

An Introduction



APPLIED FINANCE
CAPITAL MANAGEMENT

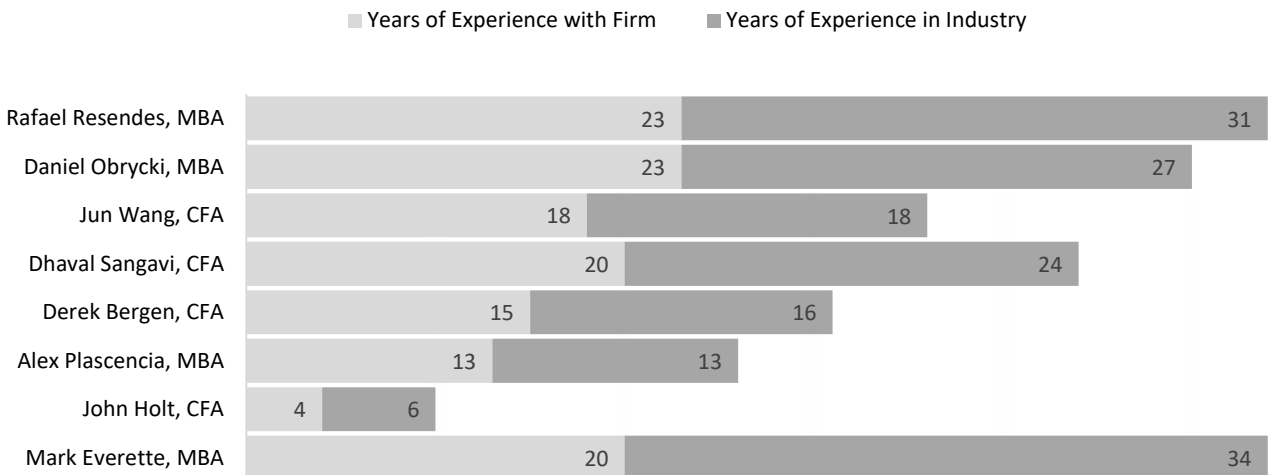
Applied Finance Capital Management (Applied Finance) is dedicated to equity research and constructing equity portfolios that outperform their benchmarks through its Valuation Driven process.

Over 20 years ago, Applied Finance developed the Economic Margin framework to measure a firm’s economic, rather than as-reported accounting performance, and directly link corporate performance to valuation. Since launching its Valuation database in 1995, Applied Finance has systematically performed and archived for research purposes over 20,000,000 individual company intrinsic value estimates. Each valuation is performed utilizing Applied Finance’s proprietary research into: corporate performance, risk, and competition.

Applied Finance’s ongoing research database provides the foundation to link valuation research to portfolio construction and its ongoing market research to expand our knowledge into how markets reward and punish firms. To our knowledge, only Applied Finance has a live database of individual firm valuations constructed in the same manner with the same valuation framework. This constitutes Applied Finance’s core Analytic Advantage.

Research is a critical part of Applied Finance’s culture. The Applied Finance team includes a mix of financial analysts, quants, database engineers, and programmers. 100% of the firm is employee owned by 10 key partners representing every department. It’s two co-founders Rafael Resendes and Daniel Obrycki met while obtaining their MBA at the University of Chicago. Both are still at the helm of Applied Finance

EXPERIENCED RESEARCH TEAM BUILT ON ACCOUNTABILITY, RESPECT AND TRUST



ANALYTICAL ADVANTAGE: REMOVING MARKET NOISE

A corporate performance metric should provide insights into what a firm is worth. Most money managers utilize common earnings-based measures of corporate performance and value, which are suspect and easy to manipulate. Applied Finance developed the Economic Margin (EM) framework to remove the noise inherent in accounting data to properly measure the return a company earns above or below its cost of capital. The EM framework incorporates the investment needed to generate the earnings, risk, cost of capital, growth, inflation, cash flow and the economic reality of competition.

While there are countless firms relying on rudimentary "Value" metrics, only Applied Finance has a 20 year and growing Economic Margin database, providing unique and actionable insights into over 20,000 company's underlying economic vitality and Intrinsic Value.

