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# Drawing Capital

# Exponential Growth Opportunities

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# drawingcapital

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## Exponential Growth Opportunities

Presented by:

Sagar Joshi and Jugal Lodaya



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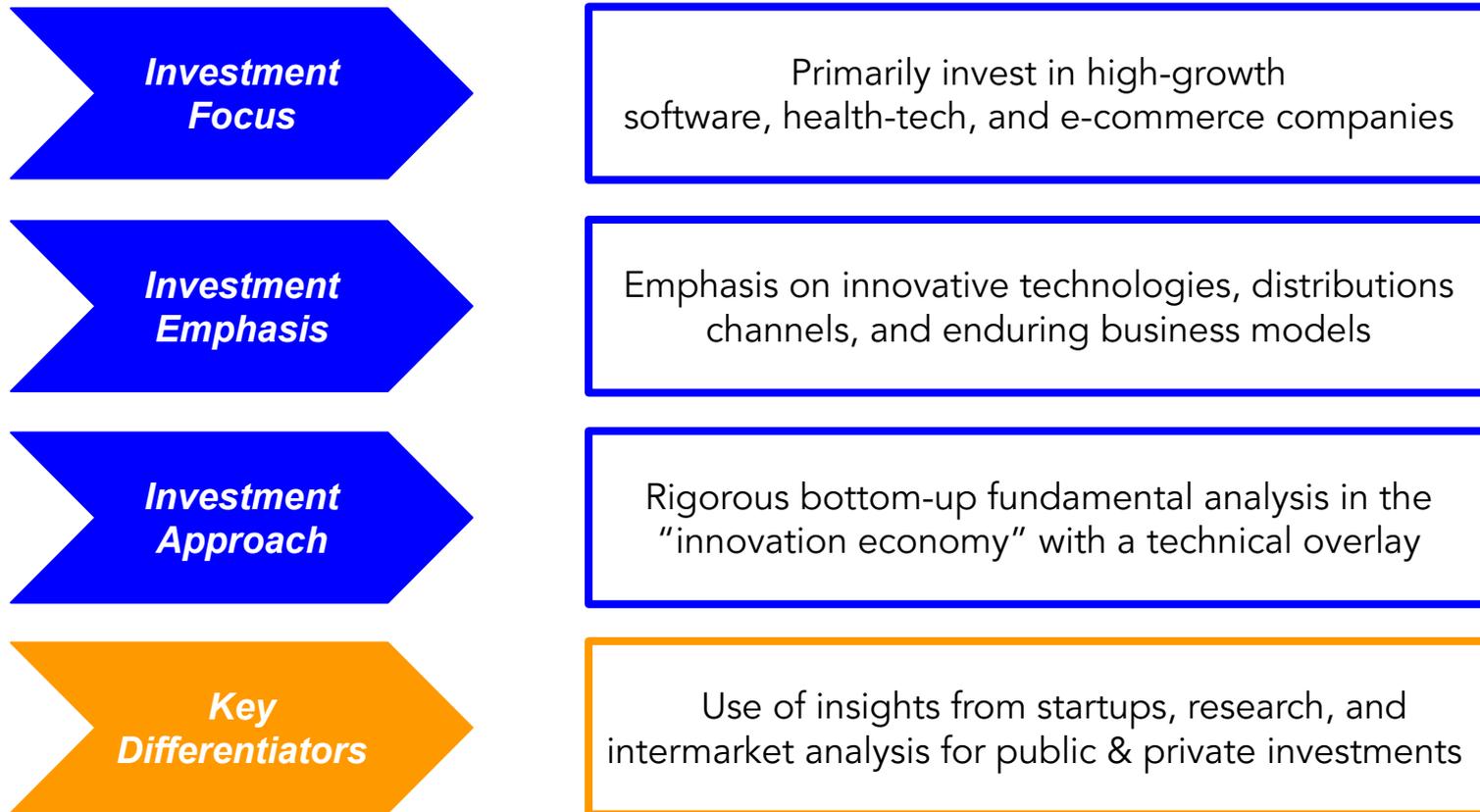
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# About Drawing Capital



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for Evaluating Companies



Summary & Resources



## Power Laws

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- Relationship between Power Laws and Investment Returns
- Distribution of Returns
- Slugging Percentage vs. Batting Average
- Investor Implications for Understanding Power Laws

## Academic Research Supports “Power Law Investing” in Equities

\$75.7T

“The top-performing 2.4% of firms account for all of the \$75.7 trillion in net global stock market wealth creation from 1990-2020”.

5

“Five firms with the largest wealth creation during the January 1990 to December 2020 period (Apple, Microsoft, Amazon, Alphabet, Tencent) accounted for 10.34% of global net wealth creation”.

55.2%

“55.2% of US stocks underperform one-month US Treasury bills in terms of compound returns over the full sample”.

2.39%

“The best performing 159 firms (0.25% of total) accounted for half of global net wealth creation. The best performing 1526 firms (2.39% of total) accounted for all net global wealth creation”.

