

## Twitter Thread by Compounding Quality

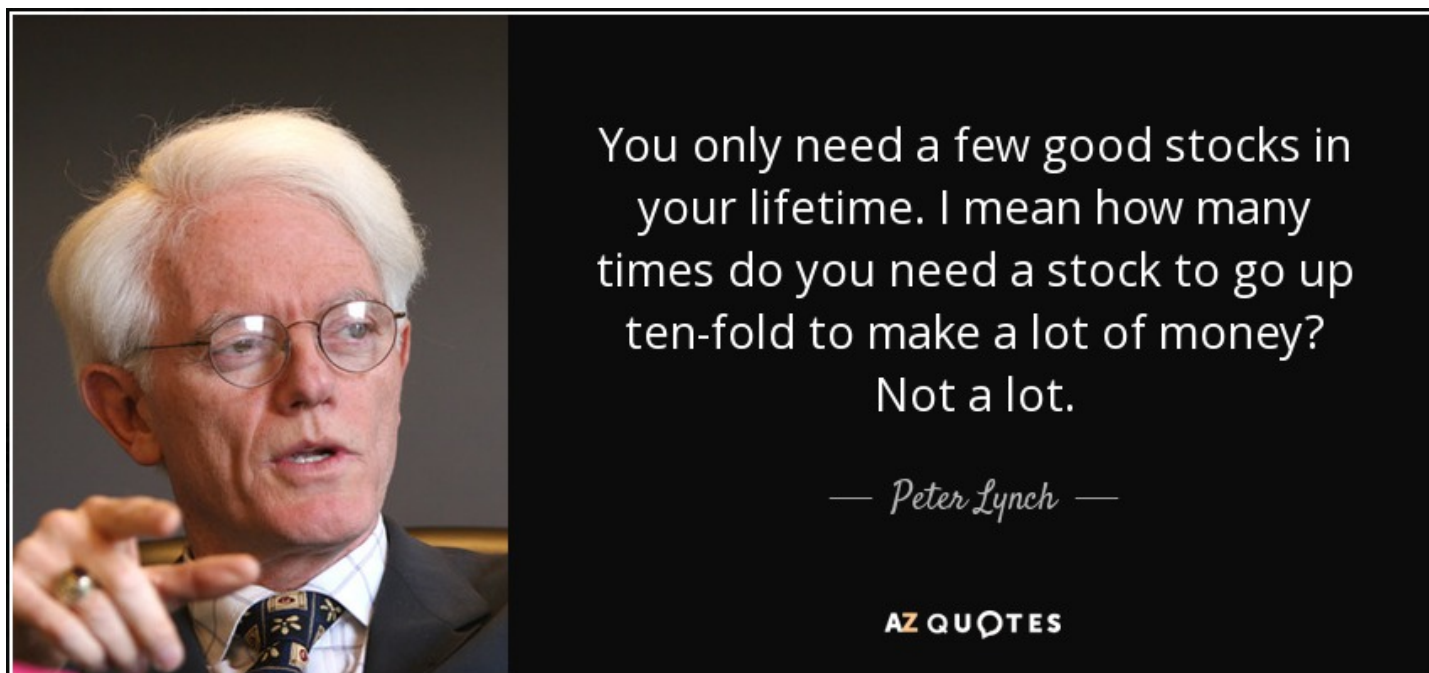
Compounding Quality

@QCompounding



■ It's every investor's dream to make a 10-bagger (a stock that goes up tenfold), or even a 100-bagger (a stock that goes up 100x).

In this thread we will learn you how to identify multibaggers together with 104 (!) concrete examples.



Lesson 1: Look for business with a wide moat.

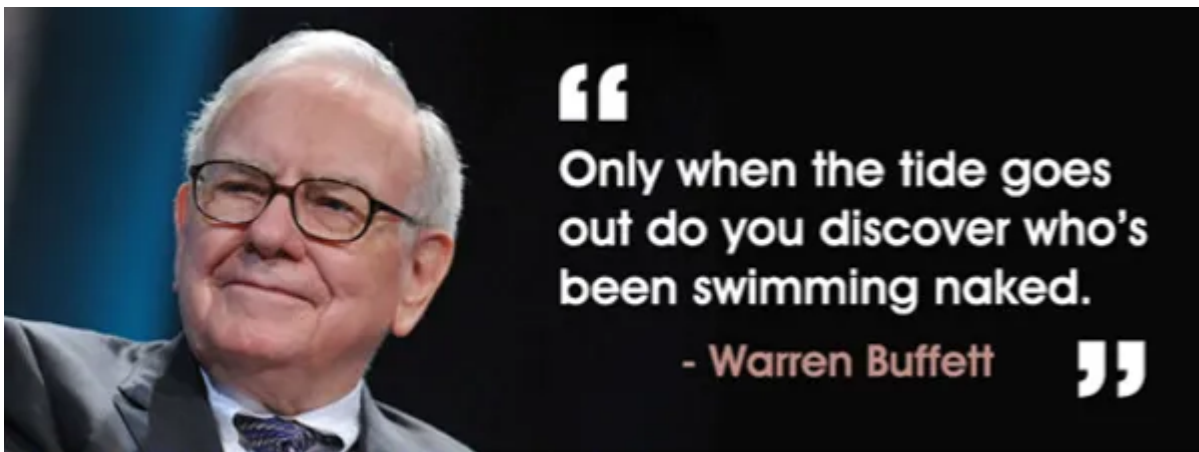
A wide moat is essential for every Quality Investment. Almost all multibaggers (91%) are characterized by a wide economic moat. Barriers to entry are the most preferred moat source for multibaggers (81%).

