INVESTING CHEAT SHEET

Author Followed by among others Jeff Bezos, Lebron James and Bill Ackman

BY COMPOUNDING QUALITY

REASONS TO BUY A STOCK

1. THE STOCK IS UNDERVALUED

- The cheaper you can buy a stock, the higher your margin of safety
- Compare a company's FCF Yield with its average FCF Yield of the past 5 years to get a first indication about valuation

2. FUNDAMENTALS ARE IMPROVING

- Stock prices follow intrinsic value over time. When a company's profit margin doubles, its earnings also double
- Watch for: strengthening balance sheet, reduced capital intensity, improved capital allocation, enhanced profitability

3. MOAT IS STRENGTHENING

- Determining the existence and durability of a competitive advantage is key to make good investment decisions
- How to identify a moat?
  - High and consistent gross margin
  - High and consistent ROIC

4. THE FUTURE LOOKS BRIGHT

- In the long term, earnings growth is the main driver for stock prices
- The longer your companies can grow their earnings at attractive rates, the better

5. INSIDERS ARE HEAVILY BUYING

- There is only 1 possible reason why an insider buys his own stock: he thinks the stock is undervalued
  Companies in which insiders are heavily buying outperform with 3-6% per year on average

REASONS TO SELL A STOCK

01 You made a mistake

- If you bought a stock for a certain reason and after a while it turns out that you've made an error of judgement, you should consider selling the stock

02 You've found a better opportunity

- You should always own the best companies you possibly can which generate the most attractive risk-return characteristics for you as an investor

03 The company is losing its moat

- Successful companies must reinvent themselves all the time to keep their competitive advantage

04 The stock is overvalued

- This is by far the most dangerous reason to sell a stock. Why? Because great companies always tend to exceed expectations

05 Change in management

- When great managers start leaving the company, it might be a reason to sell the stock

06 Growth is slowing down

- To generate above-average returns as an investor, you should own companies which are able to grow their earnings at above-average rates

07 Need for cash

- If you need cash, it might make sense to sell the least attractive stock you own

TYPES OF INVESTORS

QUALITY INVESTOR
- Investing in the best companies in the world
- Most important metrics: the competitive advantage and ROIC

VALUE INVESTOR
- Investing in companies that are trading at low valuation levels
- Most important metrics: price-to-earnings ratio and free cash flow yield

GROWTH INVESTOR
- Investing in companies that should be able to grow at attractive rates
- Most important metrics: revenue growth and earnings per share growth

DIVIDEND INVESTOR
- Investing in companies that consistently pay out a dividend
- Most important metrics: dividend yield and dividend payout ratio

MOMENTUM INVESTOR
- Investing in companies that have the wind in the sails (the trend is your friend)
- Most important metrics: stock price appreciation over the past 6 and 12 months

MINIMUM VOLATILITY INVESTOR
- Investing in companies with very predictable cash flows (low beta)
- Most important metrics: beta and standard deviation

ANALYZE A STOCK IN 5 MINUTES

01 Look at the company profile
- Why: Only invest within your circle of competence
- How: Use websites like Yahoo Finance or Morningstar

02 Study the profitability
- Why: You want to invest in companies with high margins
- How: How? Gross Margin > 40% & Profit Margin > 10%

03 Look at capital allocation
- Why: Capital allocation is key for value creation in the long term
- How: ROIC > 15%

04 Search for winners
- Why: Losers tend to keep on losing. Winners tend to keep on winning
- How: Look for stocks that compounded with > 10% over the past decade

05 Analyze the growth
- Why: In the long term stocks tend to follow the evolution of the intrinsic value
- How: Revenue growth > 8% & Earnings growth > 10%

06 Don't overpay
- Why: You want to buy wonderful companies at a fair price
- How: Compare a company's current valuation with its 5-year average

EVERYTHING YOU NEED TO KNOW ABOUT MOATS

What is a moat?

- A moat or durable competitive advantage is a condition that puts a company in a superior business position
- This will allow the business to maintain and increase its profit margin and market share

How do you know a company has a moat?