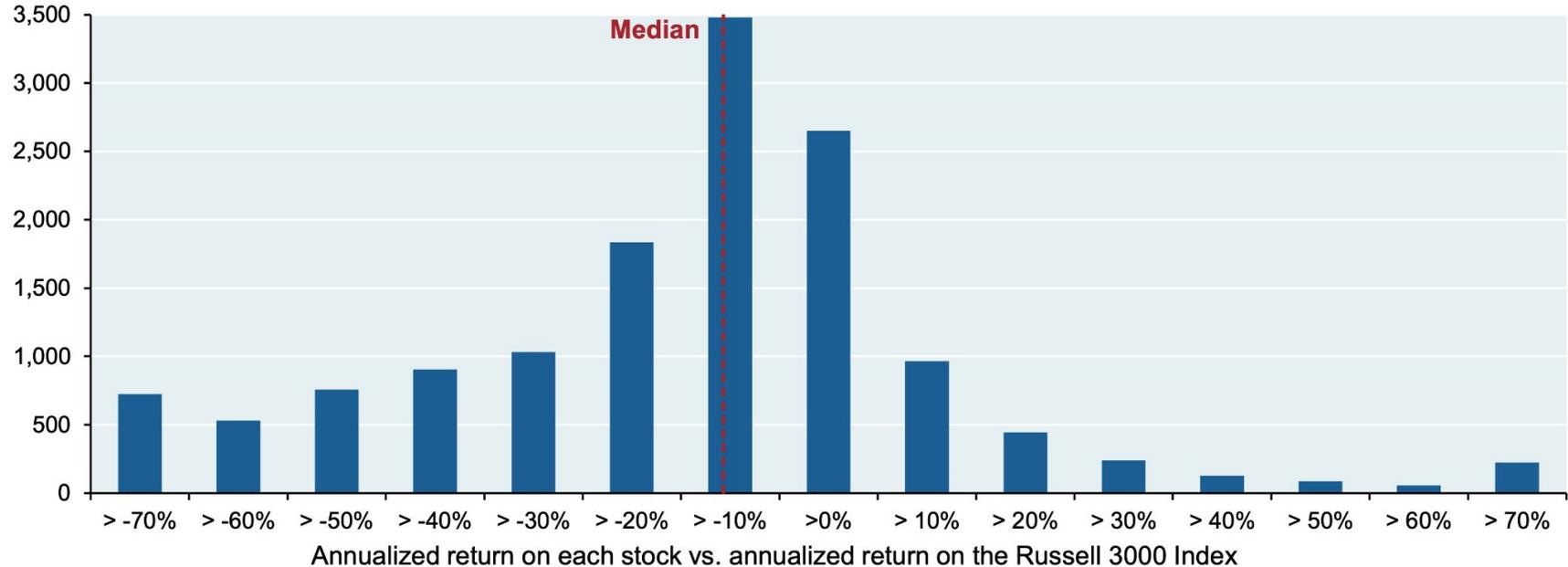
*The Key Conclusion: Wealth Creation in the Stock Market is Highly Concentrated*



# Historically, the Winners Generate Large Excess Returns While the Median Stock Underperforms the Russell 3000 Index

## Distribution of excess lifetime returns on individual stocks vs. Russell 3000, 1980-2020

Number of stocks



Source: FactSet, Bloomberg, J.P. Morgan Asset Management. September 2020.

Additional Source: J.P. Morgan Asset Management's "Eye on the Market" Report Published on March 15, 2021.

Source Link: <https://privatebank.jpmorgan.com/content/dam/jpm-wm-aem/global/pb/en/insights/eye-on-the-market/agonny-ecstasy-2021.pdf>.

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# Baseball Analogy: Slugging Percentage vs. Batting Average

Number of Investments	Dollars Invested	Return on Investment	Multiple on Invested Capital	Dollar Value (=Multiple on Invested Capital * Dollars Invested)
2	\$2	30%	1.3x	\$2.60
5	\$5	20%	1.2x	\$6
2	\$2	0%	1x	\$2
1	\$1	-50%	0.5x	\$0.50
Totals				
<i>10</i>	<i>\$10</i>			<i>\$11.10</i>

**Batting Average:**  
Investing for Recurring Return

**Slugging Percentage:**  
Investing for Growth

Number of Investments	Dollars Invested	Return on Investment	Multiple on Invested Capital	Dollar Value (=Multiple on Invested Capital * Dollars Invested)
1	\$1	900%	10x	\$10
1	\$1	200%	3x	\$6
1	\$1	0%	1x	\$1
7	\$7	-50%	0.5x	\$3.50
Totals				
<i>10</i>	<i>\$10</i>			<i>\$20.50</i>



# Investor Implications in Power Laws

1

Few Portfolio Positions  
Generate Significant  
Portfolio Returns

2

Winner-Take-Most  
Environment for  
Business Categories

3

Finding & Investing in  
Legendary and Enduring  
Enterprises is Lucrative

4

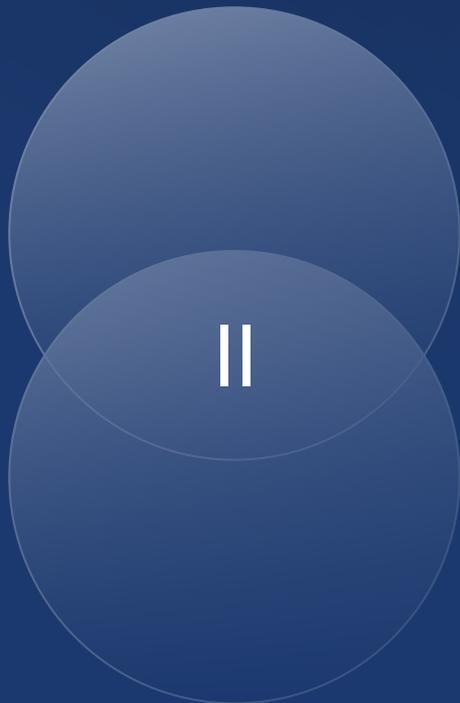
Positive Asymmetric Returns  
Create Favorable  
Risk-Reward Profiles

5

“Power Hours” in  
Investment Research

6

Size of the Prize  
Matters a Lot



## Finding 10X Opportunities

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- Circles of Excellence & Expansion
- Apple Case Study
- High-Growth Triangle
- 10-Step Framework for Seeking 10X Investment Opportunities

