# The Cash Flow Compounder
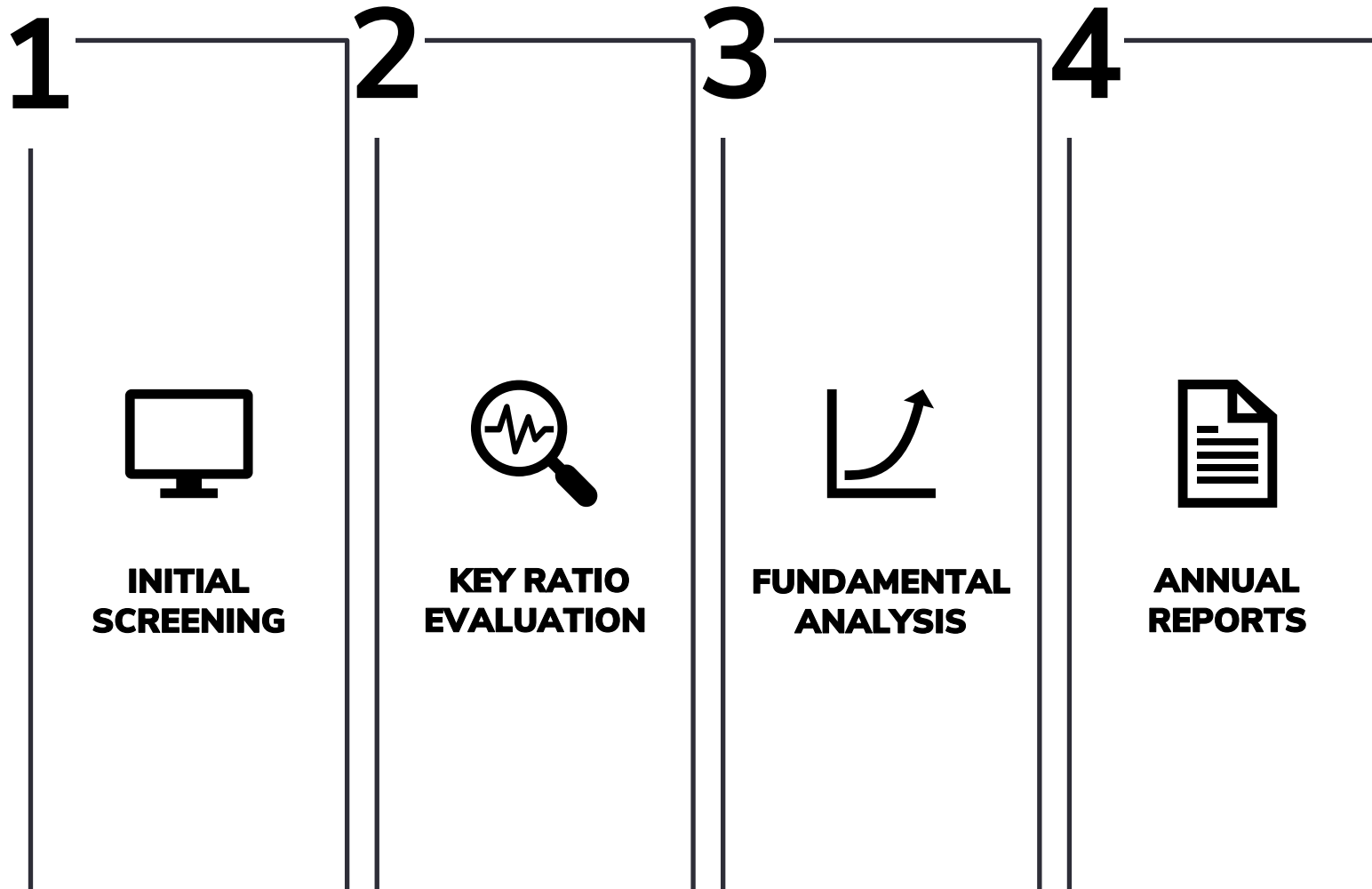
## Investing Guidebook

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

**1** **2** **3** **4**

**INITIAL SCREENING**

**KEY RATIO EVALUATION**

**FUNDAMENTAL ANALYSIS**

**ANNUAL REPORTS**

**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% | 3.48 | 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 | 3.73 | 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 | 3.66 | 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**