- A moat is a structural business characteristic that allows a firm to generate excess economic returns for a long period of time
- There are two critical factors to determine whether a company has a moat:
  1. ROIC > WACC
  2. The ROIC has maintained high and constant for a long time

Different kind of moats

Switching costs
- The costs a consumer pays because of switching brands or products
- These costs can be monetary, but also psychological, effort-based, and time-based

Examples: salesforce, Apple

Intangible assets
- A moat based on intangible assets includes a competitive advantage because of the strong brand, patents, or regulatory licenses
- This may prevent competitors from duplicating products or allow a company to charge a premium price

Examples: Coca-Cola, See's Candies

Network effects
- A network effect exists when the value of a product or service grows as its user base expands
- Each additional customer increases the value of the product or service exponentially

Examples: amazon, Mastercard, Alphabet

Cost advantage
- Companies that are able to produce products or services at lower costs than its rivals benefit from cost advantages
- Firms with a structural cost advantage can either undercut competitors on price while earning similar margins, or can charge market-level prices while earning relatively high margins

Examples: IKEA, Walmart

Efficient scale
- In some markets, there is only room for a few players. These kinds of markets are called monopolistic (only 1 company) or oligopolistic (only a few companies) markets
- Scale economies are very important in business. It is the dynamic in which a market of limited size is effectively served by few companies

Examples: S&P Global, Union Pacific

STOCKS VS BONDS

In the investment world, there are 2 main asset classes: Stocks and Bonds

What do they have in common?

- When you invest, you try to let your money work for you
- Both stocks and bonds are typically bought and sold in financial markets
- They are both financial securities with respective risks and rewards

Stocks
- You are the owner of the companies you invest in
- You might receive dividends (not guarantueed)
- As company value increases, shareholders prosper

VS

Bonds
- Bond purchase: lending to government/company
- You'll receive yearly interest payments
- Surviving bankruptcy ensures repayment at maturity

	Stocks	Bonds
What	Ownership in a company	Debt instrument
Risk and return	Higher risk, potential for higher returns	Lower risk, more predictable returns
Income Generations	Dividends (not guaranteed)	Interest payments (fixed rate)
Ownership Rights	Voting rights in corporate decisions	No ownership rights
Market influence	Influenced by company results	Influenced by interest rate changes
Liquidity	Generally more liquid	Varies based on issuer and bond type

THE BEST INVESTING TOOLS

Tools	Companies
Stock screeners	stratosphere.io, finviz, TIKR Terminal
Stock analysis	Seeking Alpha, Bloomberg, Morningstar
Financial data	roic.ai, koyfin, Investing.com
Portfolio trackers	DATAROMA, WhaleWisdom, Stockcircle
Newspapers	WSJ, FT Financial Times, Barron's
Market news	yahoo! finance, Quartr, Google Finance
Investment brokers	Interactive Brokers, Fidelity Investments, charles Schwab
General concepts	The Motley Fool, Investopedia

10 VALUATION RATIOS

Price-to-Sales
Stock Price / Sales

Price-to-Book
Stock Price / Book Value Per Share

EV / EBITDA
Enterprise Value / EBITDA

EV / EBIT
Enterprise Value / EBIT

Price / Earnings
Stock Price / EPS

Earnings yield
EPS / Stock Price

Price / Forward Earnings
Stock Price / Expected EPS

Price / Cash Flow
Stock Price / Operating Cash Flow

FCF yield
FCF Per Share / Stock Price

PEG Ratio
(P/E Ratio) / Earnings Growth

HOW TO FIND GREAT STOCKS

- Revenue growth > 7%
- Earnings growth > 9%
- ROIC > 15%
- Profit Margin > 10%
- Operating Cash Flow / Net Income > 90%
- Net Debt / Ebitda < 3

6 STEPS TO FIND GREAT STOCKS

1 Study the competitive advantage
- Why: You don't want to invest in The Next Big Thing. You want to invest in companies that have already won
- How: Gross Margin > 40% & ROIC > 15%

2 Look for companies with skin in the game
- Why: Companies with skin in the game outperform the market
- How: Insider ownership > 10%

3 Low capital intensity
- Why: Companies that require very little capital to operate are very attractive for investors
- How: CAPEX/Sales < 5%

4 Great capital allocation
- Why: Capital allocation is the most important task of management
- How: ROIC > 15% & ROCE > 20%

5 High profitability
- Why: You want to invest in companies that translate most revenue into earnings
- How: Profit Margin > 10% & FCF Margin > 10%

6 Secular trend
- Why: In the long term stock prices tend to follow earnings growth
- How: Revenue growth > 5% & EPS Growth > 7%

10 INVESTMENT LESSONS FOR EVERYONE

01 Invest for the long term
02 You can double money every 10 years in stock market
03 In the long run, stocks are less risky than bonds
04 Don't try to time the market
05 History doesn't repeat itself, but it often rhymes
06 Don't invest in highly disruptive industries
07 Let your winners run
08 Low stock prices are great for investors
09 Invest in very profitable companies
10 Stock prices tend to follow earnings growth