# Pathway for Circles of Excellence & Expansion





# Don't Lose Sight of the Forest from the Trees: Apple Case Study

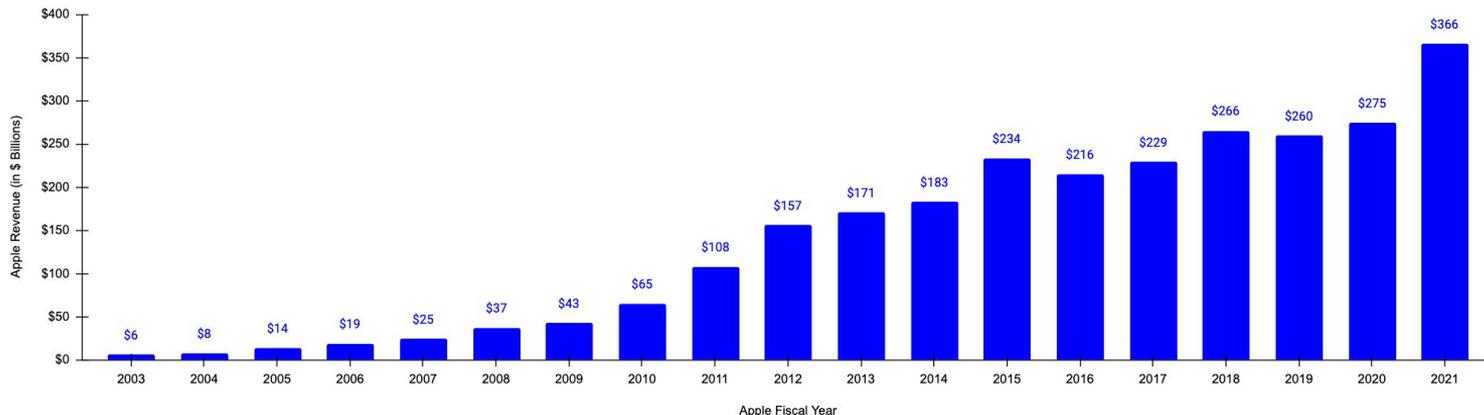
~53%

Historical Probability of a Positive Return in a Single Trading Day for Apple's Stock Price, 2012-2021

1200%+

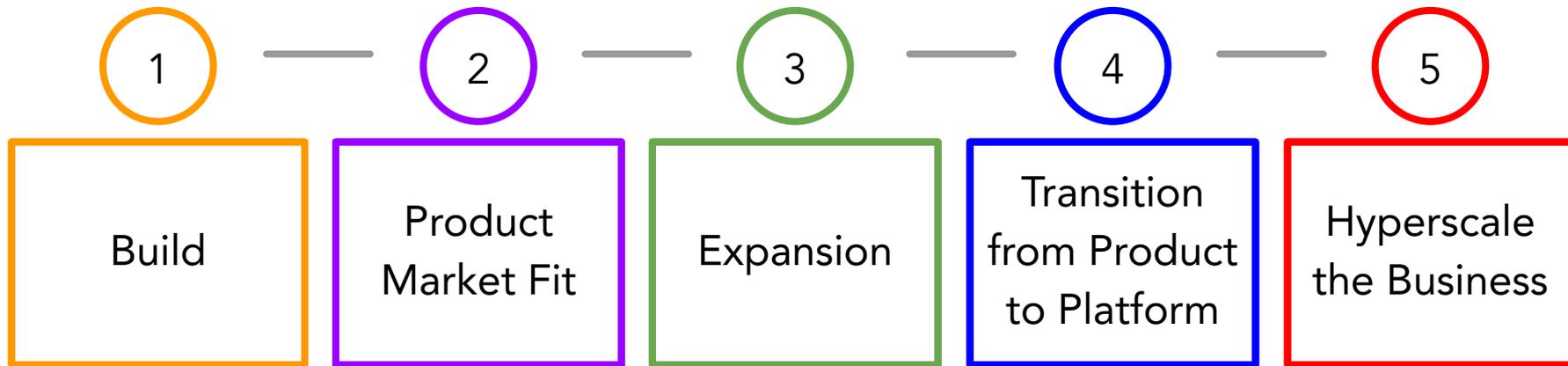
Cumulative Percentage Gain in Apple's Stock Price, 2012-2021

Apple's Revenue Grew from Over \$36B in FY 2008 to Over \$360B in FY 2021



Data Source: Koyfin. Data is measured from 2012-2021 for stock price data (\$AAPL). Data is measured for FY 2003-FY 2021 for revenue data. Any stock, options or futures symbols, companies or investment products displayed are for illustrative purposes only and are not intended to portray recommendations. Past performance is not necessarily indicative of future results.

