

Is this exceptional?

The five structural tests behind the Exceptional Company Series — what to actually check on a filing, not just what the test is called.

BEFORE THE FIVE TESTS

CLASSIFY IT FIRST

Fast grower, steady compounder, cyclical, turnaround, or asset play — the five tests do not mean the same thing across types.

ONE SENTENCE

Say what it does. If you cannot, you do not know it well enough to hold it through a fall.

NAME THE MOAT

Switching cost, network effect, scale, brand, regulation. “Great business” is not a moat; saying how is.

THE FIVE TESTS

1 Compounding is growth real, and repeatable?

- ☐ 10+ years of earnings history, not two or three good ones
- ☐ The CAGR over the whole period, not just trailing twelve months
- ☐ The % of periods with earnings up, not just the average growth rate
- ☐ The worst drawdown in earnings (not the share price)

2 Earnings quality cash-backed, or engineered?

- ☐ Does free cash flow track reported earnings, or diverge from them?
- ☐ The margin trend — expanding, stable, or eroding?
- ☐ How much of “earnings” is one-offs — buybacks, tax credits, asset sales?

3 Balance sheet could it survive a bad decade?

- ☐ Net debt to equity — low, or net cash?
- ☐ Interest coverage — how many times over can operating income pay the interest?
- ☐ Would a real recession break it, or just slow it down?

4 Capital allocation is the cash deployed sensibly?

- ☐ Where does free cash go — reinvestment, dividends, buybacks, debt paydown?
- ☐ Track record on acquisitions — value-additive, or empire-building?
- ☐ Are buybacks made below or above what the business is actually worth?

5 Per-share value does the compounding reach the shareholder?

- ☐ Is the share count shrinking (buybacks) or growing (dilution)?
- ☐ Does EPS growth match net income growth, or is share count doing the work alone?

AFTER THE FIVE TESTS

WHAT WOULD HAVE TO GO WRONG

Name the bear case before you are in the position, not after.

EXCEPTIONAL ≠ CHEAP

“Good business” and “good price” are two separate questions. This checklist only answers the first.