

## Audio file

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## Transcript

Good afternoon, everyone. Welcome to Chapter 3 of Investing 101, how to analyze a balance sheet and cash flow statement. The same format as the last one, we're going to use an Excel spreadsheet with the same companies. And I'm going to keep it open for questions as soon as we finish a tab and move to the next one. Very simple. What is a balance sheet? A balance sheet is what you own and what you owe. It's always balanced between the assets on one side and the liabilities on another. Before I get into the Google spreadsheet, let's just take a very simple example. You own a house that you rent. It's a business for you. And your asset in that case would be the value of your house, say \$1 million. Your liabilities would be like, say, 700,000, which is the amount you borrowed from the bank, and 300,000, which is what you've put in as your down payment. So it balances out 1 million in asset from the house and 1 million in a combination of a loan from the bank as a liability and 300,000 as your equity in the business. So Let's see what our favorite company, Google, looks like. Google has a pretty hefty and large balance sheet. You can see that the total assets they have is about \$450 billion. The bigger, the first component in a balance sheet will always be the current or the cash that you have. It always goes from what's easily owned by you and you can use right away to what you've invested in as a long-term asset. So whenever you see something called cash in short-term investments, it's the total of the cash that you have in the bank and also the short-term investments that you've made to earn some interest. This could be treasury bills. It could be any sort of paper that is easily sellable in a day. So Don't think that Google only has 23 billion in cash. It has the equivalent of another 72 billion, totaling 95 billion. Current assets, that is always the next line item in the balance sheet. In Google's case, accounts receivable is about 52 billion. And this is an important number. because you always want to see how much of receivables is outstanding. A standard 60 days is okay. What are 60 days means? It means that you have about two months of receivables of your customers' invoices that you need to get paid. And in Google's case, it is below 60 days, so that's a pretty standard number. Receivables will always keep going up. If they're selling more, they'll naturally have more receivables. So this is a fairly decent progression. And if you see anything beyond two months, then you want to think, why is the company extending so much credit to its

customers? Are the customers getting better terms, or are they just not able to pay? Or is the company in a weak position? That's the total of your current assets. Now, where does Google spend all its money? They have about \$264 billion in gross property, plant and equipment. So Google's data center and server farms started like way back. You know, the simply to power a search query that you do on Google search, you need vast amount of data crunching. And it's not with the recent AI boom that Google has been building data centers. They've been building it for a long time. They started, I mean, in 2015 itself, they had about 40 billion, and now it's about 264. And this number will keep going up, as you well know. Depreciation is a real expense, no matter what any analyst will tell you, and it's accumulated over the years. The 264 has about 80 billion in depreciation with a net value of 184. What else does Google own? They have about 41 billion in long-term investments, which is Anthropic, is one of their larger ones. They have several others. And last year, they invested about 9. So in this scenario where talent is scarce and where you want to get the leg up on AI, I suspect they will be making more investments or probably more acquisitions. Goodwill is a number that you record on the books when you pay for more than the book value. A simple example is right now people are valuing Warner Brothers assets a lot more than what we are seeing. And they're overbidding, tripping over themselves to acquire the company. So whatever the overpay from what's in Warner Brothers books is going to show up in Goodwill. For a serial acquirer or for companies which have this to grow inorganically, this is a number that you should keep a lookout for. There are some deferred tax assets and other long-term assets, but that's out of the scope of this class. So for right now, we'll just move on. So Google has about 450 billion worth of total assets. Now, where does that? money come to power these assets. They have about 89 billion in current liabilities. The largest portion of this is about accounts payable and accrued expenses. These are non-trade payables at year end. They're only relevant if there is a big gap or there is a huge difference between the previous year. But for a company of Google's size, having 40 billion of accrued expenses at the end of the year is normal. And 7 or 8 billion in accounts payable is also normal. This is money that they owe to, say, a YouTube creator or a content creator. Google does borrow money. It's not that they don't. They have about 11 billion in long term debt. Don't forget this is 24, the 25 balance sheets. It is not out yet. And I suspect that will go up substantially to maybe 15, 20, 25 billion. What else do they owe? They also have something called a capital lease, which is also important because you know you're going to be renting all these uh data centers and it's not that you can walk away from a liability like that uh walking away from a lease involves penalties so it is a liability which people should count towards their total debt that's about a total of 125 billion and what did they put in on their own and what have they earned in the last 2025 years Common stock is 84. Just see this number going up from 76 to 84. This is basically stock-based compensation and reducing the stock buybacks. So stock-based