Exhibit 1: Most investors assume that higher earnings growth rates correspond to higher P/E multiples. However, regardless of how well a firm performs as measured by earnings growth, the market appears indifferent to such growth in assigning a firm's P/E.

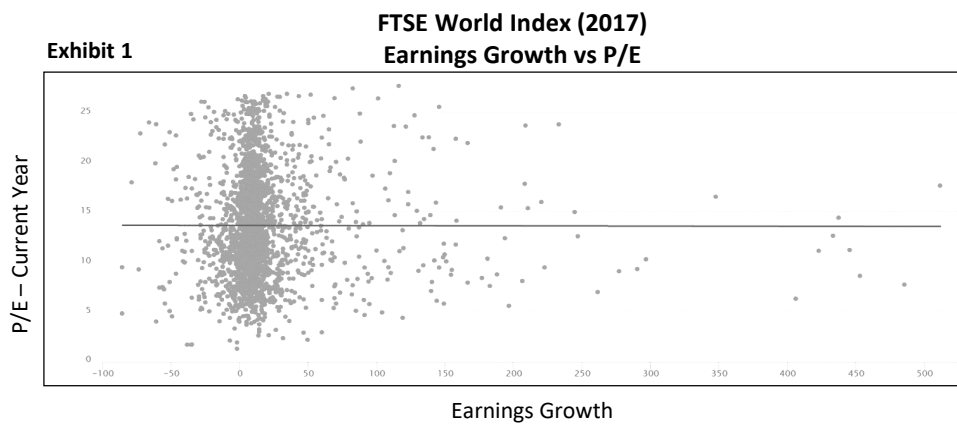
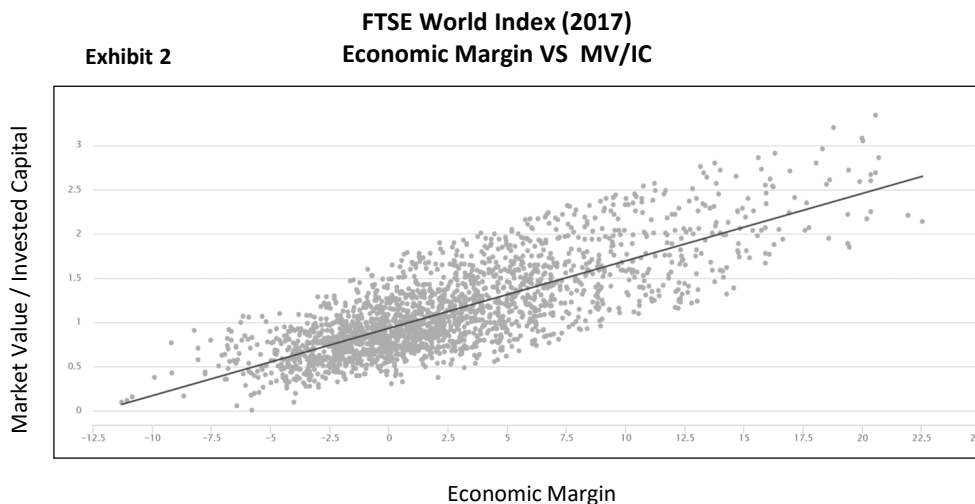


Exhibit 2: Because EM corrects accounting distortions by taking into account a company's: Risk, Asset Life, Asset Mix, Asset Age, Capital Structure and Growth, effectively linking the income statement and balance sheet, EM levels have a much higher correlation with market Values.



By evaluating corporate performance for each company in the FTSE World Index from an EM perspective, we can clearly see that the market is willing to pay a higher multiple for companies that are generating higher EM's.

Analytical Advantage: Consistency and Objectivity

Applied Finance’s Economic Margin framework, provides a consistent, clear, and objective approach to understand a firm’s wealth creation across time and countries.