## Business Strategy: "Circles of Excellence & Expansion"

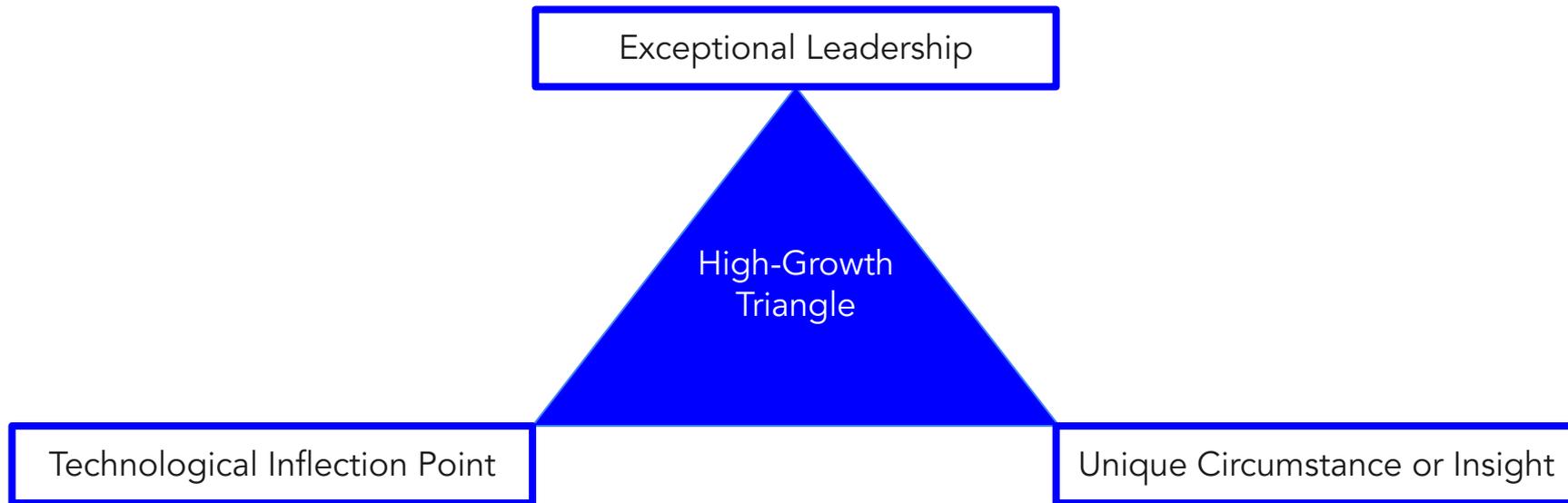




# The 5 Steps in “Circles of Excellence & Expansion”

- 1 Build: Build 1 product that becomes a category leader
- 2 Product Market Fit: Improve the product offering over time to improve sales, create better customer experiences, and reply to customer feedback. Pivot or improve the product approach until strong product market fit is achieved.
- 3 Expansion: Based on positive customer feedback and customer demand, earn the right to expand the product offering and/or form new concentric circles.
- 4 Transition from Product to Platform: Transform ideas into products and a suite of products into a platform. Platforms with positive network effects and a virtuous data cycle can benefit from accumulating business advantages at scale.
- 5 Hyperscale the Business: Pursue growth opportunities. Continue to develop and improve product quality, business sales cycles, talent acquisition & retention, and corporate capital allocation decisions. Make thoughtful decisions about building products in-house vs. buying other companies.

# Identifying Exponential Opportunities: The High-Growth Triangle





# 10-Step Framework for Seeking Potential 10x Investment Opportunities

10X Improvement over Incumbents

Market Share & Total Addressable Market

High Team Quality & High Product Quality

Economies of Scale with High Contribution Margin

Financial Metrics, Revenue Growth, and Growth Endurance

Idea >> Product >> Platform

Network Effects & Virtuous Data Cycle

Branding

Distribution Channels & Hyperscale Capabilities

Unique Circumstance or Contrarian Insight



## Power of Compounding Returns

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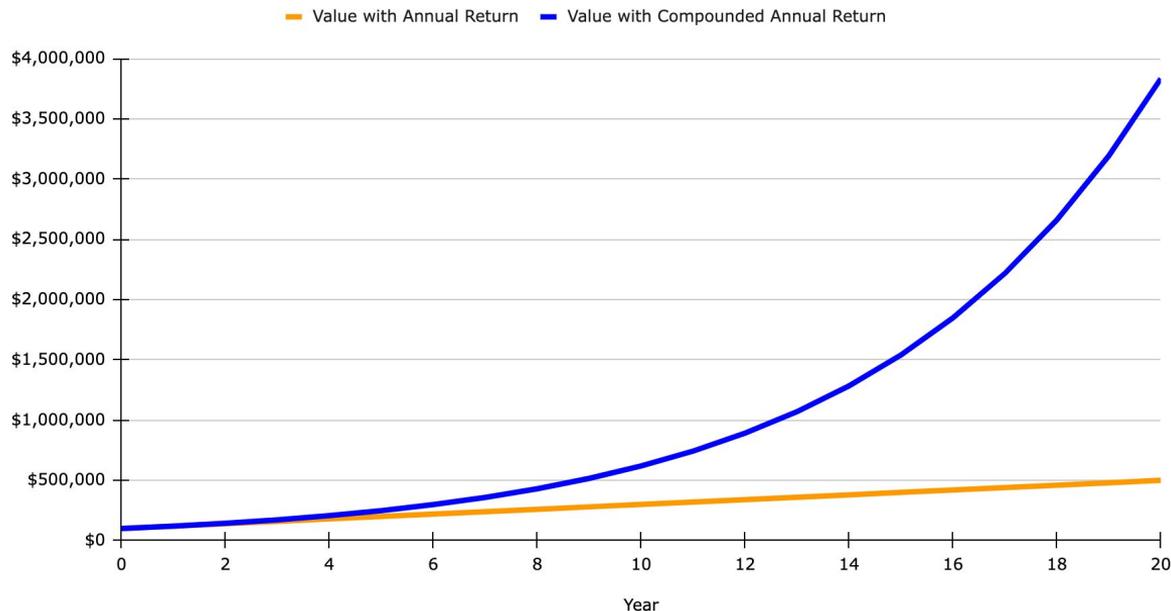
- Higher compounded returns lead to higher investment multiples and enable less sensitivities for saving and more emphasis on growth & lifestyle enjoyment.
- Companies with higher revenue growth rates have historically experienced higher stock price appreciation.
- Only a select group of companies in the S&P 500 Index have annualized revenue growth rates that exceeded 25%+ in the past 5 years.
- We present 2 case studies for comparing linear returns versus compounding returns.

# Case Study: Compounding Return vs. Linear Return

Example: \$500K vs. ~\$3.8M

## The Value of Compounding: Linear Annual Return vs. Compounded Annual Return

Hypothetical Example: Initial \$100K Investment with a 20% Return Over 20 Years



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## Case Study: Power of Compounding

Which do you prefer: 5 cents compounded daily at 5% for 1 year or \$2M in 1 year?

~\$2.7M

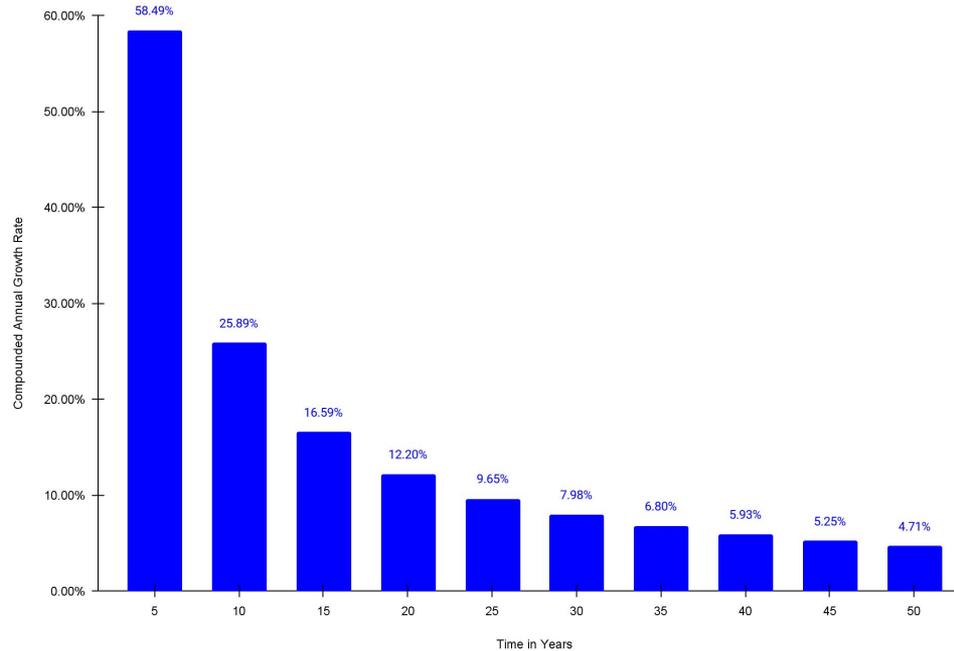
5 cents compounded at 5%  
daily for 1 year