compensation is RSUs, stock options, which you give your employees, and when they exercise, they will give you a little bit of cash. Cumulative earnings so far, this number, as you see, it just adds the net income after dividends, and it just keeps going up every year with the previous year's income. So you like to see a progression like this, that there is not a single down year where retain earnings have gone down. Okay. So they have about 400. They have exactly the same amount in liabilities and equities, which is 450 billion. And it's a very, very, very healthy balance sheet. When you have 325 billion out of the 450 of your own money, you have a lot of room to borrow, which is better than, say, like an Oracle, which does not have a clean and healthy balance sheet like this. So Google is in great financial shape. I always look at the growth in their long-term or fixed assets. Between long-term assets and fixed assets, there's no difference. It's just a terminology. And if you hear the, it's the same term. The growth is mostly in CapEx and mostly for data center. And I believe this number will keep going up. Receivables only went up by 9%, which is nothing. Goodwill is also 9%. There's nothing here. This is a metric you must look at. It's basically 15%. So two months of sales is about 16.67%. And anything below that is about they have receivables of about, say, 55 or so days, which is pretty good. They have 11% in long-term liabilities versus the equity, which is an amazingly strong number. And I've included capital leases in that. And you can see that from the number, there's about 25 billion versus equity of 325. This is this calculation. OK. What does Google return on on their total assets? So if you're analyzing a company, you're you're looking at the EPS, you're looking the earnings growth, you're looking at the quality of the margins, you know, and all the other strategic factors. But if you're committing. To continue building out and acquiring assets, what is your return on assets? So there's a simple ratio called return on assets, ROA, which is the net income divided by the total assets. And you'll see this number here that the 100 billion in net income which they earned last year, here's the 100 billion in net income, which is last year's and divided by the total assets, which is the 450 billion, and that's 22%. That's pretty solid. Okay. Normally you want to go into an asset light company which doesn't consistently have to spend money to keep growing, but if it's doing it, it's doing a good job. Google's doing a good job. Same way you do a return on your equity. which is your net income divided by the total equity. So that's the same 100 billion number divided by the 325. And that is a pretty good percentage, 31%. Just imagine if you had a business which gave you a 30% return on your equity. That's a great business to own. There's another ratio called the return on capital employed. All it does is it takes the operating income and divides it by the total equity plus the debt. So the denominator is slightly higher because you've included this debt here. And even with that, you're doing about 32% in return on your capital employed. So that's that's that's pretty solid. Google's balance sheet is very strong. Should we move on to cash flow or do you guys want to ask some questions on the balance sheet?

Good. Thank you.

