Investment Selection Methodology

BLUEPRINT 2014 -2024

3 Pillar Approach

- Valuation
- Growth
- Profitability

3 Foundational Principles

- Free Cash Flow
- High Margins
- Historical Book Valuations

Applying Our 3 Principles

Free Cash Flow High Margins Historical Book Valuations

- We VALUE companies based on FREE CASH FLOW using FCF /EV while looking for HIGH MARGINS on FCF Yield, FCF/ROIC, FCF/Debt
- We look for MARGIN of Safety by looking for High Operating and Profit Margins
- We look for High Returns on Capital PROFITABILITY , ROIC, RoE, RoA
- We look for consistent GROWTH by looking at 5y FCF Growth, 5y RoA, RoE, EPS and Sales Growth, Operating Margin Growth,
- We look for reasonable HISTORICAL BOOK VALUATIONS using 3y P/FCF, 3y P/ BV , 3y EV/EBITDA to capture cheap asset VALUATIONS

Pillar 1 - Valuation

Valuations are still representations of current environment.
Improving metrics migrate value and lead to price appreciation

- Valuations are 'moment in time' snapshots of an environment that is everchanging and moving
- A company's stock price reflects its valuation at that moment in time.
- *We look for **improving metrics** over time that will re-rate the company and **migrate Value** at higher levels eventually leading to **price appreciation***

Valuation Pillar - Free Cash Flow

Yield and Growth

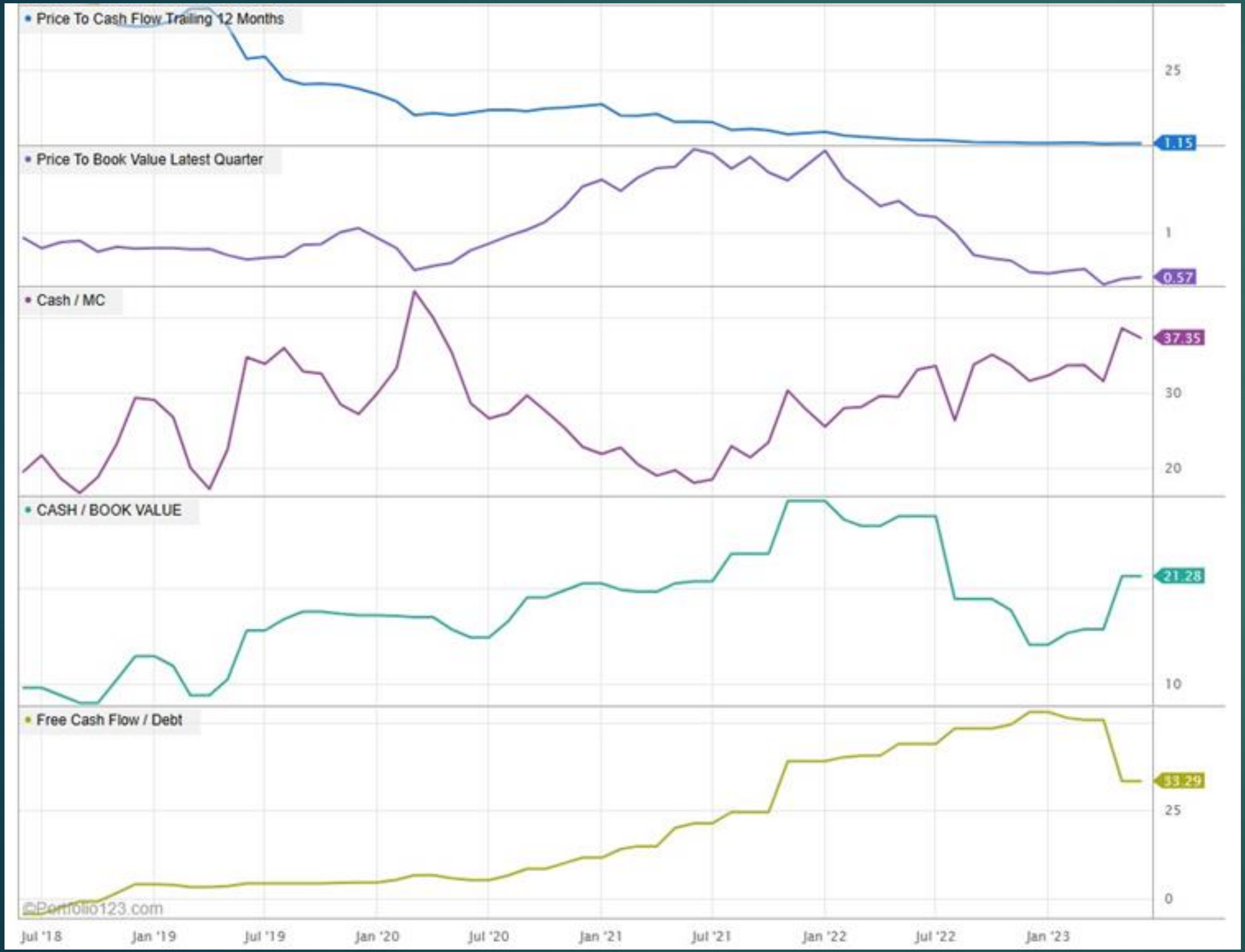
Company	Free Cash Flow Yield %
....:SWE	183
....:NOR	155
....:GBR	150
.....:DEU	142
.....:SVN	97
.....:GBR	76
....:DEU	64
....:POL	59
......:DNK	54
.....:NLD	54
.....:FRA	50
....:NOR	50
....:NOR	49
.....:GBR	46
.....:HUN	44
....:POL	44

