

## **Process**

The following is a list of questions with the goal understanding a business and finding reasons to NOT invest in it. If such reasons cannot be found, then the investment passes the checklist.

### **First Filter**

1. Is the business within my circle of competence?
2. Is the business selling cheaply?

### **Business Understanding**

1. Do I understand the business?
  - a. Describe what the company does in 1 paragraph.
  - b. What problem does the company solve?
  - c. How does the company make money?
2. Do I understand the durability of the business?
  - a. Is the industry growing rapidly?
  - b. Is the business likely to change in the next 5 years?
  - c. Is the company's product likely to change in the next 5-10 years?
  - d. Am I confident that the business will be here in 10 years?
3. Does the business have a moat?
  - a. What is the company's marketshare?
  - b. Has marketshare changed significantly between competitors in the last 5 years?
  - c. How many competitors does the company have?
  - d. How could I hurt the company if you gave me \$10B?
  - e. If yes, what is it and why does it exist?
    - i. Lowest cost producer
    - ii. Distribution
    - iii. Patent
    - iv. Brand
    - v. Network Effect
    - vi. Economies of scale

## **Industry Understanding**

4. How old is the industry in which the company operates?
5. Is the industry growing rapidly?
6. Is the industry consolidated or fragmented?
7. Who are the biggest competitors in the industry?
8. What is the company's market share?
9. Has market share changed significantly between competitors in the last 5 years?
10. Does the industry have high barriers to entry?
11. Are there any trends that indicate that earnings will grow/decrease in the future?
12. What will the industry look like in 10 years? How sure am I of this?

## **Country Risk**

13. In what countries does the company operate?
14. Does current legislation present a risk to the company?
15. In what currencies does the company earn revenue?
16. Has the government implemented actions to limit or restrict the industry?

## **Profitability**

17. What is the company's gross margin?
18. Do gross margins fluctuate?
19. What is the company's operating margin?
20. What is the company's return on equity?
21. What is the company's return on net tangible assets?
22. Does growth add value?
  - a. Does the business earn a greater return than its cost of capital?
23. How does the company's profitability compare to competitors?
24. Does the company have untapped earnings power?
25. What factors affect the company's profitability?

## **Earnings Growth**

26. Am I 90% confident that owner earnings will grow in the next 5 years?
  - a. If yes, why?
27. Do tailwinds exist that will drive future growth?
  - a. GDP growth
  - b. Population growth
  - c. Technology

## **Downside**

- 28. Does the current price give you asset protection?
  - a. If yes, what?
  - b. What constitutes the book value of the business?
- 29. What is the worst-case scenario?
- 30. How have competitors in the same industry gone bankrupt?
  - a. Could this happen to the company?

## **Management**

- 31. Is management competent?
  - a. Track record
- 32. Is management someone I can trust?
- 33. Are management's incentives aligned with shareholders?
- 34. Has management been involved in fraud?

## **Credit Risk**

- 35. Does the business have more cash than total debt?
- 36. Can the company pay its obligations?
  - a. EBITDA / Interest Payments
- 37. Is the company in risk of going bankrupt
- 38. Is the business overly leveraged compared to competitors?
  - a. Total Debt / Total Assets
- 39. Is the company involved in a lawsuit that could significantly affect its operations and well being?
- 40. Is the company vulnerable to important lawsuits?

## **Capital Intensiveness**

- 41. Is the business capital intensive?
- 42. How does the company allocate capital?
- 43. Does the company generate free cashflow?

## **Other Investors**

- 44. Do super investors own shares in the company?

## **Labor**

- 45. How many employees does the company have?
- 46. Has the company significantly increased its work force recently?
- 47. What percentage of the company's work force is unionized?

48. If the company was liquidated, will its work force be a problem for shareholders?

### **Shareholders**

49. Is the company family owned?

50. What percentage of the company's shares are floated?

51. Does the company consistently pay out dividends?

52. Does the company repurchase its stock?

### **Valuation**

53. Is the company selling at an acceptable free cashflow multiple?

54. Does a margin of safety exist?

a. Is the company selling at a significant discount?

55. Describe why it makes sense to invest in the company in 1 paragraph. This should include the intrinsic value of the company and the reason it is worth that.