Good afternoon. All right, so let's move on to the cash flow then. Okay. Yeah, Google's cash flow also looks pretty solid. Why do we look at cash flow? Why is that, you know, why am I throwing income statement, balance sheet, cash flows? Why are they important? So the difference between a net income from the income statement and the cash flow are a lot of the non-cash charges or non-cash inflows, sorry, non-cash charges which make the difference. In depreciation is not a cash charge, but it is a real expenditure, all right, because what you're doing is if you're spending 50 billion in CapEx, you're going to depreciate it over five years. So every year you will take out maybe, you know, 10 billion out of it. So this is going to hit your income statement, which is 15 billion in depreciation. And it's going to add to your cash flow because it's not a cash charge. It's not like money going out of your pocket. You have already spent that money in CapEx last year or during the year. This is also not a cash charge, so you're adding it to net income, which is 22 billion in stock-based compensation. So this is always added back. What's taken out? If your receivables go up, which means what money you should have realized from your customers is now into next year. So that's also going to reduce your cash by, in Google's case, as well. 6 billion. It's not a significant number because, you know, we saw that Google sales is about 350. Their receivables were about, I think, what, 50 something. So this is this is nothing, nothing different. If it's positive, it's great. If it's negative, it should not be too high. At the same time, they are the changes in there are no other significant changes in their working capital. And what you see as a net income of 100 billion is now 125 billion in cash flow. So cash flow is 25% higher than their net income, which is always nice to see in a number. From the 125 billion which they generated last year, they spent 52 in capital expenditure. This is a number I look at very closely because when you want to generate, when you're generating cash, you're not going to take it back. I mean, you're going to do something with it, right? So this 52 is what they spent in capital expenditure in 24. In 25, it'll be about 90 billion and 26, it'll be 115 billion. But the way they are growing, I would not be surprised if this cash from operations is about 150 or maybe 170 in, you know, in the years to come. So they will have enough cash generation to keep spending. The cash from investing is your total of your capex plus these are the numbers and cash flow from financing activities. What is financing activities is basically where you, where you, where you see their debt. They've issued 13.58 billion in debt, but they also repaid 12.7. So there is a net difference of pretty much nothing. They didn't have to go out and raise more debt to finance the capital expenditure. And you'll see that what did they do with the other balance that they have? They have a lot of cash, right? 62 billion went into share repurchases. And that's the reason why you're seeing the share count decrease that you can see it here in the balance sheet. You had 12.46 billion shares outstanding. You've

reduced that by 200 million or to 12.211. So you spend 62 million buying back your stock in 2024. If they bought it at one 70 or 160, it's been great for the company. They've retired those shares simply. Okay, what else? So I look at the ratios here as well. I just want to see the growth. How much is my operating cash flow growing? 36%. It was a little choppy in these years, but 23% growth last year in 2024. The share based compensation after growing is pretty much the same, but now this is a number that strikes out. This is when they are now realizing that they have to start spending on AI. In 24. They spent 63%. Extra in Capex spending. Capex as a total of operating cash is only 42%. So, you know, plenty of cushion. And the like I showed you guys. The operating cash flow is 1.25 times the cash flow, so 125%. This is a positive number. Why cash flow is important? Because if this number was below the net income means your money was getting stuck somewhere. You've got an income of say, you know, a billion dollars, but you're realizing only 800 million out of that. Where is that 20% going? Either that's stuck in inventory, either that's stuck in accounts receivable. So I always look for a positive operating cash flow over the net income. Any questions?

Nope, thank you.

So I'll go ahead. Let's look at a balance sheet which is not so pristine. How about Dell? Okay, Dell has 3.7 billion in cash. Okay, they don't generate much money. It's not a very profitable company. Accounts receivable has not gone up, which means also the customers are paying them on time. So this is good. Dell's business model is actually very, very interesting. And it's, they don't really carry that much inventory. And if you ever ordered a PC from Dell, you realize that you put in your order 1st and then they ship it out to you after. And they were the pioneers in doing this in the early 2000s. So it's really a contract manufacturer. And the reason I say that is because even a company of Dell's size, which is how much is their income? Okay, Dell is doing about 88 billion in sales and they are producing all that from just 7 billion net in property plant and equipment. Okay, so it's not like they're going around the world and setting up huge plants. Most of their hardware sales servers, PCs and peripherals and any other computer hardware is coming from the production base is outsourced from OEMs all over the world. It's not just China. They've been they've been sourcing it from Mexico. They've been sourcing it from Poland. So what's interesting about this company is that even though it should be an asset heavy model, they've done an amazing job in supply chain management. And it's I like that that they don't have to constantly spend money on, you know, more plant and equipment. The other one thing I wanted to point out here was in their goodwill jumped up substantially in 2017. See, they paid up, they bought EMC at that time. And this shows you how much they paid above the book value. And of course now it's gone down because even the goodwill is amortized. Okay. So Dell has about 80 billion in assets and let's let's have a look at their liabilities. This