- **Our preferred measure of valuation is the free cash flow (FCF) yield.** Free cash flow is the cash generated by a company after paying for everything except the dividend divided by Market Capitalisation.

- While quality companies typically have high valuations, we need to search for comparatively attractive valuations. We look at **Free Cash flow over the company's Enterprise Value (FCF/EV)** and **Free Cash flow over Debt** to discover quality companies with attractive valuations

- **High FCF over EV** companies offers high reinvestment potential in the business or looking at it otherwise, how quickly it can replay its own acquisition cost considering that EV is accurate mean of assessing company valuation since it includes debt and excludes cash.

Valuation Pillar - Historical Book Valuations

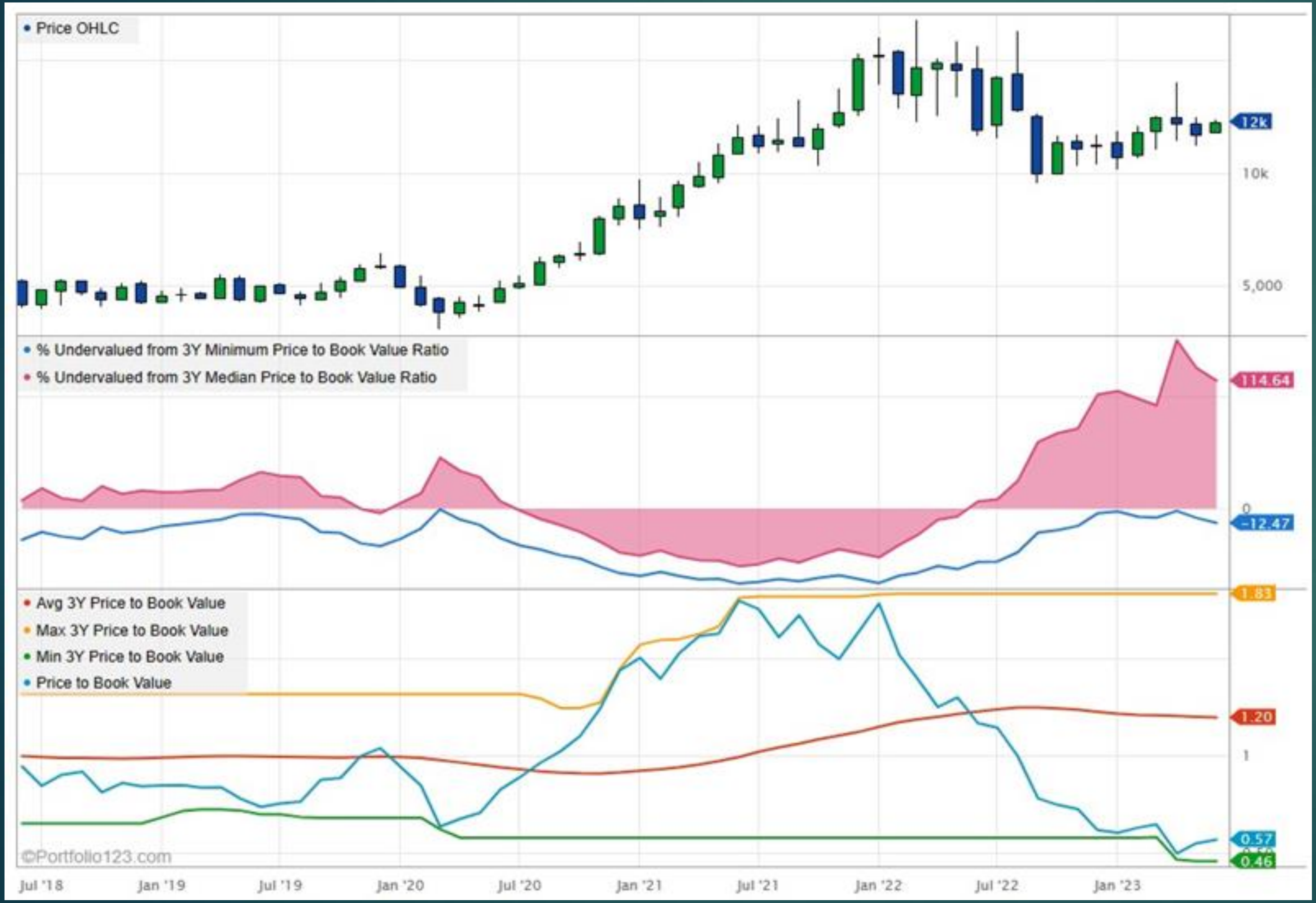


- **Price to Cash Flow** is a market price measure of the acquisition cost of the company relative to 1 year cash flow generation.

- Cash to Book Value indicates a "cash-rich" company and how much of its value is pure cash in the Bank. A crude but very effective measure

- **Free Cash Flow to Debt** shows the fraction of all debt that would be repaid in 1 year if all of the free cash flow was utilised and depict a simplistic view of a healthy balance sheet.

Valuation Pillar - Historical Book Valuations



