	11.23%	4.99	0.30%

Seeking Alpha Stock Screener

Summary							Trading	Dividends	Earnings	Valuation	Growth	Performance
Rank	Symbol	Company Name	Quant Ratings	SA Analyst Ratings	Wall Street Ratings	Market Cap						
1	CRM	Salesforce, Inc.	4.94	3.72	4.25	194.65B						
2	FSLR	First Solar, Inc.	4.94	3.85	3.92	22.22B						
3	BRK.B	Berkshire Hat...	4.94	4.00	3.75	707.84B						
4	ANET	Arista Networ...	4.93	3.66	4.11	50.13B						
5	COTY	Coty Inc.	4.93	4.50	3.86	10.45B						
6	VLO	Valero Energy...	4.91	3.61	4.23	48.50B						
7	DECK	Deckers Outd...	4.90	3.86	4.50	12.31B						
8	VICI	VICI Propertie...	4.90	4.00	4.71	32.49B						
9	BKNG	Booking Holdi...	4.88	3.75	4.00	99.76B						



## Relevant Filter Criteria



Return on Investment



Insider Ownership



Debt to Equity



Current Ratio



Earnings & FCF Growth



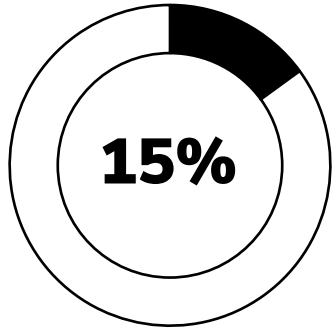
Profitability Margins

➤ By tweaking parameters, investors can widen or narrow the scope to more or fewer stocks



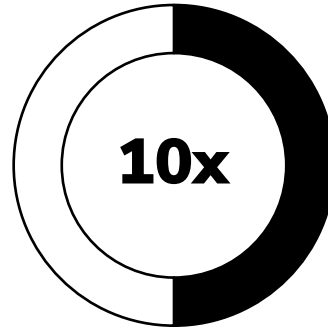
Step 2 consists of ensuring that the companies are above the set thresholds set for these ratios, with ROCE and the interest coverage ratio being the most important

Key Ratio Evaluation -



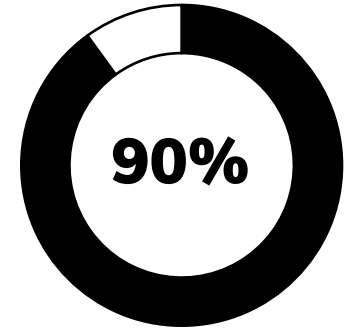
### ROCE<sup>1</sup>

- Measures a company's efficiency in generating profits from investments
- Higher ROCE may indicate better utilization of capital and higher profitability



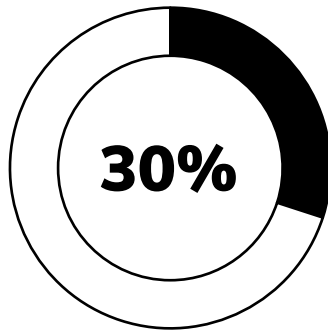
### Interest Coverage Ratio

- Measures a company's ability to cover its interest expenses with its operating income
- A ratio of above 10x suggests a more controlled financial position



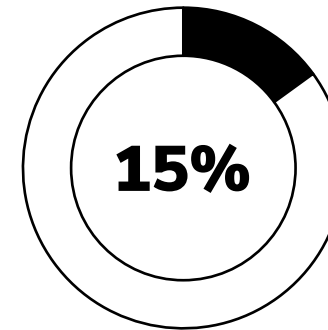
### Cash Conversion Ratio

- Measures how efficiently a company is converting its income into free cash flow
- A higher FCF can cause for dividend increases, or share buyback programs



### Gross Margin

- Portion of revenue that exceeds COGS<sup>2</sup>
- A higher margin may indicate a stronger competitive position



### Net Margin

- Portion of revenue that exceeds all expenses
- A higher net margin suggests a greater ability of generating net income

1. ROCE stands for Return on Capital Employed  
2. COGS stands for Cost Of Goods Sold



# Step 3 consists of deep diving into the fundamentals of the company to guarantee that it will be able to compound its earnings into the long term