is always going to be a very large number for Dell because they are sourcing their components from all over the world. And this is contract manufacturing and supply chain management at a very, very high level. And Dell is probably one of the best in doing that. And when you see a high payable at the end of the year, this is the money they owe their suppliers. And it's not like it's gone up substantially. It's pretty much in around the same 20 billion which it had over the years, okay? They don't even borrow that much. This is, they borrowed basically to buy EMC. But after that, the debt has come down substantially. It's only 16 billion right now. So this is a pretty decent number for a company of that size. I honestly, I had not seen the balance sheet of Dell, and I'm pleasantly surprised to see a low number like this. When you see a number that's not heavy, you know, they have either the capacity to borrow more and they have the capacity to service the debt very easily. Okay. What else is interesting? Capital leases are not that much. You see that retained earnings. Look at that. Compare this to Google. It's all negative. And this retained earnings is also probably they took a lot of charges from the EMC acquisition and it's getting a little better as you know as they keep earning money. But you do have large companies. that have negative retained earnings. And which means your equity will show that it's a negative, you know, and you really the only you have financed all these assets by borrowing. You know, it's a strange balance sheet to look at, but it's not like it's going to go under or something when you see a negative equity. It's just that over the years they've They've not had a positive retained earnings year after year. It's just taking a while to go down. What does their growth look like? They're not growing their fixed assets as much. Like I said, the CapEx was quite reasonable. It's only 3% higher. Receivables grew by 10%, but then that's all over the place. There is no trend from that. Inventory has gone up by 85%. So somewhere we may have to do a deep type. And again, this was last year. And if this persists, where you're sitting on too much inventory, which means your merchandise or your goods are not selling, your computers are not selling or your servers are not selling. So that is not a good sign when your inventory grows so much. Receivables to sales, 11%, clients are paying on time. But inventory as a percentage of sales is also in great shape. So this number may be like a blip because it's not a significantly higher number than sales. It used to be 4 and 5%, it's gone up to 6. If say it goes up to 7 and 8, then yes, we got to see why this is happening. The equity was negative, so this number is a minus. And we saw that Google was earning 20% on their total assets. Look at Dell. It's only 6% net income divided by total assets. So the asset heavy company compared to Google with a poor return on assets. But I and I bought this stock. I believe this number will keep improving in 26 and 27. Return on capital employed is a good number because the equity is negative, because, you know, basically, everything is being financed through debt. So this is this is a good percentage. What is Dell's cash flow look like? It's basically the net income plus you're going to have some depreciation. which is not a very large number because they don't have

that many assets. Dell doesn't give too many stocks. You know, it's not like a tech company. So this is a small number. Look at the difference between the net income and the cash flow. It's basically any difference. So this in this in Dell's case, the working capital, the cash from operations is is not a significant metric to look at. Capex is small. It's only 22.6 billion. total debt issued, total debt repaid. They actually repaid more than they borrowed. So this this tells us that, you know, it has the cash flow to pay back. and they had the cash to repurchase stock. So they also did some buybacks. probably at a good price. So hopefully, that's good. They paid some dividends and they earned operating cash of 4.5 and they paid out 5.8 towards buybacks and dividends and some repayment. So this number tells you what the cash level changed from the previous year to this year. Dell's cash actually went down. The net change in cash is 3.7. And you, you can see that, you can see that here. Not that it's very relevant, but you'll see, see the cash going from down from 7.3 to 3.6.

Okay. Bharjada, can you explain retained earnings again, negative for Dell?

So negative for Dell is, where is retained earnings here now? Oh, balance sheet, sorry, yeah, not the cash flow. Okay, so they started with retainer. So if you have like, say, just let's do a simple example. Say if you had common stock of whatever, you know, 1 million, 1 billion and the first year itself, you lost about 1.5 billion. So your retained earnings would be minus 1.5, and then next year you lost another 1 billion. That would become minus 2.5. So that number keeps going up. And to me this seems to be a basically a very large charge from the you see this big jump here. 6.8 to 21.3 3 9. This is a charge from the Emc. For all the amortization and depreciation that they did that year. Let's look at the income statement from February 2, 29, February, 2019. That should tell us why this retained earnings went down so much. Yeah. net income was down lost. They lost 2.3. So retained. So you see, all these are net income going down, and that's affecting your retained earnings.