\$2.0M

\$2 million in 1 year

# There is an Inverse Relationship Between CAGR and Investing Time Horizon for Generating the Same Dollar Return

The required annual growth rate to transform \$100K into \$1M based on varying investing time horizons.

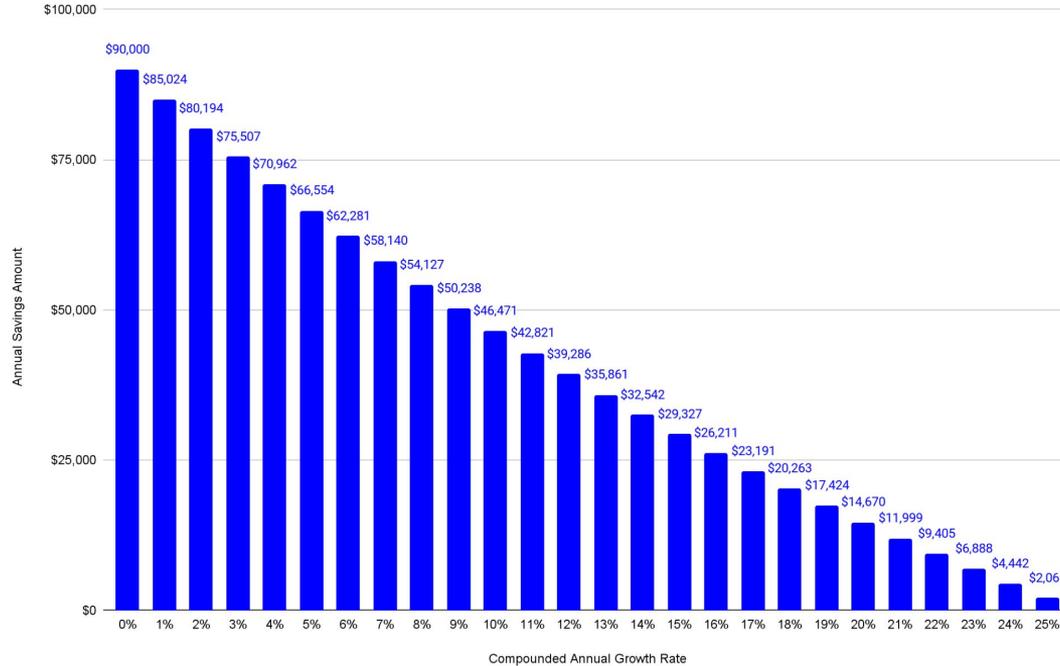


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# Inverse Relationship Between Required Savings & Compounded Growth

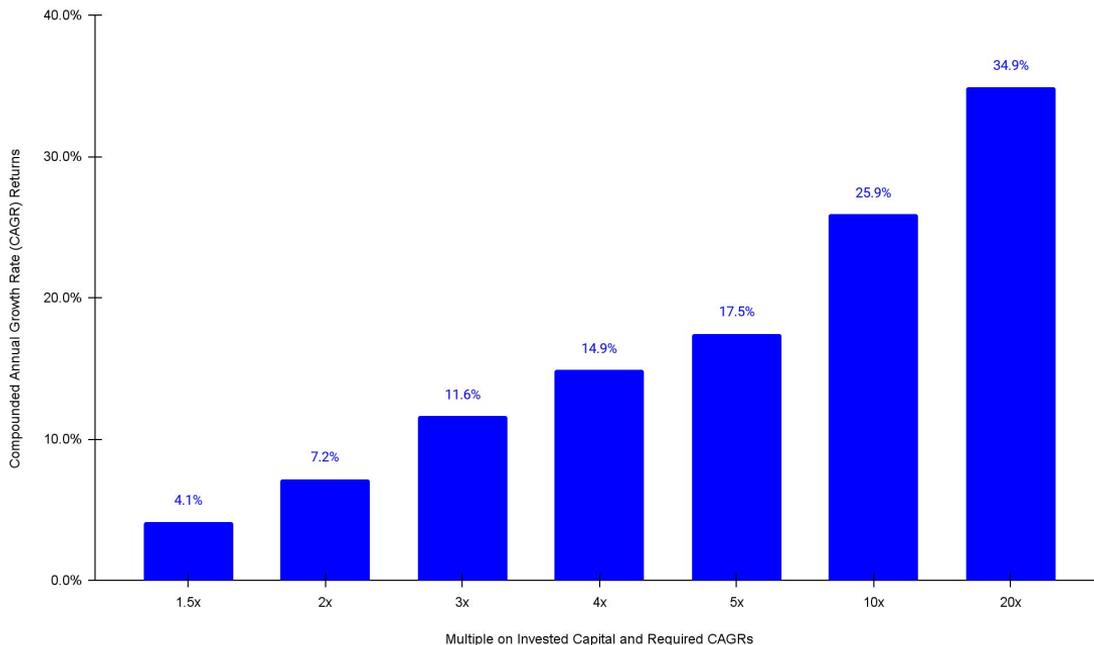
Minimum annual savings to transform \$100k into \$1M in 10 years based on varying annual growth rates.