## OK, What is an Economic Moat?

- Capital flows to the areas of highest potential return, so all firms face competition that seeks to force down high returns on capital.
  - But some firms generate high returns for a very long time.
  - How? By creating economic moats around their businesses.
- An economic moat is a structural business characteristic that allows a firm to generate excess economic returns for an extended period.
  - Firms with moats have ability to invest incremental capital at high rates of return = faster earnings growth and/or higher free cash flow.
  - Firms with moats have more predictable cash flows, limiting the risk.

Lesson 2: Invest in financially healthy companies.

Great companies are very cash-generative and have a healthy balance sheet. Seek for companies with a low net debt / EBITDA and high interest coverage. When the company has a net cash position, this is a great surplus.



Lesson 3: Acquisitions can create a lot of value.

While many acquisitions fail to create value, the best performing stocks use acquisitions to bolster their returns.

If you want phenomenal returns, find great acquirers. Constellation Software, and Lifco are beautiful examples.

# What Drove EBITDA / Revenue Growth 1/2

Acquisitions, new products, and new contracts were often central to the growth algorithms of the companies in the set.

## Companies often made acquisitions

56%

Percentage of companies where acquisitions were key to their growth<sup>1</sup>



19%

Percentage of companies who not only made acquisitions but made at least one transformative acquisition<sup>2</sup>



EVI and JD used acquisitions to grow from 2015-2020.



ERI's acquisition of Caesars Entertainment was a transformative acquisition.

## Transformative New products

27%

Percentage of companies which launched transformative new products<sup>2</sup>



EOS launched new Remote Weapon System's product which enabled the company to become profitable.

## Major New Contracts

17%

Percentage of companies which won major new contracts<sup>2</sup>



IVU landed major new contracts in Germany for its rail software.

## Companies Benefited from COVID-19 Related Demand

17%

Percentage of companies whose stock was positively impacted by the coronavirus pandemic<sup>2</sup>



SLP saw its demand jump considerably as companies began racing to develop a COVID-19 vaccine.

Lesson 4: Don't rely on multiples.

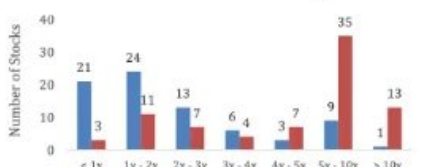
When you want to buy something great, you have to pay for it.

While it's always better to buy a great business at a low multiple, many of the top performing stocks started compounding with multiples which were already high.

## Valuation Multiples

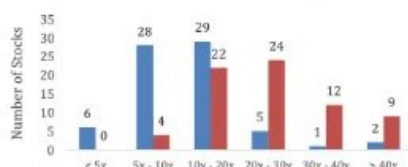
■ 2015 ■ 2020

### NTM Revenue Multiple<sup>1</sup>



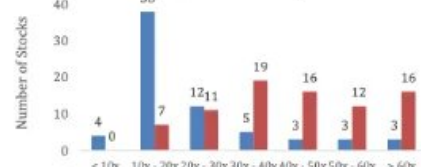
	2015	2020	Change
25 <sup>th</sup> Percentile	0.94x	2.88x	208.02%
50 <sup>th</sup> Percentile	1.68x	5.53x	229.17%
75 <sup>th</sup> Percentile	3.09x	8.64x	179.45%

### NTM EBITDA Multiple<sup>1</sup>



	2015	2020	Change
25 <sup>th</sup> Percentile	7.58x	16.52x	117.91%
50 <sup>th</sup> Percentile	10.26x	24.79x	141.62%
75 <sup>th</sup> Percentile	13.77x	32.52x	136.18%

### NTM P/E Multiple<sup>1</sup>



	2015	2020	Change
25 <sup>th</sup> Percentile	14.05x	30.49x	116.94%
50 <sup>th</sup> Percentile	17.57x	42.90x	144.13%
75 <sup>th</sup> Percentile	27.12x	55.75x	105.55%

Along with revenue, EBITDA, and net income growth (and better outlook) multiples expanded for a variety of reasons - including better management, better investor relations, and mitigating financial crises.