So when they acquired AMC, how does it affect the net income in the sense that it's not an operating cash? It's not an operating income.

No, it'll come in your depreciation. It'll come in a very large amount of depreciation. So you'll see this in the cash flow. Let's look at 19. Depreciation and amortization total. It's 5 goes to 8.5. So this affects your income, but it's not affecting your cash. So the net income is minus 2, right? Minus 2.8. They're getting, they're getting back this amortization number from the EMC acquisition. And the cash from operations is 6.8. So their books are showing a loss, but they've actually got a lot of cash generation. So when they may have even bought EMC with borrowed money, they borrowed money and bought EMC. You see this here, they borrowed 46 billion as total debt issued and they repaid 16. They borrowed net

of 30 billion. From the 30 billion, they acquired EMC. And then next year, because of the EMC acquisition, they have to write off 4 billion extra in amortization expenses for what they paid EMC. So that's affecting your net income, but it's not affecting your cash.

Okay.

That's the catch. So you'll see the net income in 17 and 18 are both negative right here. Okay. 1718, the net income is negative in both years. Even though they made profits out here, this is this is where they go net negative because the amortization and depreciation is coming into this call, this this number here in the SGNA. It's an administrative. It comes under the general and admin amortization.

Okay, and it's jumped up significantly after 16 and it continues to stay very high?

Yes, But the it's come down if you see from the high of 18, it's still it's come down to 12 and 11 because the say if you buy something for Say whatever. I don't remember what they paid for EMC, but if they borrowed about, you know, 40 billion that year or 30 billion that year, a 30 billion amortization over five years is or six years is about 5 billion a year in extra amortization.

Okay.

Yeah. So it's an it affects your income, net income account, but it helps you with the cash flow.

It was 67 billion, the acquisition.

It was 67, so it must have been a, it must have been a mix of shares and look at this, yes, see this? Shares went up by 282.

Right.

So they must have given EMC shareholders some shares of Dell.

Okay.

Yeah, because I'm, I don't think they spent 67 billion. It doesn't show up in the numbers. So it has to be the 200 and 282 billion in shares, million in shares outstanding must have been given for the EMC shareholders.

Okay.

At least this is what is showing.

And just a general question, the issuance of additional shares, it of course dilutes existing shareholders, but is it something that is viewed negatively by the market and hence they penalize the share price? How does it work?

Yes, yes, because what will happen is it'll affect your EPS. So your EPS is your net income. Okay, here is your net income divided by the number of shares outstanding. So if I make this 900, look at what the EPS goes down to 510. Right? The more shares I issue, the more I'm reducing my EPS because it's dividing the net income. So this is where the calculation comes in. And if your EPS goes down, your multiple will go down and affect your share price. So what happens with all these tech companies that don't have the money to expand and they keep issuing shares. And that's when you hit a certain level where you say, I don't want to, you know, and that's what's going to happen to all these nuclear companies and these quantum companies that are spending a bomb on either research or, you know, setting up their nuclear plants. All of them are going to dilute the shareholders or have already done so. Same thing with your biotech companies. Cause where you, how you gonna finance your, your, you know, 5 years of drug discovery, for example. So the only way you can raise money of Nebius Corviv, that's the big worry. Corviv, Corviv is is going to dilute shareholders or otherwise borrow at 10%. So that's that's where you're gonna see this dilution. Yeah.

Okay, thank you.