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# Positive Relationship Between Higher CAGR and Higher MOIC

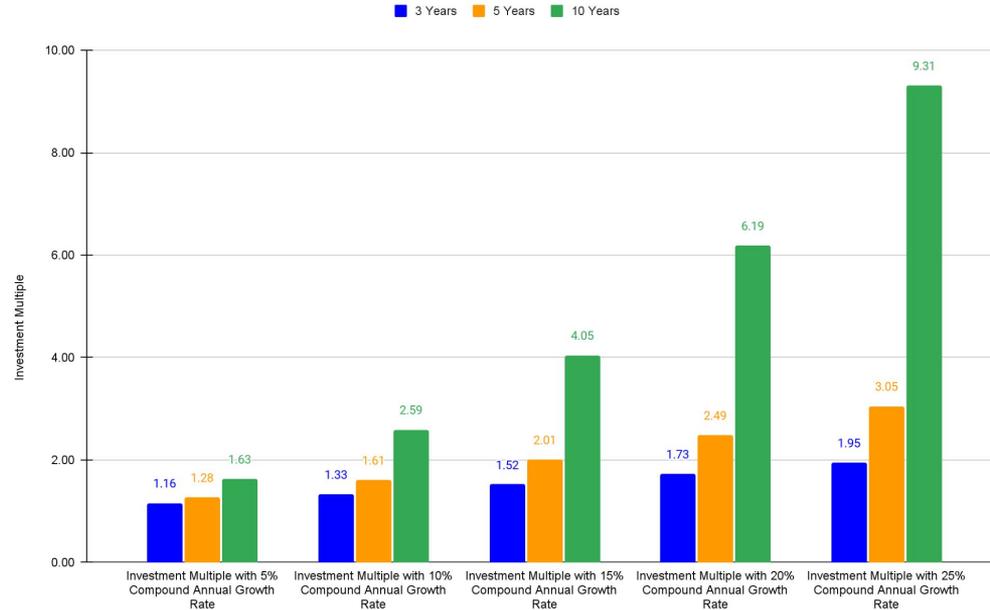
The following chart displays the required CAGR that is needed to achieve the desired MOIC in 10 years.



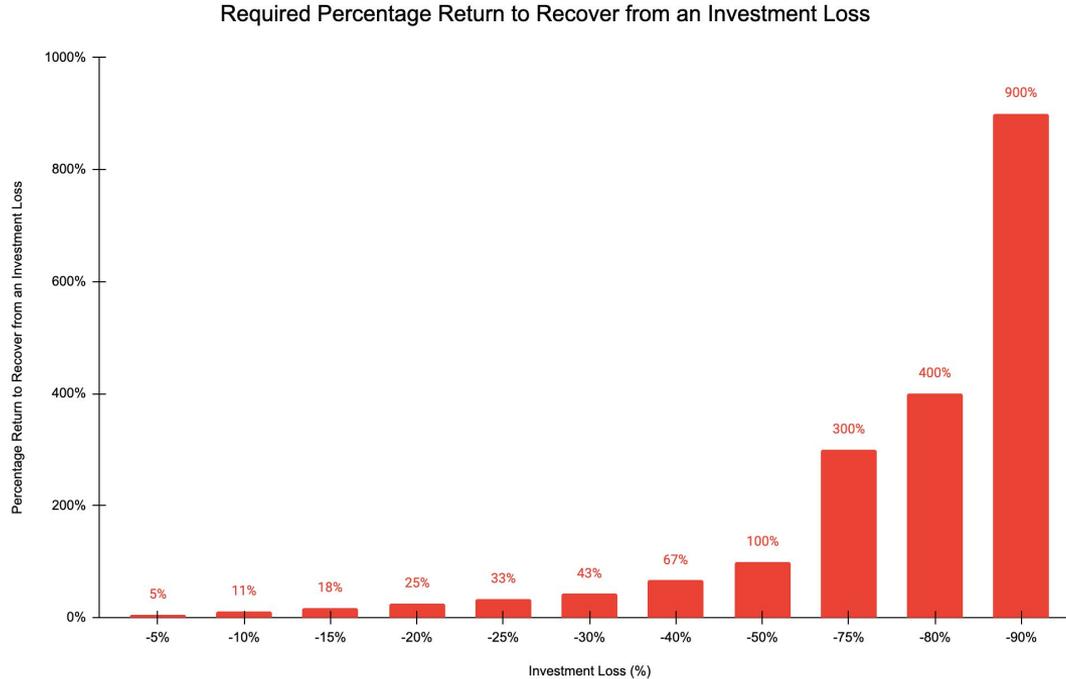
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# MOIC and Compounding Returns Over Long Time Periods: A 15% CAGR for 10 Years Leads to a 4x Gain

Investment multiple increases with more years of compounding positive returns over 3, 5, and 10 years. Higher annual growth rates in returns lead to higher investment multiples.



# Loss Recovery and Breakeven Analysis: Larger Percentage Losses Require Larger Percentage Gains to Breakeven

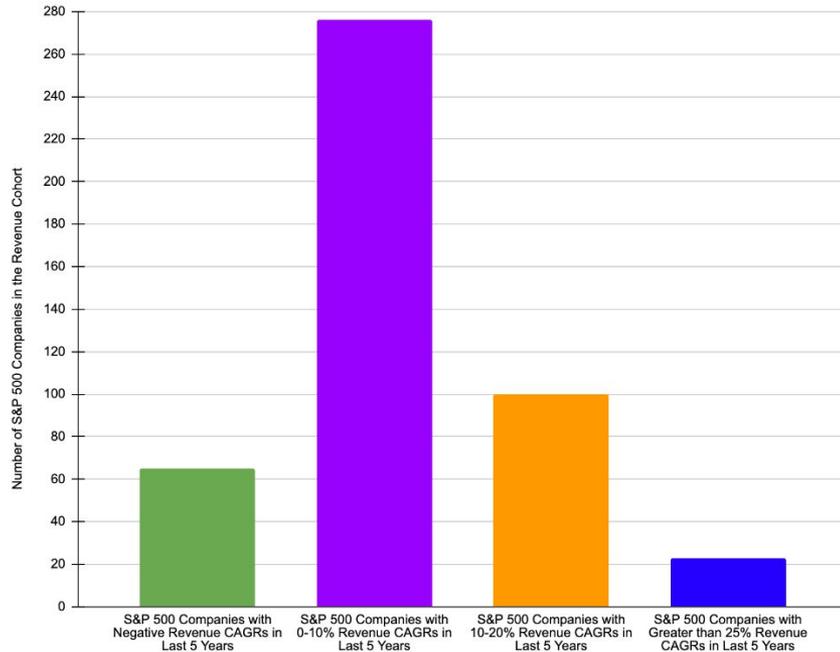


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# Revenue Cohort Analysis for Companies in the S&P 500 Index: Companies with Higher Revenue Growth Often Experienced Higher Stock Price Appreciation

