HOW TO READ AN ANNUAL REPORT

THE 6-STEP FRAMEWORK FROM ASWATH DAMODARAN

1 Confirm the timing and currency

- What period is covered?
- What currency are they reporting in?

2 Map the business mix

- In which segment does the company operate?
- What does the geographic breakdown look like?

3 Find the base inputs for valuation

- **From the Balance Sheet**
  - How much debt does the company have?
  - Does the company have more current assets and current liabilities?
  - Does the company have a lot of goodwill on its balance sheet
- **From the Income Statement**
  - Are revenues steadily increasing over time?
  - Does the company need a lot of COGS to sell its products?
  - How much revenue is translated into net income?
- **From the Cash Flow Statement**
  - Are most earnings translated into operating cash flow?
  - Does the company have a positive free cash flow (operating cash flow – CAPEX)?
  - Did the company manage to increase its cash position compared to last year?

4 Keep digging In the footnotes look for

- Does the company use a lot of SBCs?
- When does the company's debt mature?

5 Confirm The Units

- How many shares outstanding does the company have?
- Does the company have preferred shares?
- Are acquisitions paid with stocks?

6 Corporate Governance

- Do insiders get special privileges?
- Does management have a lot of skin in the game?

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HOW TO ANALYZE STOCKS

BY COMPOUNDING QUALITY

1. BUSINESS MODEL
- Do I understand how the company makes money?
- Does the business model look attractive to me?

2. CAPABILITY OF MANAGEMENT
- Has management a strong track record in creating shareholder value?
- Does management have skin in the game?

3. SUSTAINABLE COMPETITIVE ADVANTAGE
- What differentiates the company from its peers?
- Does the company have pricing power?

4. ATTRACTIVENESS OF THE INDUSTRY
- Who are the main peers of the company?
- Does the end market grow at an attractive rate?

5. MAIN RISKS
- What are the main risks for the company?
- Are there any potential Black Swans?

6. BALANCE SHEET
- Does the company have a healthy balance sheet?
- Has the company a lot of goodwill on its balance sheet?

7. CAPITAL INTENSITY
- How much capital does the company need to operate?
- Is the company investing a lot in future growth (growth CAPEX)?

8. CAPITAL ALLOCATION
- How efficiently does management allocate capital?
- Does the company have a high and robust ROIC?

9. PROFITABILITY
- How much $ does the company make per $100 in sales (profit margin)?
- Does the company translate most earnings into free cash flow?

10. HISTORICAL GROWTH
- Did the company manage to grow its revenue by more than 5% in the past?
- Did the company manage to grow its earnings by more than 7% in the past?

11. USAGE OF STOCK-BASED COMPENSATION (SBCS)
- Does the company use SBCs to reward management and employees?
- Are outstanding shares increasing or decreasing?

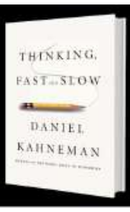
12. OUTLOOK
- Does the future look bright?
- Can the company grow its revenue and earnings by more than 5% and 7%?

13. VALUATION
- at which valuation level does the company trade right now?
- Is the company undervalued or overvalued?

14. OWNER'S EARNINGS
- Owner's earnings = EPS growth + dividend yield
- Did the company grow its owner's earnings by more than 10% per year?

15. HISTORICAL VALUE CREATION
- Did the company create a lot of shareholder value in the past?
- At which rate did the company compound since its IPO?

FULL COURSE
- How to find attractive companies
- How to analyze stocks like a Professional



10 LESSON FROM THINKING FAST AND SLOW

BY COMPOUNDING QUALITY

1. Our brain uses two systems: System 1 and System 2

System 1 is fast, intuitive and automatic. It is prone to biases and errors such as overconfidence.

System 2 is slow, analytical, and deliberate. It is necessary for complex tasks requiring focused attention.

2. Irrationality

Humans are not rational. We all make a lot of irrational mistakes. 90% of Americans think they can drive better than average and 70% think they are smarter than average.

3. The Halo Effect

The halo effect is a cognitive bias where your overall impression of a person influences your perception on their individual traits or qualities.

If you like someone, you'll overestimate their capabilities and vice versa.

4. Sunk cost fallacy

The sunk cost fallacy appears when you keep investing in something even if it's not worth it, simply because you've already invested resources in it.

Think about choosing to finish a boring movie because you already paid for the ticket.

5. Hindsight bias

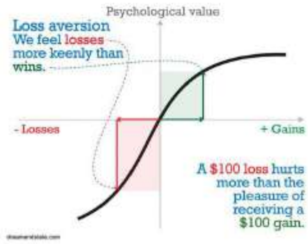
The tendency, after an event has occurred, to believe that one would have predicted or expected the outcome.