Sure, Micron's balance sheet should be similar to Dell, but it's in much better shape. Even though it's much more capital intensive, Micron has always had a very strong cash cushion because Micron knows its memory business always requires a huge amount of CapEx. It's, and Micron will always carry a lot of inventory and accounts receivable. So they have about 10, 28 in total. These two are big numbers. They spent from 88 to 96 to 110. So that's 13 billion extra in 25. I believe they're setting up a couple of plants in the US. There's one in India. So I don't see anything below 10 billion for the next 2, 3 years. And this keeps going up. Very high capital intensive. It's 82 billion in total assets. How are they financing this? This is low. I mean, for a size like, you know, for so much financing, their long-term debt has not gone up too much. It's 11, 11, 11. It was 6. It jumped up in August 23. And capital leases are also not high. So with this low leverage, it can borrow a lot more if it wanted to. Micron, even though it had a lot of ups and downs, they haven't had any years where this is the year you see, this is going to go down. This year they had a loss, 47 to 40 in September 22. So their retained earnings went down, now it's climbed back. Still, they are a pretty decent sized, 54 billion in equity and about 28 billion in liabilities. So what is that debt equity is about 30%. You see it was high as high as 71 at one time. So at 27%, it has a lot of room to borrow. So this is a pretty solid number and Micron is going to need to borrow. So

this is a low ratio and this is a good ratio, you know, for a company that needs so much CapEx, they could have easily done a lot worse. Return on assets is okay, but it's low. These numbers should improve. I'm not terribly happy with these numbers. But you see, when you get into all these capital intensive businesses, you know, memory, tech, this is pretty much the norm. You really don't get too much money even if you're investing so much capital. 10%, 16%, 14%, never gone higher than 17 and 18 unless this was an exceptional year. What if they do that that year? Retained earnings, yeah, it went up by, they had a very high profit that year, 14 billion increase. Okay. So that's why the return on your equity was so high. Return on assets was so high. But if, 26 might be that year where you'll see this number, they're doing that well. Cash flow, let's have a look at the-?

I got a question.

Sure.

Now, receivables, the receivables have been going up so high.

Yes.

And are these net of the doubtful receivables also?

Yes, yes.

Okay, but they don't show it here. There will be a separate schedule for that, I guess.

Yes, yes, this I've I've taken the total numbers.

And yeah, I agree with you. Yeah, I didn't see any provision for that. So it must be some.

It will be there in the 10 K. Sorry. Go ahead.

There must be a sub sheet where they have the numbers, they're bringing into the balance sheet the net of that.

Yes, yes, very much. But the interesting point that you point out, look at how much is tied up in working capital, right? 41%. Yeah. So that's what, four and a half months, almost five months of working capital.

Right.

So I was saying that it's not capital intensive from a fixed asset point of view. But there is money getting stuck here. And the the other thing is, so if they have to, they have to commit a certain amount of purchases also to make sure that they are first in line. I mean, you're hearing about a memory shortage every day, right? So some of this is also commitments to inventory. They have to keep that inventory in hand because they'll miss the bus.

Otherwise, look, look what happened to AMD. So yeah, cash flow. Cash flow was solid. The net income was 8.5. Cash went up to 17, which was a big amount of depreciation coming to cash flow. It was about 8 billion here. Accounts receivable was a minor change. They've always been on the higher side. Inventory was positive. It was only 520 because they always keep more. So that working capital wasn't significantly different in 25. Capex is, yeah, 7 to 8 billion every year. That's going to keep increasing. They use the cap. Cash for CapEx. They repaid, borrowed net effect is nothing. Net change in cash, so it's good that they have some cash left over. Operating cash flow growth was 100%, which is good. Share-based compensation was only 17% higher. CapEx was a big jump of 89%. Now they are using about 90 90% of the operating cash for capex. So I they're putting it to good use. I just hope they keep generating more cash. and it's about twice the amount of net income because of the depreciation. Yeah.

I got a different question. Sure. If I'm an investor, you know, I'm not analyst. I want to either buy the stock or sell the stock or do some of the position in the stock market of, let's say, micron technology. So what numbers or what I'm quickly wants to look at rather than sitting and analyzing everything in the balance sheet. Is there any line I want to quickly look into that and make a decision.