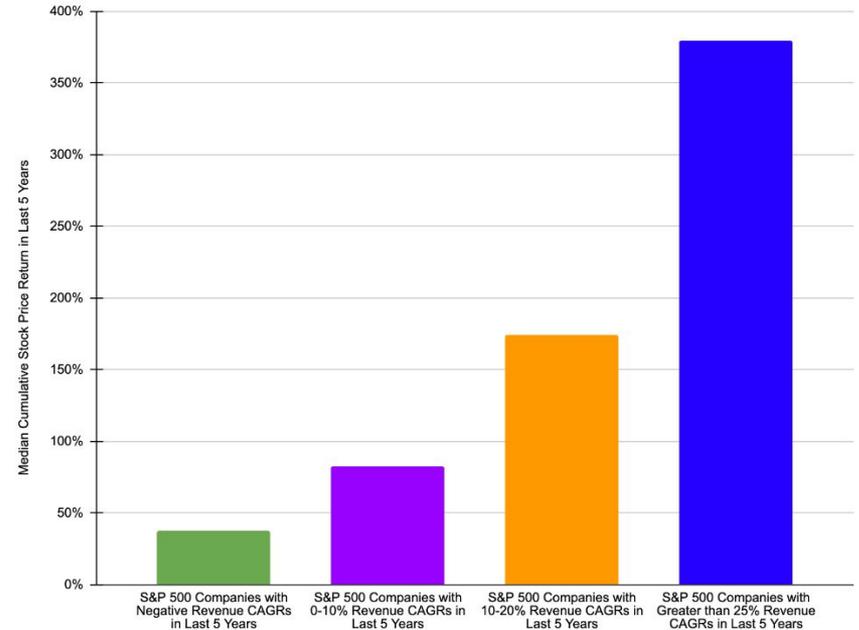
Less than 5% of S&P 500 Companies have 5-Year Revenue CAGRs that Exceeded 25%

Chart by Drawing Capital. Data is sourced from Charles Schwab as of February 18, 2022



Median Cumulative Stock Price Return for Revenue Cohorts for S&P 500 Companies: Positive Correlation Exists between 5-Year Revenue CAGRs and 5-Year Median Cumulative Stock Price Appreciation

Chart by Drawing Capital. Data is sourced from Charles Schwab as of February 18, 2022



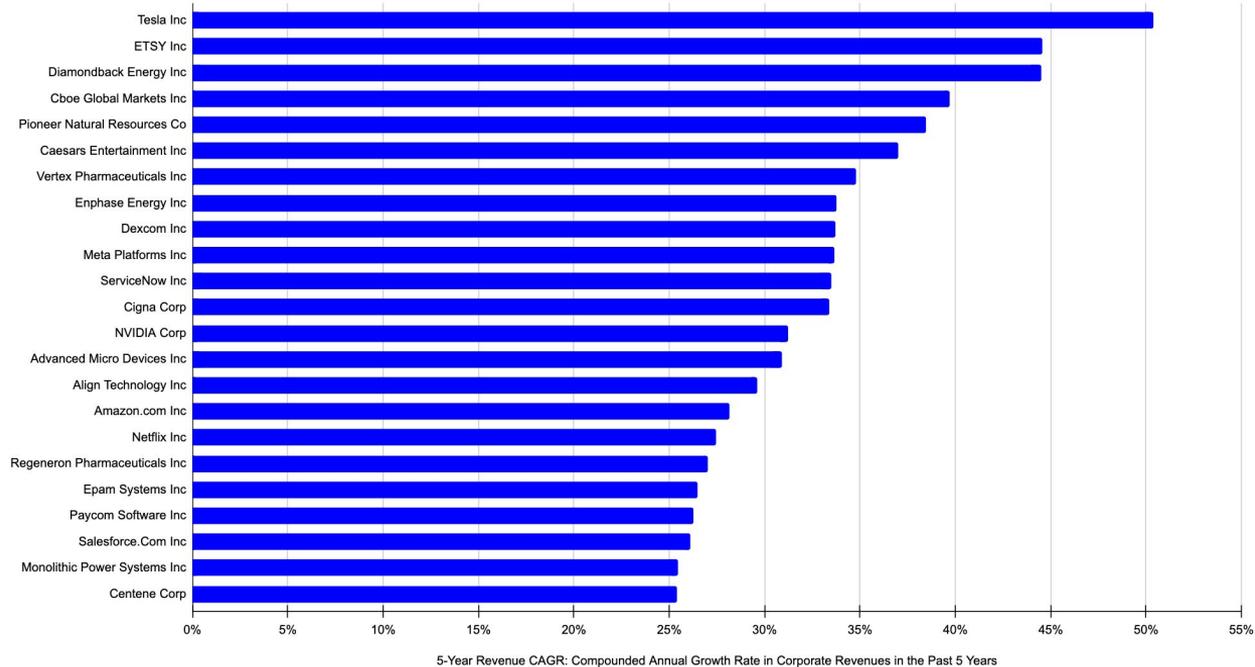
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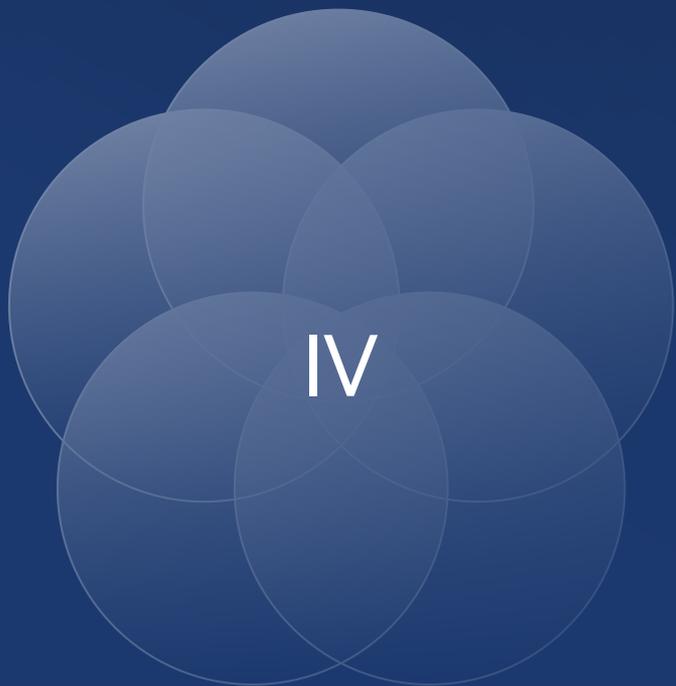
# Only 23 Companies in the S&P 500 Index Have 25%+ 5-Year Revenue CAGRs