6%

Percentage of times new management was noted as a key event and helped expand the company's multiple



ETSY's new CEO turned the helped make the company profitable.

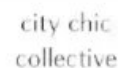
Better investor relations efforts was often a source of multiple expansion due to an increased awareness of the company; this often took the form of attending conferences and providing more detailed financials



NLAB improved IR by releasing English financial reports, among other improvements.

12%

Percentage of times mitigating a crisis was noted as a key event and helped expand the company's multiple



CCX divested from multiple unprofitable business units.

Lesson 5: Invest in small caps.

In general, small caps perform better than large cap stocks because they have more upside potential.

When you can find an owner-operator small cap stock which is a market leader in a niche with high margins, you have found a (potential) goldmine.

## Size of the Companies

While some large companies were included in the set, smaller companies were represented more often and returned larger TSRs on average.



Investors need to be willing to look at small, under looked, and under covered stocks to find some of the biggest winners:



But with that said, many companies with >1B market caps outperformed as well:



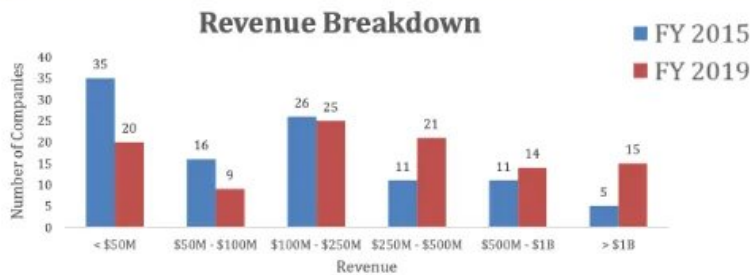
Lesson 6: Margin expansion is great.

As a quality investor, you should love margin expansion.

When the profit margin of a company doubles, the EPS of the company doubles too.

In the long term, earnings growth is the leading factor for stock price performance.

## Financial Metrics



### Gross Margin

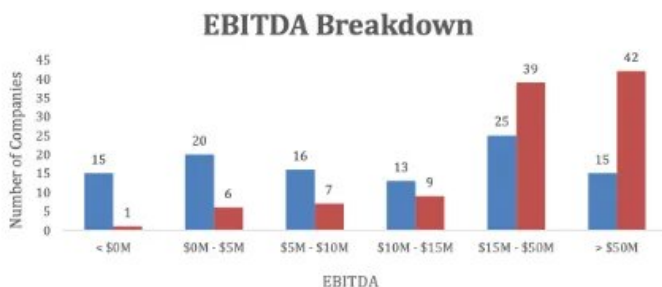
	FY 2015	FY 2019	Change
25 <sup>th</sup> Percentile	30.42%	31.69%	127 bps
50 <sup>th</sup> Percentile	46.40%	49.19%	279 bps
75 <sup>th</sup> Percentile	61.39%	66.68%	529 bps

### SG&A Percentage

	FY 2015	FY 2019	Change
25 <sup>th</sup> Percentile	53.57%	45.11%	-846 bps
50 <sup>th</sup> Percentile	34.43%	30.27%	-416 bps
75 <sup>th</sup> Percentile	16.30%	14.35%	-195 bps

### EBITDA Margin

	FY 2015	FY 2019	Change
25 <sup>th</sup> Percentile	4.75%	11.43%	668 bps
50 <sup>th</sup> Percentile	10.22%	17.75%	753 bps
75 <sup>th</sup> Percentile	17.88%	27.16%	928 bps



Lesson 7: Let your winners run.