- **Price to Book Value** in comparison to **historical minimum Book Values** provide a trigger to a "value for money" proposition and add comfort and a margin of safety to a healthy balance sheet

Pillar 2 - Growth

High Margins

Company	Operating Margin %	Operating Income Growth %
....:HUN	57	382
....:SWE	29	309
....:POL	28	258
....:POL	35	187
....:DEU	32	148
....:DEU	53	130
....:NOR	82	127
....:BGR	23	121
....:SWE	42	114
....:POL	59	100
....:GBR	43	94
....:POL	51	86
....:POL	62	85
....:GBR	45	74
....:GBR	59	72
....:DEU	24	68

- While this is useful, we also need to factor in Margins and Growth rates
- High Operating Margins and Growth, ideally high Net profit Margins as well
- Margin of safety in high margins: absorb downside volatility in sales and economic downturns
- Ranking high quality companies by their Operating Margins provide a starting point to the investor to pinpoint where there maybe be opportunities to invest

Pillar 2 - Growth

Free Cash Flow and high Margins

- While this is useful, we also need to fac tor in FCF Margins and Growth rates
- Free Cash Flow Margins (FCF over Enterprise Value and Market Cap)
- Free Cash Flow Growth consistency over 1 year , 3 year and 5 years
- Ranking high quality companies by their FCF yield allows the investor to pinpoint where there is currently the most value.
- Improving Margins throughout a given time horizon

Pillar 3 - Profitability

Identifying companies that grow consistently

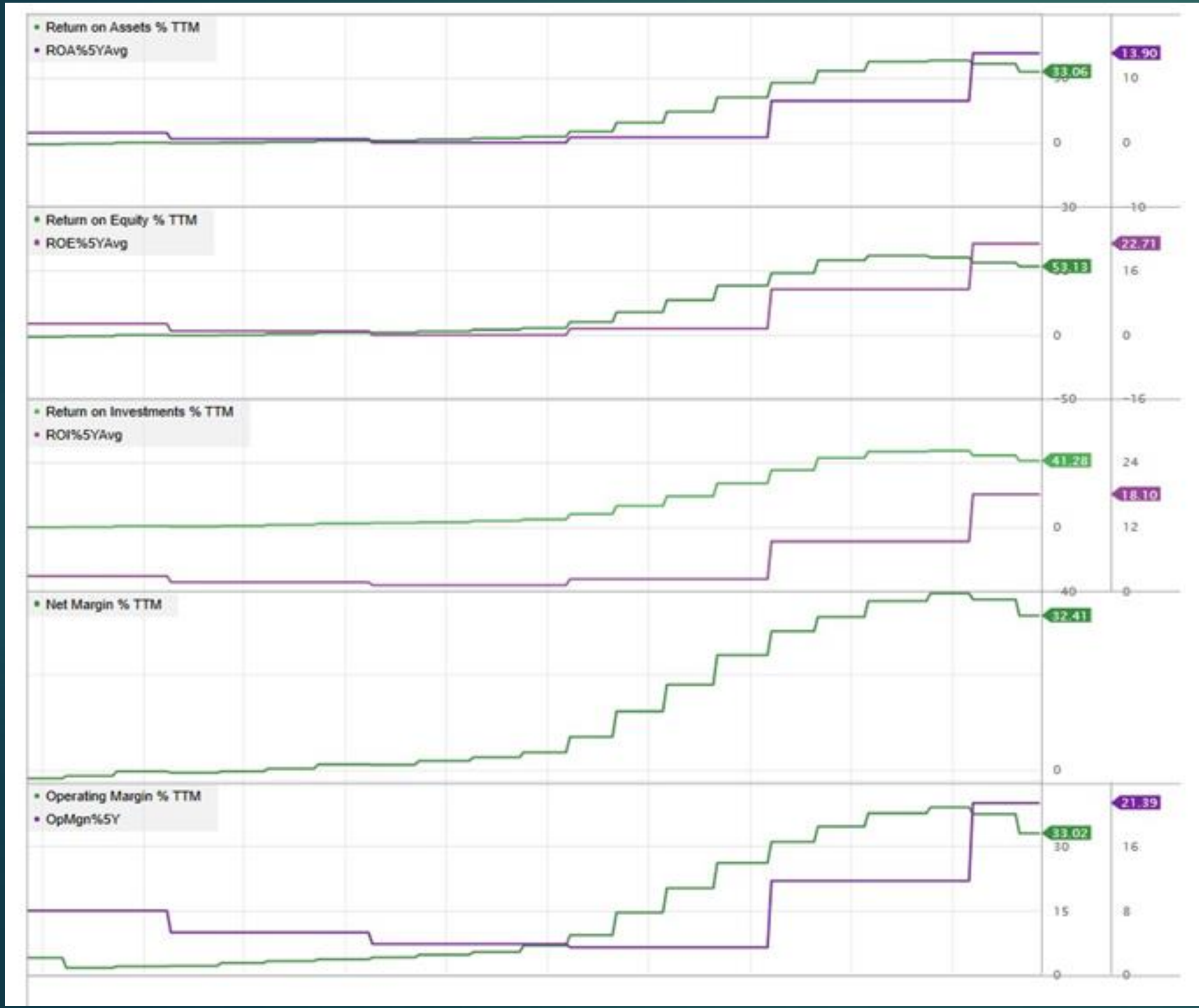
- Consistent High Return on Capital (ROCE)