A good example is that after attending a baseball game, you might insist that you knew that the winning team was going to win beforehand.

6. Prospect theory

The prospect theory suggests that people feel losses twice as hard as gains.

Many people don't want to play a Heads or Tails game where they can win $100 but risk losing $50.



You should take this bet every single day.

7. Availability heuristic

The availability heuristic is a cognitive bias where you judge the likelihood of an event based on how easily it comes to mind.

A good example is 9/11 which made people afraid of flying.

8. Confirmation bias

People tend to seek out information that confirms their existing beliefs and ignore information that contradicts it.

As an investor, always talk with people who have opposing views. It will be very insightful.

9. Framing effect

When the way information is presented influences your decisions and perceptions, we call it a framing effect.
For example: studies have shown that 75% lean meat is usually preferred over 25% fat meat, even though it's the same thing.

10. Anchoring effect

The anchoring effect is a bias where you rely too heavily on the first piece of information you receive when making a decision.

If you first see a car that costs $100k and then see a second one that costs $70k, you tend to see the second car as cheap.

10 INVESTMENT TIPS FROM WARREN BUFFETT

BY COMPOUNDING QUALITY

01 **The longer you invest, the better**

Today, Warren Buffett's net worth is equal to more than $100 billion. More than 95% (!) of this wealth was created after his 65th birthday

02 **Do not borrow money to invest**

My partner Charlie Munger says there are only three ways a smart person can go broke: liquor, ladies and leverage

03 **Boring companies are usually great investments**

Only invest in what you understand. Boring companies are usually great investments. Good investing is as watching paint dry

04 **Invest in companies with integer management**

The interests of management and shareholders should be aligned. Companies with skin in the game outperform the market

05 **Buy quality businesses**

Invest in robust companies with a healthy balance sheet and high margins which can grow their earnings attractively

06 **Be disciplined**

Every investment strategy will underperform the market from time to time. As an investor you are running a marathon, not a sprint

07 **Market fluctuations are your friend**

The best thing that can happen to investors who will still be buying shares in the next 10 years, is falling stock prices

08 **Organic growth is the preferred growth source**

Compounding machines are companies which can reinvest their earnings in organic growth for years or even decades

09 **Give your top ideas the most weight in your portfolio**

Diversification only makes sense for those who don't know what they're doing

10 **Pricing power is crucial**

Pricing power is the best protection against inflation

THE POWER OF COMPOUNDING

BY COMPOUNDING QUALITY

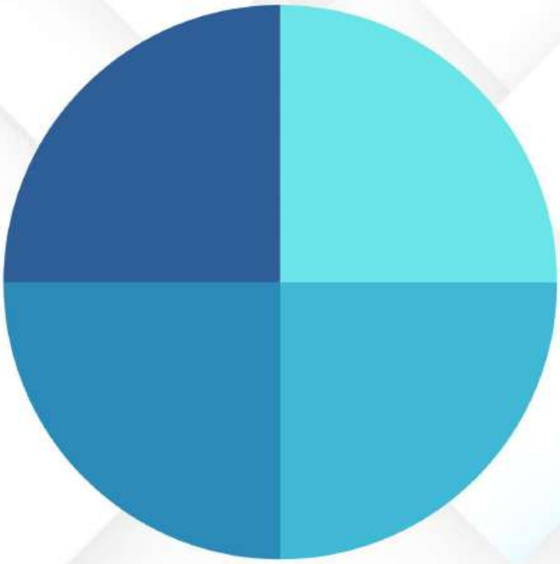
If you were to double $0.01 everyday for 30 days, you would have...

Day 1	$0.01	Day 11	$10.24	Day 21	$10,485.76
Day 2	$0.02	Day 12	$20.48	Day 22	$20,971.52
Day 3	$0.04	Day 13	$40.96	Day 23	$41,943.04
Day 4	$0.08	Day 14	$81.92	Day 24	$83,886.08
Day 5	$0.16	Day 15	$163.84	Day 25	$167,772.16
Day 6	$0.32	Day 16	$327.68	Day 26	$335,554.32
Day 7	$0.64	Day 17	$655.36	Day 27	$671,088.64
Day 8	$1.28	Day 18	$1,310.72	Day 28	$1,342,177.28
Day 9	$2.56	Day 19	$2,621.44	Day 29	$2,684,353.56
Day 10	$5.12	Day 20	$5,242.88	Day 30	$5,368,709.12