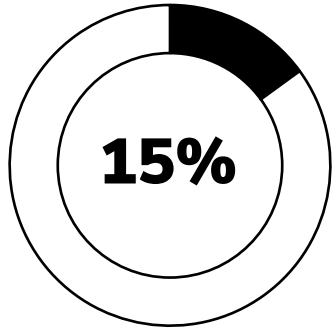**Current Ratio**

**Earnings & FCF Growth**

**Profitability Margins**

➢ **By tweaking parameters, investors can widen or narrow the scope to more or fewer stocks**
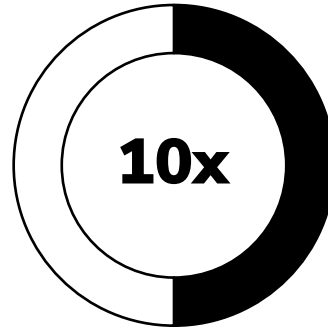
# Step 2 consists of ensuring that the companies are above the set thresholds set for these ratios, with ROCE and the interest coverage ratio being the most important
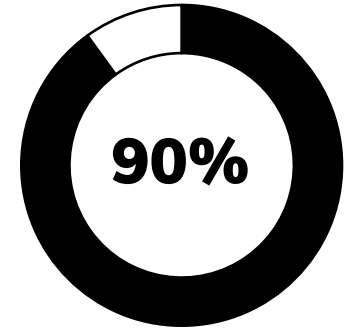
**15%**

## ROCE[1]

➢ **Measures a company's efficiency in generating profits from investments**

➢ **Higher ROCE may indicate better utilization of capital and higher profitability**
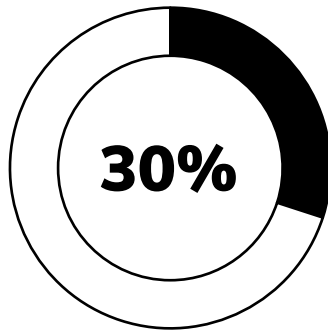
**30%**

## Gross Margin

➢ **Portion of revenue that exceeds COGS[2]**

➢ **A higher margin may indicate a stronger competitive position**

**10x**

## 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**

**15%**
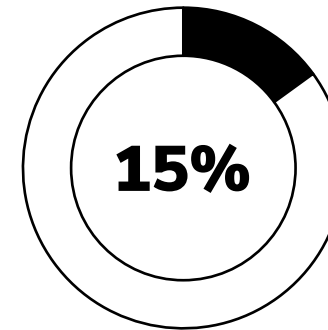
## Net Margin

➢ **Portion of revenue that exceeds all expenses**

➢ **A higher net margin suggests a greater ability of generating net income**

**90%**

## 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**

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

## 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)

### 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)

### 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)

### 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)

### 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)

### 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)

### 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)

### 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
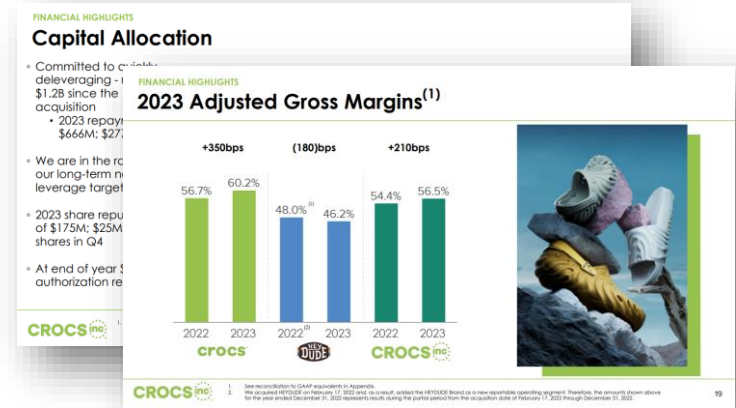
Annual Report -

## 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

## 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

# 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
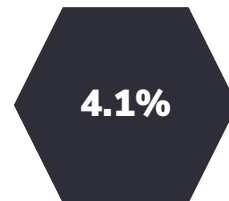
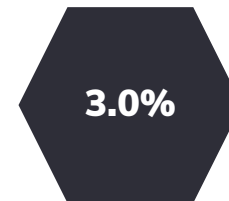### $SPGI Historical P/E Ratio
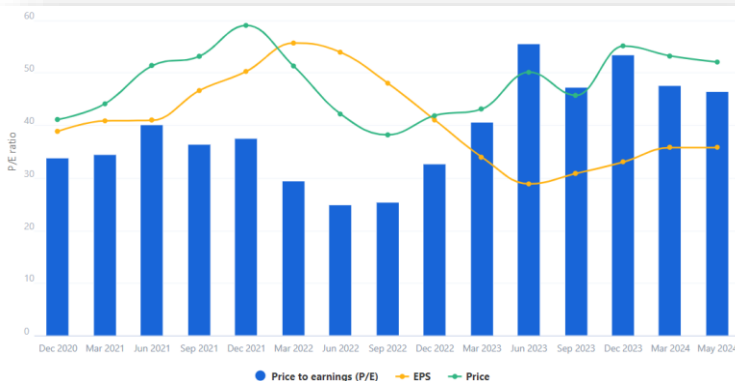


## Free Cash Flow Yield

➢ 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

**4.1%**

**FREE CASH FLOW YIELD**

**3.0%**

**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)

LNTH DCF Value
Base Case
**99.51** USD

UNDERVALUATION 32%

DCF Value

Price

Worst Case | Base Case | Best Case