Only a Select Group of 23 S&P 500 Companies have Revenue CAGRs that Exceed 25% in the Past 5 Years

Chart by Drawing Capital. Data is sourced from Charles Schwab as of February 18, 2022



Data is sourced from Charles Schwab. Any stock, options or futures symbols, companies or investment products displayed are for illustrative purposes only and are not intended to portray recommendations. Past performance is not necessarily indicative of future results.

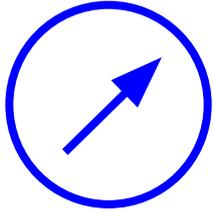


## Data-Informed Investment Decision Framework for Evaluating Companies

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- What are 7 questions that are useful in evaluating companies?
- How do companies benefit from stock price appreciation?
- How can we identify companies with business moats and competitive advantages?

# 3 Traits to Understand if a Business Has a Moat with a Competitive Edge



Competitive Win Rate &  
Strong Customer Retention

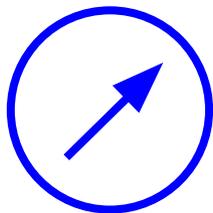


Pricing Power for  
Advantaged Business Models



Returns on  
ROE & ROIIC

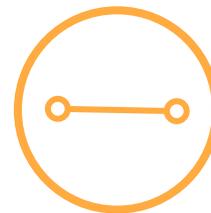
# 1. Is This Business Growing?



Revenue Growth Rate



Growth in Operating Cash Flow & Earnings Per Share



Revenue Growth Endurance

## 2. What is the Company Earning from its Capital Base?

1

Return on Invested Capital  
(ROIC)

2

Asset Turnover Ratio &  
EV / Revenue Ratio

3

Operating Cash Flow /  
Asset Ratio

4

EV / EBITDA Ratio

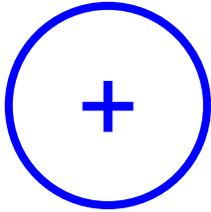
5

Rule of 40

6

Hurdle Rate Achievement

### 3. Is the Company Benefiting from Increasing Its Size & Benefiting from Scale?



Increasing ROIC and  
FCF Yield Over Time

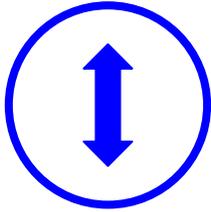


Increasing Asset Turnover  
Ratio and Operating  
Cash Flow / Asset Ratio



Economies of Scale with  
Margin Expansion &  
High Contribution Margin

## 4. Is the Company Increasing Its Market Share or Have Market Share Dominance?



Competition, Oligopoly, or Monopoly Business



Rising Margins Over Time



Rising Revenue/TAM Ratio



## 5. Does the Company Make Best-In-Class, High-Quality Products that Consumers Enjoy?

1

Revenue / S&M Ratio &  
Sales Efficiency

2

High Net Promoter Score

3

High Net Dollar Retention  
or Same Store Sales Growth

4

Viral Word-of-Mouth  
Marketing

5

Favorable Industry Rankings

6

Top 3 Product in the  
Industry Vertical

## 6. What is the Quality of the Corporate Leadership Team?

1

Founder's Edge

2

Significant Ownership

3

Quality Capital Allocation

4

Shareholder-Friendly

5

Pursuit of Excellence & High  
Competence

6

Alignment of Incentives



## 7. Are You Buying a High Quality Company at a Reasonable Price?

1

Underwriting Investments  
with High Rates of Return

2

Revenue and Cash Flow  
Payback

3

Future Cash Flow Potential

4

Price Multiples &  
Discounted Cash Flow  
Analysis

5

TAM Expansion

6

Business Moat with  
Perceived Margin of Safety

# How Companies Benefit from Stock Price Appreciation

1

Ongoing Secondary Share Issuances

2

Recruiting and Retaining Talent with Cash Preservation

3

Share-Based M&A

4

Free Marketing, Branding, and Publicity

5

Conversion of Convertible Debt Reduces Total Debt

6

Ancillary Benefits, such as Index Inclusion & Gov't Tax Revenue

# Summary

- 1 Data-informed decision-making creates a framework for allocating investments in a portfolio. Successful investing is about identifying, investing in, and correctly sizing good investments in a portfolio.
- 2 Most investment returns are not equally distributed. Power laws are prevalent in investing (particularly in equity investments and in the distribution of venture capital returns), and understanding them can improve efficiency in investment research & productive output in investment returns.
- 3 Exponential growth is a powerful force. Higher compounding returns lead to higher investment multiples over time. There exists a correlation between high revenue growth & cash flow and stock price appreciation.
- 4 The outcomes from growth investing and investing in innovative technologies can be spectacularly significant, especially when maintaining a long-term investment focus.
- 5 Equity markets are not zero-sum. Multiple stakeholders such as companies, employees, governments, and shareholders can benefit from a rising stock price.

## Resources



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