WHAT WILL PEOPLE REMEMBER ABOUT YOU

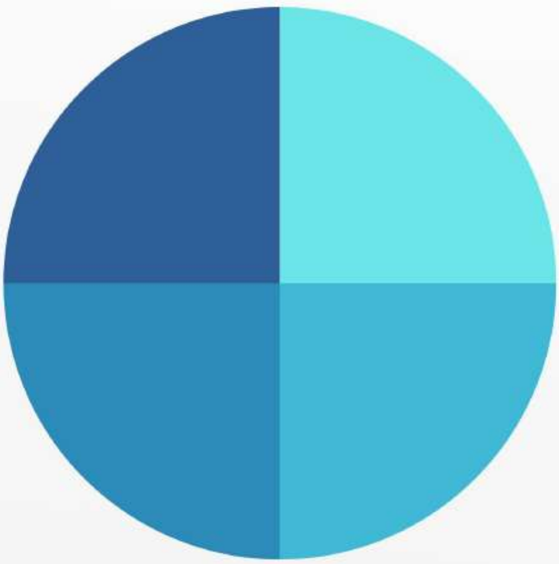
BY COMPOUNDING QUALITY

Nobody will remember:



- Your salary
- How “busy” you were
- How many hours you worked
- How many Gucci bags you owned

People will remember:



- How you made them feel
- The time you spent with them
- If you kept your word
- If they could count on you

12 BIASES THAT HARM YOUR DECISION-MAKING

BY COMPOUNDING QUALITY

1 Anchoring Bias

You rely heavily on the first piece of information you receive.

Example - First seeing an expensive watch makes others seem cheaper.

2 Authority Bias

You trust opinions from perceived authorities more.

Example - Believing a product is good because a celebrity endorses it.

3 Availability Heuristic

You judge things based on info readily available or easily recalled. You tend to follow popular opinions or trends.

Example - Seeing a type of car as unreliable due to a friend's issues with it.

4 Bandwagon Effect

You tend to follow popular opinions or trends.

Example -Buying a certain phone because you see other people using it.

5 Confirmation Bias

You favor information that confirms your existing beliefs.

Example -Dismissing data that questions your favorite diet's effectiveness.

6 Dunning-Kruger Effect

You overestimate your ability when you know little about something.

Example -Thinking you're an expert after reading one article on a subject.

7 Endowment Effect

You value things more when you own them.

Example - Trying to sell your house above market value because it's yours.

8 False Consensus Effect

You overestimate how much others agree with you.

Example - Assuming all your friends will like your preferred restaurant.

9 Halo Effect

You judge a person's character from an overall positive impression.

Example - Thinking a candidate will do a job well because they're attractive.

10 Illusory Correlation

You mistakenly believe two unrelated things are connected.

Example -Believing black cats cause bad luck.

11 Negativity Bias

You focus more on negative events than positive ones.

Example -Dwelling on one negative comment in a sea of compliments.

12 Outcome Bias

You judge a decision by its outcome, not the decision-making process.

Example - Calling a bad investment smart because it unexpectedly paid off.

10 LESSONS FROM THE PSYCHOLOGY OF HUMAN MISJUDGMENT

BY COMPOUNDING QUALITY

1 Why People Make Mistakes

- Investment advisors might make decisions that benefit them more than their clients
- They might trade a lot, even when it's not needed.
- Always remember that it's important to find advisors who truly care about your goals.

6 Tips from Others

- If someone gives you advice about a "hot" stock, be cautious
- Do your own research before buying anything
- What works for one person might not work for you.

2 Following the Crowd

- When everyone's talking about a stock, it's easy to feel like you should buy it too
- But just because it's popular doesn't mean it's a good investment
- It's better to base decisions on facts, not what's trending.

7 Holding On Too Tight

- When a stock's value drops, it's tough to let it go
- But sometimes, it's better to sell and find something better
- Don't let emotions cloud your judgment.

3 Jumping to Conclusions

- Sometimes, people buy a stock just because its price went up, even if the company's not doing well.
- And sometimes they sell a good stock when the price drops
- It's better to think carefully before making moves.

8 Following the Experts

- Just because a big-name investor likes a stock doesn't mean it's a sure thing
- Do your own research to understand the risks
- You can borrow someone's idea, but you can't borrow their conviction.

4 Being Too Hopeful

- People can get really excited about a company or industry and invest too much in it
- This can be risky and lead to bad decisions
- It's smarter to spread your investments out to stay safe.

9 Ignoring Warning Signs

- Sometimes, people don't want to see when things are going wrong
- Pay attention to signs and be ready to make changes if needed
- Ignoring problems won't help

5 Wanting What Others Have

- Seeing others make money quickly can make you want the same
- But copying their strategy might not work for you
- It's better to understand things well before investing.

10 Being Too Sure

- Feeling really confident can be good, but thinking you're always right can lead to mistakes
- Stay open to learning and don't let pride get in the way.