I would look at your 10 years of In the 10 years is if it's in a spreadsheet, it's not like you have to pour through the 10K. But what I would do is I would look at the cyclical of Micron before deciding that, okay, this year I've got a growth of, you know, I'm very excited, okay, Micron jumped from 30, 20 or 5 billion in revenues last year to 37 billion in this year. and it's going to go up to maybe 45. So yeah, and this is my first number I want to look at. I think the share price will go up because, you know, even your net income is gone up 800%, you know, but then you look back and see that this was so cyclical that in in one year alone, they dropped revenues by 15 billion. So the you have to look at the growth number one and say, yeah, I don't want to see the balance sheet, but You also need to look at growth over a slightly longer, not slightly, I would say at least at least a one or two economic cycles. So that's especially when you know that the company is a memory cyclical producer. And right now, because there is such a huge demand for high bandwidth memory that it's become like, okay, the next two, three years I'm going to grow. But then in this company, you want to get into Micron at about 100, 120. at 400, most of the, you already got the benefit of the biggest growth and unless they double next year, then you have to ask yourself, do you really see Micron doubling revenues to maybe 80 billion or net income to whatever, you know, the EPA is going to \$20 a share? Okay, then there's still room for the stock to run. But if it's, if suddenly There is a glut in memory and memory prices stop dropping. Micron will lose 100 bucks in 2 months or a month. That's that's a very, very high likelihood. So yeah, not a very short answer, but.

Yeah, I agree with you. But the even though you do your work like the way we are doing right now, but sometime. the analyst, you know, they start using a high multiples, you know.

Yeah.

And they, I mean, really blow up the number two. And it becomes a hot cake. You know, everybody's chasing it. And yeah. And before you know that, you know, you could be the one caught at the high end, you know?

Like, like musical chairs. Yeah.

So there's no chair left. So this is why, as an investor, the kind of market we are running, anytime it goes up, 10%, 15% profit on my investment, I start chiseling some of it or try to get out and then look for a re-entry again. For a small- I don't know if it's a good policy or not, but it is working for me.

It's working for you, right? I agree with you to the extent where even 15, 20%, especially in stocks where I know that the gains have been very, very fast and very, you know, and I'm a little, even I want to be conservative and I do take some money off the table every now and then. I think that's a good strategy. Yeah.

Yeah. Thank you. Sure.

ServiceNow is a software company. It's the SaaS company that we looked at last time. It's slightly more, I would say, a bit like Google, where the cash will be a large portion because it's, you know, it's a SaaS business. You're selling seats, you're selling licenses. There's not much CapEx required. You'll see just it's like. the interesting thing about software companies is you are developing a big asset. It's your platform. And the software is also a fixed capital asset. But the way the accounting treatment is done in a software company is that all of this will show up in high R&D. And I think we spoke about it last time that it's not like you're building a service now, which is you know, doing what, 10 billion in revenues you over the years, you've probably spent close to 30, 35, 40 billion in in building that platform. So it just shows up a little differently. It's not like it's it's it's a business built out of nothing. Okay. You'll see this in in every software SaaS company, which is called the unearned or the deferred revenue. And it's it's like a ServiceNow will have a contract for two or three or maybe longer with their clients. And you can't book that revenue just because you booked the contract. You will have to, you will have to book the revenue. But this is basically telling you this is the backlog they have. Okay, this is the outstandings that they have. And this is good to see that it keeps going up. When you see that your Backlog of deferred revenue goes down, which means they don't have as many bookings as they should have. So this is