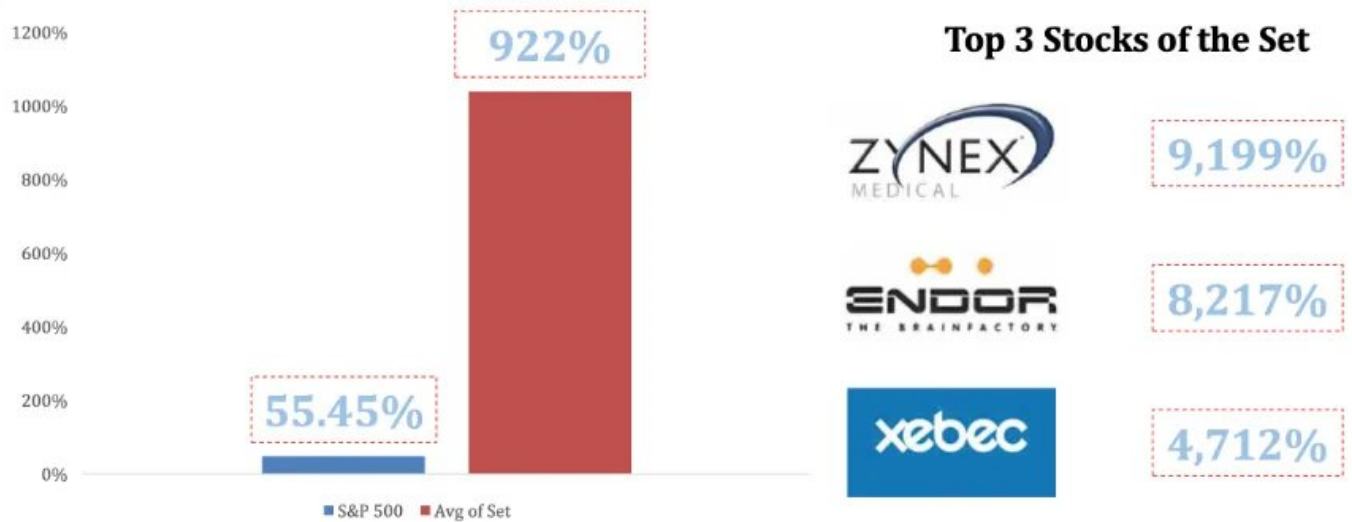
The only thing you need during a successful investment career, is a few big winners.

Between June 2015 and June 2020 Zynex Medical, the best performing stocks over the studied period, returned almost

9200% (!) to shareholders.

## What Caused This Set of Companies to Outperform So Much?

The S&P 500 returned 55.45% from June 2015 to June 2020 while the average return of the set was 922% and the highest performer returned 9,199%.

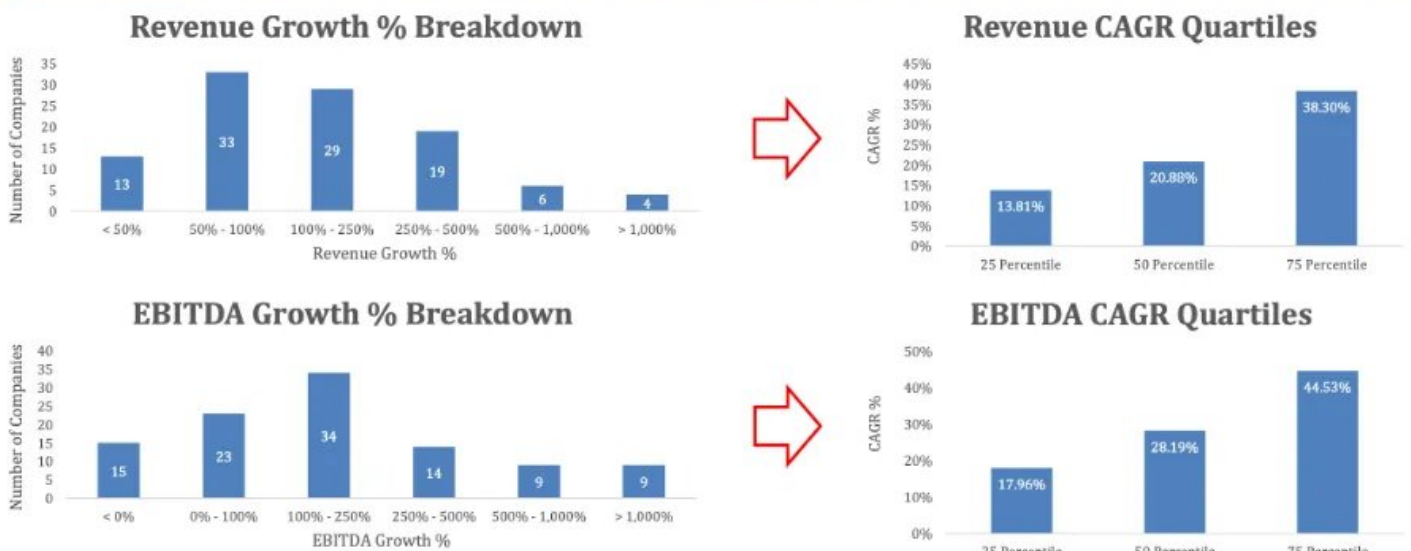


Lesson 8: Organic growth is the most preferred source of growth.

When you can buy companies which can reinvest a lot of their FCF in organic growth opportunities at high margins, the company's earnings will explode over time.

## Revenue and EBITDA Growth

Median revenue grew from 113% and median EBITDA grew 137% from FY15 to FY19.



Lesson 9: Learn with concrete examples.

Do you want to learn more? Download all 104 (!) multibagger stocks which were studied here:

<https://t.co/LQOtuyqLVp>