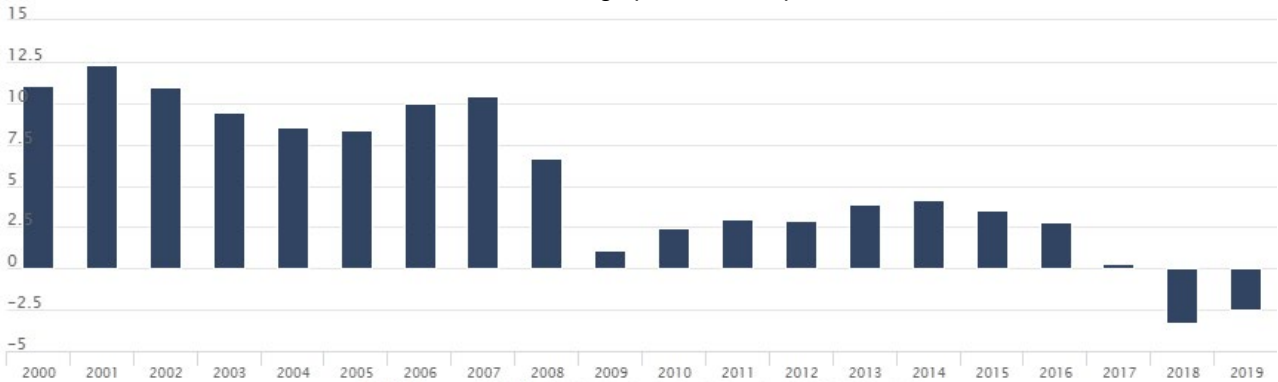
The Applied Finance Wealth Creation Report, prepared on 20,000 firms globally, provides our analysts and portfolio managers a clear look into how companies are deploying their assets and whether they should trade at premiums or discounts to their book value. For example, as shown in the chart below, since 2001 GE’s Economic Margins have been on a steady decline, despite increases in accounting earnings over much of this period. Consistent with this insight, it is no surprise the stock has dramatically underperformed the market since then.

General Electric Company (GE) | Comp Grade: **F** | Inv Grade: **F** | Ind: Industrial Elec. Eq. | Sec: Capital Goods | Mkt Cap Mil: \$ 69,063.04 USD

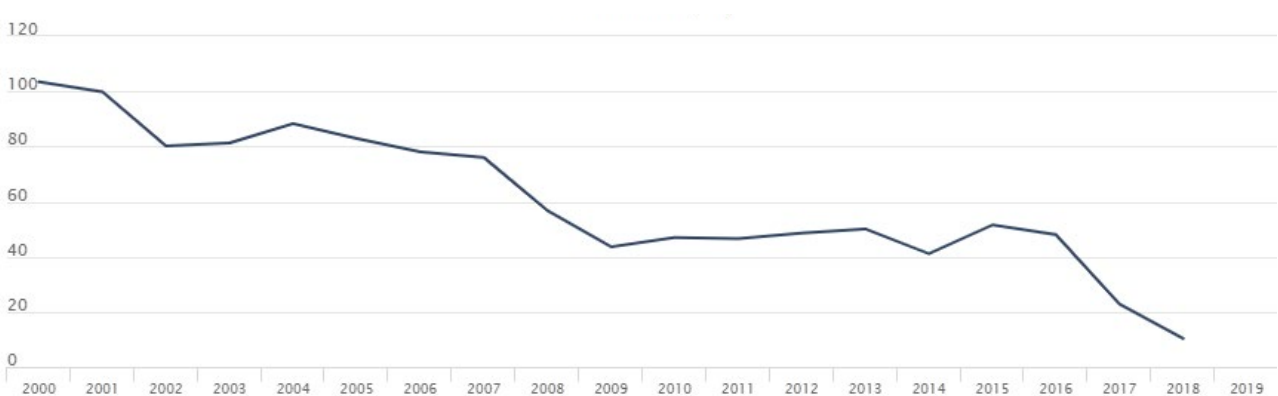
[VE](#) [Portfolio Peek](#)

Valuation		Quality		Momentum	
F	F	F	A	F	F
Intrinsic Value: Current	EM + 1 Change	Management Quality	Earnings Quality	EM Momentum	Price Momentum
Global Sector Rank: 16 Country Sector Rank: 21	Global Sector Rank: 6 Country Sector Rank: 6	EM+1: -3.33 Asset Growth LFY: 14.26% Wealth Destroying	Global Sector Rank: 2 Country Sector Rank: 2	EM Momentum: -10.31%	Global Sector Rank: 13 Country Sector Rank: 5

Economic Margin (Wealth Creation)



Return vs Market



Analytical Advantage: Valuation Driven

All of Applied Finance's portfolios are Valuation Driven, which differs significantly from a "value" perspective. To gain a better understanding into Applied Finance's Valuation Driven approach, let's first review traditional approaches to "Value".