Fundamental Analysis -



## Key Stock Fundamentals To Look For



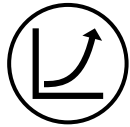
### Clear Competitive Advantage / Wide Moat

- It should be hard to compete against this company (for example some pharmaceutical companies may have patents which will expire in 20+ years, creating a wide moat)



### Pricing Power

- The company is able to raise prices above inflation without losing customers to competition (For example Netflix has been rising prices while also attracting more clients in the past)



### Highly Scalable

- The company possesses the capacity to increase its sales with minimal incremental cost (for example, each customer that Visa adds to their network does not increase costs proportionally)



### High Operating Predictability

- The future of the company should be somewhat clear (for example VICI Properties has extremely predictable revenues since its clients must pay rent to operate and earn income)



### Highly Focused on Cash Flow Generation

- This company should have the objective of maximizing cash flow generation (for example Microsoft is managing to earn more while reducing expenses, increasing its cash flows)



### Mainly Driven by Organic Growth

- Solely relying on M&A for growth can lead to value destruction (for example although IKEA has conducted some acquisitions, its main growth source has been its core operations)



### Low Need of Reinvestment, R&D, and CAPEX

- Increases available cash for companies to spend on dividends, share buybacks, or debt repayments (for example GOOG can aggressively buyback shares and even introduce a dividend)



### Clear Growth Strategy

- The management should have a clear growth strategy with prioritized cash allocations (for example Crocs clearly outlines their growth strategy and their priority of repaying their debt)





# Step 4 consists of analyzing the company's annual report and earnings presentation to gain deeper insights of the company's operations, risks, and financial position

Annual Report - 

1

2

3

4

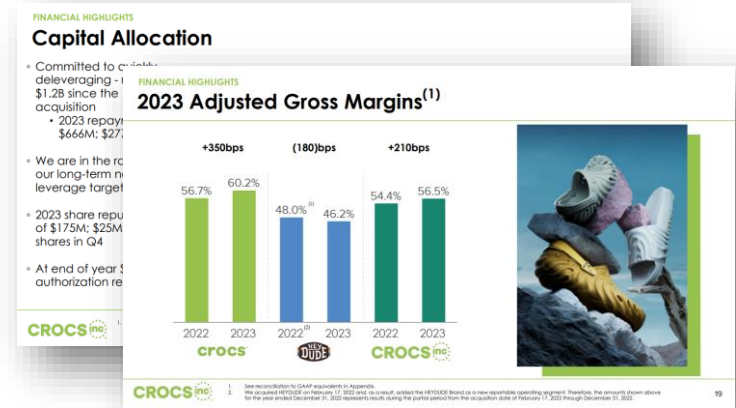
Financial Statements

## Business Operations

- Gain insights into the company's core activities, products, and services
- Understand the industry dynamics and competitive landscape
- Learn about strategic initiatives, expansion plans, and growth opportunities



## \$CROX Earnings Presentation



## Risk Factors

- Identify potential risks that could affect the company's performance
- Assess factors such as regulatory changes, or technological disruptions
- Understand the different mitigation plans put in place by the company's management



## \$PERI Stock Risk Factors

D. RISK FACTORS
We are subject to various risks and uncertainties relating to or arising out of the nature of our business and general business, economic, financial, legal and other factors or conditions that may affect us. We believe that the occurrence of any one or some combination of the following factors could have a material adverse effect on our business, financial condition, cash flows and results of operations.
Risks Related to our Search Business
Our search advertising solution depends heavily upon revenue generated from our agreement with Microsoft Bing, and any adverse change in that agreement could adversely affect our business, financial condition and results of operations.
We are highly dependent on our search services agreement with Microsoft Ireland Operations Limited, ("Microsoft"). We entered into our first agreement with Microsoft in 2010. In November 2020, we entered into a renewed agreement with Microsoft effective as of January 1, 2021 until December 31, 2024 (the "Microsoft Agreement"). In 2022, our search advertising business unit, CodeFuel, was named by Microsoft Advertising the "Global Supply Partner of the Year". The Microsoft Agreement accounted for 37% and 35% of our revenue, in 2021 and 2022, respectively.
If our Microsoft Agreement is terminated or substantially amended (on terms not favorable to us), we would experience a material decrease in our search advertising revenue or the profits it generates and would be forced to seek alternative search providers, at less competitive terms or accelerate the business we have with such search providers. There are few companies in the market that provide internet search and search advertising services similar to those provided by Microsoft such as Google and Yahoo. Such companies are substantially the only participants in western markets, and competitors do not offer as much coverage through sponsored links or searches. If we fail to quickly locate, negotiate and finalize alternative arrangements or otherwise expedite current operations we have with such alternative search providers, or if we do, but the alternatives do not provide for terms that are as favorable as those currently provided and utilized, we would experience a material reduction in our revenue and, in turn, our business, financial condition and results of operations would be adversely affected.