  which comprises of
  - Consistent High Return on Equity
  - Consistent High Return on Assets
  - Low Cost of Capital and Debt

- Growth Sector and Geographical Location
- Favourable Regulatory Environment

Pillar 3 - Profitability

High Margins



- High returns on Equity and Investments
- Consistently throughout 1y to 5y horizon
- High Operating and Net Profit Margins
- Improving Margins throughout a given time horizon

Pillars and Principles -- A Summarised View

Growth Value and Profitability

- Free Cash Flow Growth consistency over 1 year , 3 year and 5 years, where there is currently the most value.
- Cash flow visibility and high margins provide a margin of safety and earnings quality

Quality	
Operating Margin	>
Net Margin	>
Return On Assets % 5Y Avg	>
Return On Equity % 5Y Avg	>
Return On Assets % TTM	>
Return On Equity % TTM	>
Interest Coverage TTM	>
Debt Total / Equity MRQ	<
Enterprise Value to EBITDA	
Operating Income Growth	>

Growth	
EPS Growth TTM	>
EPS Growth 5Y	>
EPS Growth Projected	>
Sales Growth TTM	>
Sales Growth 5Y	>
Operating Income Growth	>

Value	
Price to Earnings (PE)	<
Price To Earnings (PE) Proj	<
Price to Sales TTM	<
Enterprise Value to EBITDA	<
Enterprise Value to Sales	<
Free Cash Flow Yield	>
Price to Book	<
Piotroski F Score	>
Dividend Yield	>

	Free Cash Flow	High Margins	Historical Book Value
Valuation	• Used in DCF model for intrinsic value estimation. • Indicates the company's ability to generate cash beyond expenses.	• Indicates efficient revenue conversion and potential market dominance. • Assists in comparative valuation analysis.	• Important for asset-based valuation models. • Reflects the company's worth based on tangible assets.
Profitability	• Direct indicator of financial health and operational efficiency. • Reflects ability to reinvest or distribute cash.	• Essential for assessing operational efficiency and cost management. • Indicates potential for sustained profitability.	• Provides insights into past profitability and asset management. • Reflects historical financial decisions.
Growth	• Indicator of growth potential and expansion capability. • Shows ability to generate increasing cash for growth.	• High margins provide capital for growth and innovation. • Reflects a company's ability to scale and expand.	• Offers insights into growth trajectory over time. • Indicates how the asset base has evolved and expanded.

Final thoughts on valuation

- Over the long-term the quality of a company's earnings and assets are more important than the market valuation of its earnings and assets.

- Historically high valuations can still provide significant returns. Why?

- Reason: High FCF growth rates will offset low FCF yields as earnings growth need to catch with FCF Growth

- Results: Price appreciation due to Earnings Growth

- A high valuation doesn't mean you're overpaying, as **Quality can be expensive and vice versa:** A low valuation doesn't mean something is cheap as it may be cheap for a reason (Value Trap)