# The words this site actually uses.

27 terms that appear across our company pages and fact sheets, defined in plain English — and, where it applies, what we look for in each. Not a finance dictionary: this is the vocabulary of one publication, so a term you meet on one of our pages is the term you will find here.

## READING THE NUMBERS

### Earnings per share (EPS)

A company's profit divided by the number of shares in issue. It is the single figure that tells you how much profit belongs to each share you own.

> **WHAT WE LOOK FOR**
> Profit alone can rise while EPS falls, if the company issued shares to get there. We read EPS rather than profit for exactly that reason.

### Trailing twelve months (TTM)

The most recent four quarters added together, rather than the last full financial year. It keeps a figure current instead of up to a year out of date.

### Compound annual growth rate (CAGR)

The steady yearly rate that would take a figure from its starting value to its ending value over a period. It smooths a bumpy path into one comparable number.

> **WHAT WE LOOK FOR**
> It hides the bumps by design, which is why we also publish the worst drawdown and the share of years that rose.

### Drawdown

The largest fall from a previous high. We apply it to earnings, not the share price: how far profits fell from their best level before recovering.

> **WHAT WE LOOK FOR**
> A small earnings drawdown through a recession is one of the strongest signals that a business is genuinely durable.

### Market capitalisation

The share price multiplied by the number of shares — what the market currently says the whole company is worth.

### Price-to-earnings ratio (P/E)

The share price divided by earnings per share. Loosely, how many years of current profit you are paying for.

> **WHAT WE LOOK FOR**
> We do not publish a view on whether any P/E is right. This series judges the business; the price is a separate question and a separate discipline.

## PROFITABILITY

### Gross margin

What is left of each pound of sales after the direct cost of producing the goods or services, before any other cost.

### Operating margin

What is left of each pound of sales after all the day-to-day costs of running the business, but before interest and tax.

### Net margin

What is left of each pound of sales as profit once everything is paid — costs, interest and tax.

> **WHAT WE LOOK FOR**
> High margins that hold steady for years usually mean the company can set its own prices. Margins that drift down usually mean it cannot.

### Return on invested capital (ROIC)

Profit measured against all the money tied up in the business, borrowed and owned alike. It answers: for every pound put to work, how much comes back each year?

> **WHAT WE LOOK FOR**
> This is the closest single number to 'is this a good business'. A company earning well above its cost of capital creates value each time it reinvests.

### Return on equity (ROE)

Profit measured against shareholders' money alone. Similar to ROIC but ignores debt, so borrowing heavily can flatter it.

### Free cash flow

The cash left after running the business and paying for the equipment and investment needed to keep it going. Profit is an opinion; cash is a fact.

> **WHAT WE LOOK FOR**
> We check that reported profits actually turn into cash. A persistent gap is one of the oldest warning signs there is.

## THE BALANCE SHEET

### Balance sheet

A snapshot, on one date, of what a company owns, what it owes, and the difference — which belongs to shareholders. It shows what a business is made of, where the income statement shows what it did.

### Net debt

Everything a company has borrowed, less the cash it holds. A company with more cash than debt has negative net debt, which is a position of strength.

### Net debt to equity

Net debt measured against shareholders' money — how much of the business is funded by borrowing rather than owned outright.

> **WHAT WE LOOK FOR**
> We favour businesses that fund their own growth. Debt is not automatically bad, but it removes the option to survive a bad decade without asking anyone's permission.

### Interest cover

Profit divided by the interest bill — how many times over the company could pay its interest from current earnings.

> **WHAT WE LOOK FOR**
> A high figure means the debt is comfortable. A low one means the lenders, not the owners, effectively control what happens next.

### Book value

The accounting value of what shareholders own: assets minus liabilities. For asset-light businesses it can badly understate reality, because brands, habits and know-how rarely appear on a balance sheet.

### Dilution

When a company issues new shares, each existing share owns a smaller slice. Growth paid for by issuing shares can leave shareholders no better off per share.

> **WHAT WE LOOK FOR**
>
> This is why our tests look at value created per share rather than in total.

## THE STATEMENTS

### Income statement

The record of sales, costs and profit over a period — a quarter or a year. It answers 'did it make money, and how much'.

### Cash flow statement

The record of cash actually moving in and out over a period, split between running the business, investing, and financing. Profit can be shaped by judgement calls; this statement is harder to dress up.

> **WHAT WE LOOK FOR**
>
> Reading it against the income statement is how you check that profits are real.

### Annual report (10-K)

The full yearly filing a listed company makes to its regulator — the primary source. In the United States it is called a Form 10-K.

> **WHAT WE LOOK FOR**
>
> Where a figure on our pages is checkable, we take it from the filing rather than a data provider, and say which.

## COMPETITIVE ADVANTAGE

### Moat

Whatever stops a competitor taking a business's customers and profits. Not the same as being good at something: a moat is a structural reason rivals cannot simply copy what works.

> **WHAT WE LOOK FOR**
>
> We ask a company to name its moat precisely. 'Strong competitive position' is not an answer; 'surgeons train for years on one console' is.

### Switching costs

The money, time or disruption a customer would face changing to a competitor. The strongest ones are not contractual — they are retrained staff, rebuilt processes and habits.

### Network effects

When a product gets more valuable the more people use it, so scale itself becomes the barrier and newcomers must attract everyone at once.

### Recurring revenue

Income that arrives again without a new sale being made — subscriptions, consumables, service contracts. It is the difference between starting each year at zero and starting it most of the way there.

> **WHAT WE LOOK FOR**
>
> A high and steady recurring share is one of the most reliable markers of a durable business.

### Structural compounder

Our term for a business whose economics — not the economic cycle, not a one-off event — do the compounding, and which has kept doing it through a full cycle.

> **WHAT WE LOOK FOR**
>
> It is what the Exceptional Company Series looks for, and most companies are not one.

## OUR OWN VOCABULARY

### Conviction play

A position in a business judged exceptional, held at a size that would matter and held through noise, because the reason for owning it is the business rather than the share price. The phrase comes from an argument this publication is named after: that what decides an outcome is not whether you were right, but how much you had on when you were.

> **WHAT WE LOOK FOR**
>
> Conviction is only worth having if it rests on something. That something is what this site publishes — whether a business is structurally exceptional. It never publishes the other half: what to pay, when to buy, or how much to hold. Those are the reader's, and they are not the same question.