## Financial Statements

- The Income Statement to analyze the company's profitability evolution
- The Balance Sheet to analyze the company's cash position and financial position
- The Cash Flow Statements to analyze cash generation and its operational efficiency



## \$GOOG Financial Statements

Alphabet Inc.  
Consolidated Statements of Income

Alphabet Inc.  
Consolidated Balance Sheets

Alphabet Inc.  
Consolidated Statements of Cash Flows

	Year Ended December 31,		
	2021	2022	2023
Revenues			
Costs and expenses			
Operating income			
Other income			
Income before income taxes			
Provision for income taxes			
Net income			
Basic net income per share			
Diluted net income per share			
Assets			
Current assets			
Cash and cash equivalents			
Marketable securities			
Other current assets			
Total current assets			
Non-current assets			
Property and equipment, net			
Goodwill			
Other non-current assets			
Total non-current assets			
Total assets			
Liabilities and equity			
Accounts payable			
Accrued expenses and other liabilities			
Deferred revenue			
Other liabilities			
Total liabilities			
Equity			
Preferred stock			
Common stock			
Retained earnings			
Total equity			
Total liabilities and equity			



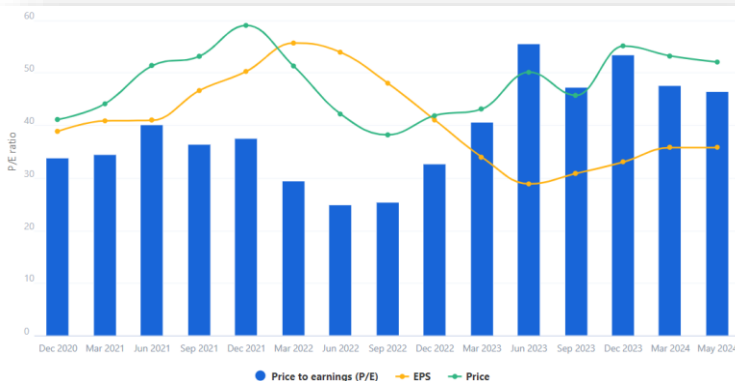
# Warren Buffett argues that “It's far better to buy a great company at a fair price than a fair company at a great price”, but here are 3 common steps to value companies

## Historic P/E Ratio

- Evaluates the company's current stock price relative to its historical earnings
- Helps assess whether the stock is overvalued or undervalued compared to its past performance
- Provides insight into market expectations regarding future growth



### \$SPGI Historical P/E Ratio

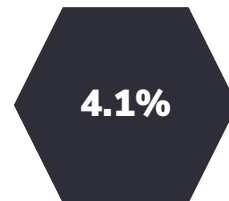


## Free Cash Flow Yield

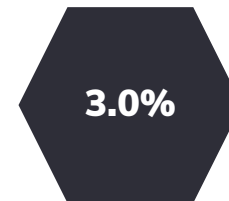
- Compares a company's yearly free cash flow generation to its market capitalization
- Terry Smith suggests that a company may be at an attractive valuation if:
  - ✓ The free cash flow yield exceeds the long-term inflation rate
  - ✓ The company is growing



### \$AAPL Free Cash Flow Yield



**FREE CASH  
FLOW YIELD**



**LONG-TERM  
INFLATION RATE**

## Discounted Cash Flow

- Estimates the intrinsic value of a company by discounting its projected future cash flows back to the present value
- Requires assumptions about growth rates and discount rates making it a more comprehensive valuation method



### \$LNTH DCF Calculation (Alpha Spread)