EBITDA 101

BY COMPOUNDING QUALITY

1 What is EBITDA?

EBITDA stands for:

- Earnings
- Before
- Interest
- Taxes
- Depreciation
- Amortization

In other words, it shows you what the company earns before costs like interest, taxes, depreciation and amortization are subtracted

2 Formula

EBITDA = Net Income + Taxes + Interest Expense + Depreciation & Amortization

OR

EBITDA = EBIT + Depreciation & Amortiziation

3 EBITDA margin

EBITDA margin = EBITDA / Revenue

You want most revenue to be translated into EBITDA

4 Adjusted EBITDA versus EBITDA

- A lot of companies also use the Adjusted EBITDA instead of EBITDA
- Adjusted EBITDA removes one-time, irregular, and non-recurring items that distort EBITDA
- This will result in a higher figure

5 EBITDA is NOT the same as Free Cash Flow

- In general, free cash flow is a way more reliable metric than EBITDA
- Free Cash Flow shows you what a company REALLY earns in cash after deducting all expenses.

6 What's all the fuss about?

Charlie Munger once said the following:

"I think that, every time you see the word EBITDA, you should substitute the words bullshit earnings."

- The issue with EBITDA is that it removes real expenses
- That's why I would never look at EBITDA to analyze a company

EBITDA Free Cash Flow

6 LESSONS MCKINSEY VALUATION BOOK

BY COMPOUNDING QUALITY

MOST MANAGERS THINK ON THE SHORT TERM

- A lot of times, management has its own personal agenda
- This destroys value for shareholders.
- Focus on companies with skin in the game to avoid this

TOTAL SHAREHOLDER RETURN

- TSR is a common metric to assess a company's performance, but it's not so good for well established firms
- Why? Because the base effect of a high ROIC earning firm is too big to gain meaningful TSR

ECONOMIC PROFIT IS KING

- Accounting profit doesn't matter. It's economic profit that matters
- Economic profit: (ROIC - WACC) × Invested capital

WACC = OPPORTUNITY COST

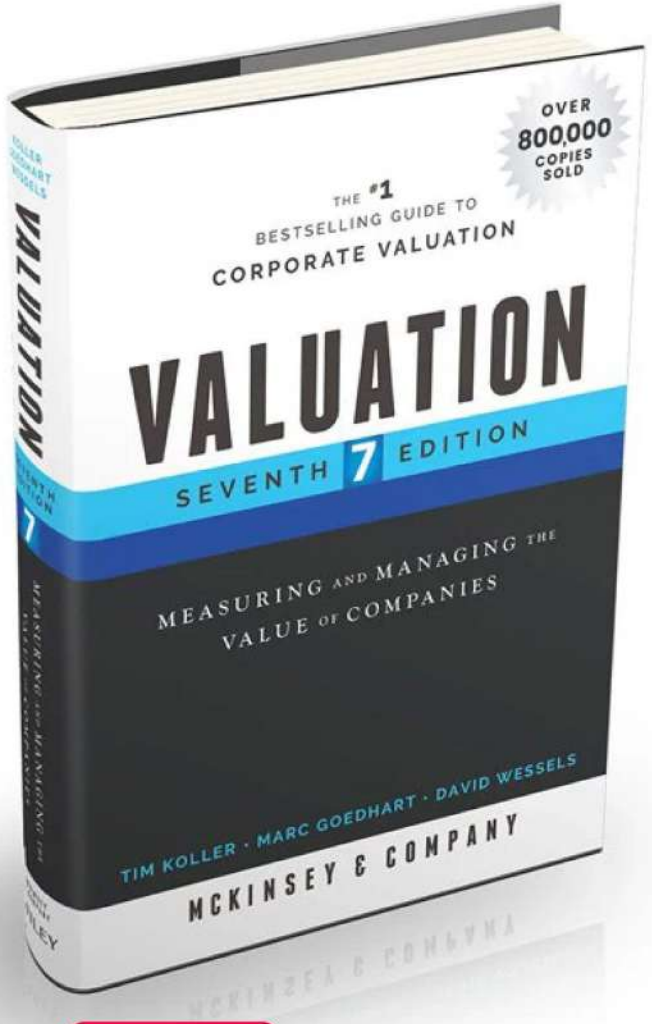
- WACC is the opportunity cost of capital, it simply states what the investors can earn by investing somewhere else with the same risk
- It's more about what the opportunities in the market are & less about the cash cost

ESG MATTERS

- The companies that scored high points on ESG metrics performed better & created more stakeholders value
- That's because companies that score well on ESG, tend to have a lot of quality characteristics (high profitability, healthy balance sheet, ...)

BUY WONDERFUL COMPANIES AT A FAIR PRICE

- Over time the growth of the FCF per share matters most
- That's why it's way better to buy a wonderful company at a fair price than a fair company at a wonderful price



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