The traditional approaches to finding undervalued stocks use a simple ratio such as P/E or P/B, or a mix of them. These common approaches to value come with many shortcomings:

- They Rely on noisy accounting data
- They look at a static point in time, assuming world stays constant.
- There is no link to Intrinsic Value. Having a low multiple might just mean the stock is in financial distress.
- They are commodity factors, available to everyone on Yahoo! Finance.

Efforts made by well intended managers using traditional Discounted Cashflow Models (DCF) have their own shortcomings:

- Perpetuity assumptions Ignore the fact that companies will face competition
- Such models are highly sensitive to changes in discount rates or growth rates, leading to drastic variance in values
- Up to 70% of NPV of estimated cashflows typically come from perpetuity assumptions,
- Growth, Risk, and Competition estimates are subjective and inconsistent from one analyst to another.

With this in mind, nobody should be surprised by the fact that the majority of money managers underperform.

In contrast, Applied Finance's Valuation Driven approach is distinctly different and superior.

Unlike traditional valuation approaches that utilize highly sensitive perpetuity assumptions, the Applied Finance approach incorporates the widely accepted economic reality of competition by gradually decaying Economic Margins to zero. This essentially eliminates the excess spread a firm generates above or below its cost of capital to then discount those cashflows without a perpetuity.

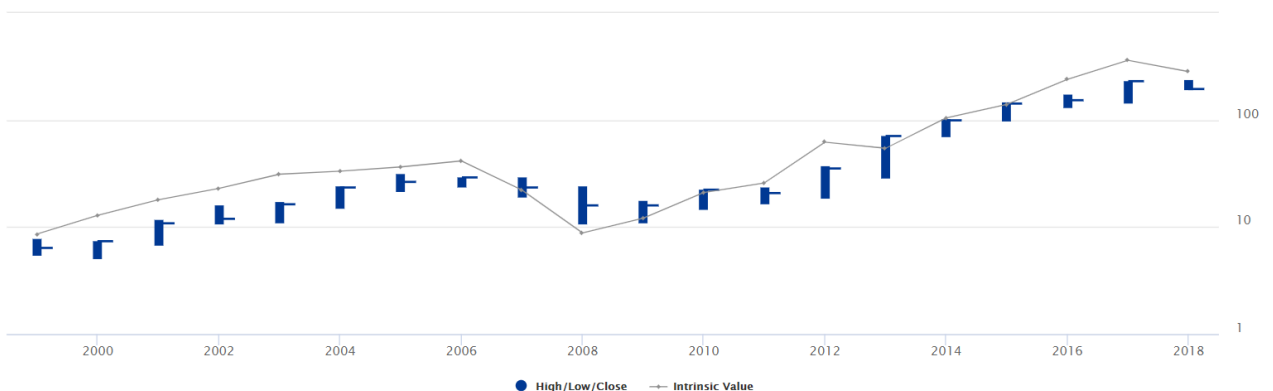
Applied Finance summarizes this information in their Intrinsic Value report, which is available for 20,000 companies worldwide. Below is an example intrinsic value report of Constellation Brands, which has traded below its intrinsic value and has been a holding in the Valuation LC 50 portfolio.

Constellation Brands, Inc. (STZ) | Comp Grade: A | Inv Grade: A | Ind: Food Processing | Sec: Consumer Non Durable | Mkt Cap Mil: \$ 37,082.88 USD

VE

Portfolio Peek

Intrinsic Value



Applied Finance has estimated an intrinsic value for each company in its database, on a weekly basis for over two decades, leading to over 20,000,000 company specific valuations. This rich research asset enables Applied Finance to better understand its investment decisions relative to other investment managers. It's an Analytical Advantage no other firm comes close to replicating.

While others chase returns, Applied Finance knows that patience is required for the valuation gap to close.

Analytical Advantage: Equity Insights - Over 20 Years Of Live Research

It's difficult to distill the vast amount of equity insights we have gained through the years, but five deserve highlighting.

Valuation - Bubbles eventually pop, as buying assets below intrinsic value eventually leads to outsized returns

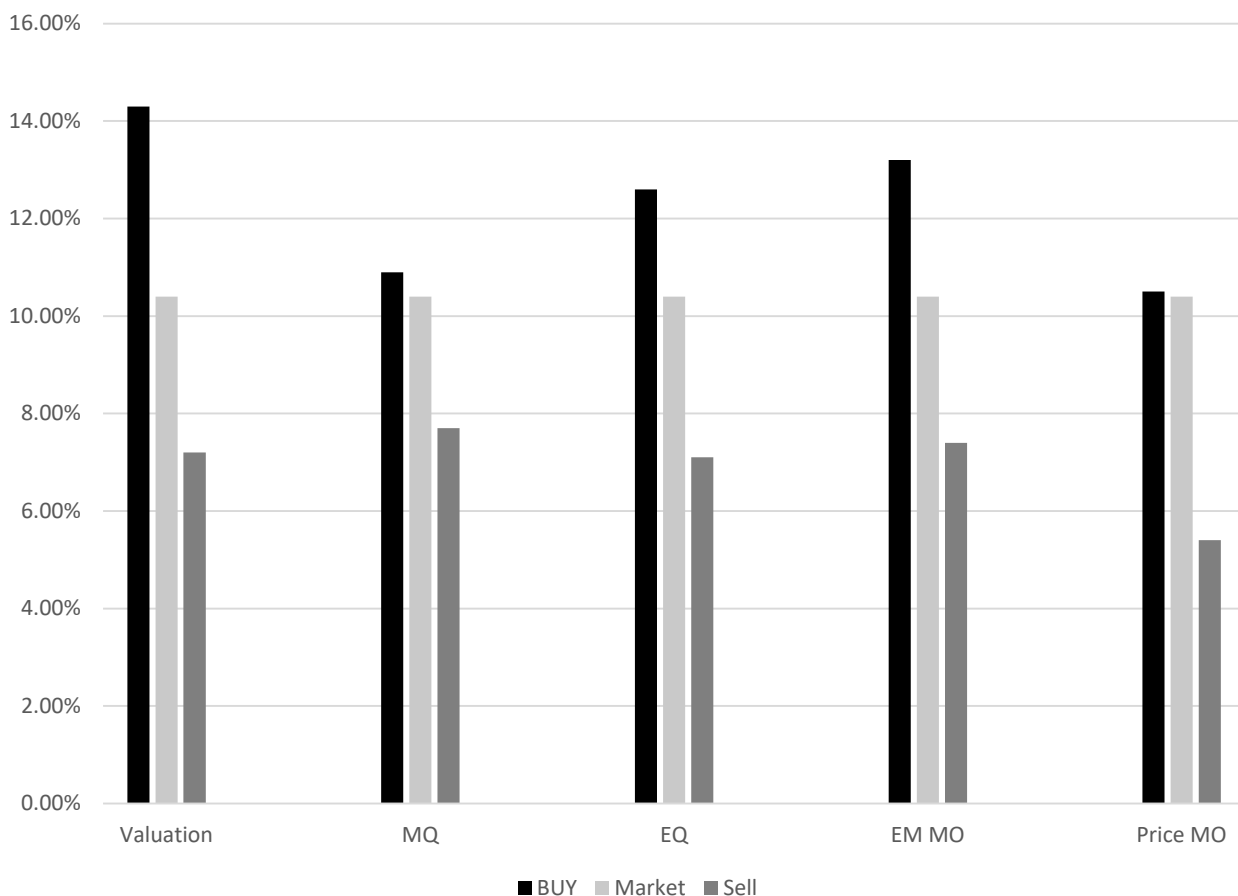
Management Quality (MQ) - Avoid management teams that pursue wealth destroying strategies

Earnings Quality (EQ) - Avoid companies with poor earnings quality

Economic Momentum (EM MO) - Identifying companies exhibiting improving economic performance

Price momentum (Price Mo) - Identifying companies with positive long-term investor sentiment

Applied Finance Buy/Sell Variables vs Market



The singular focus of Applied Finance Capital Management is to harness its research insights and create equity portfolios through its Valuation Driven Investing process to outperform chosen benchmarks.