something I always look at for software companies. And any financial statement, income statement, or a company press release will try and give you the RPO, the remaining performance obligations, or simply they'll just say that we have so many back orders left. Not any debt here, very little, no capital leases, everything positive here. They actually even bought back stock, which is, you know, for a 10 year old company, not mature to buy back stock, but you know, what the hell, they did it. There's not much here. Receivables are just normal. This is more than two months worth of sales. Okay. But it's I guess the cycle in licensing and software might be different from other-- they must be having terms. It's also possible that these projects, when they have a new client, they take a while to implement. So nobody's going to pay you right away. So nothing to be perturbed about, but it shows that this cycle is definitely higher than 60 days. Long-term debt is lower as a percentage of equity. It's only 23% now. Return on assets is low. and they should be managing a lot better. I'll tell you why this is because you'll see the high stock based compensation number. The cash flow divided by total assets will be closer to 25% or maybe even more. Same thing. These are all mediocre because you're looking at net income. Now see, look at the cash flow. Okay. A big chunk of this is in SBC. The net income is 1.4 billion. Cash flow is cash from operations is 4.2 billion. So they're actually doing extremely well, but The general rule, or it's basically a rule of thumb that at some point of time you want to see, you want to see your gap net income to be equally higher. You can't keep paying your, you know, you can't keep understating your salary expenses by putting so much in stock-based compensation. There are certain, probably certain investors or certain hedge funds or institutions who will not buy, you know, they will this this net income ratio will be too low, and they'll ignore this completely. So you'll you'll see a you know. The stock getting punished. If the Sbc. Is too high. what else? Stock based.

Can you go to the previous page, please? Sure the the one which shows unearned revenue.

Yeah, go ahead.

So honor is really, have they received the cash though?

No, it could, they could have, but it won't show up in this number necessarily. It might show up in their bank balance.

This could be based upon the contracts they have.

Yes, yes.

And doesn't mean that they really, so just like insurance companies, you know, they get the premium for three years now.

Right.

And they use a short term or long term, you know, basis of unearned income, you know.

Yes, yes.

Okay.

Yeah, the cash, cash, they may have been paid in advance. Sometimes I've seen that a lot of people, especially in larger companies, have a budget and they are told to spend it. Otherwise, you know, they won't get it the next year. So they may even pay you advance. But you obviously can't book it as revenue. You know, you can keep the cash in your bank and enjoy the interest, but you know, You have to account for it properly.

Yeah. If I will sign a contract, I won't give them money upfront.

No, but I've seen that in some of my clients also that we got a check and you know, we have to cash it because the purchase manager told us that, listen, I won't have the budget for you guys next year. Please cash the check. And thank you, sir. We're very happy to do that.

That's the exception to the rule.

Yes.

Yeah. Okay, I got it.

Okay, so cash flow is here. Operating cash flow is growing well at 26 share based. This is this is going to help the stock because you see. They've they've stopped increasing it from the way they did. It's only 9% and I suspect the 25 will be even lower. And here's this, the CapEx as the operating cash is low, it's only 20%. Look at the difference between the net income and the cash flow. It's like 300%. So if you're doing a cash flow margin, it's very healthy. It's like close to 35 or 40%. And that's one of the reasons why I bought this stock, even though the EPS was low. The cash flow per share was very high. But I don't, I'm not sure it's, you know, it's, it's a strategy that works most of the time. It doesn't have to work all the time. Yeah.

This, is this a start which has this symbol now and now.

Yes, yes. It's down to about 120 something.

They have lost close to \$100, you know, in the. Yeah, yeah.

So the, the problem with ServiceNow is that they feel that ChatGPT and especially Claude Anthropic. So Anthropic is trying to get into enterprise software where they are saying, why are you paying ServiceNow per license, which is an expensive license? Take the API from us, do the coding in-house, which makes it cheaper. We are giving you a coding tool, which

is replacing your engineers. That's the business they want to take. And I think we discussed it on the Thursday webinar, like Adobe, Salesforce, all of them are suffering from the same problem.

Right. Even SAP also.

SAP also, yeah. So that is one worry. So all these SaaS companies are going to have that they may lose a lot of business to the foundational models like Claude, especially Claude.

I want to know if you may have the answer, you know, simple answer, you know, when they talk about organic growth, what are they really are?

Without, without acquiring. That's the answer.

Yeah. Okay.

Simple. I mean, Hardik is just, I'm going to look at one of his companies that Constellation Software, which is like a serial acquirer. which which is always acquiring company instead of, you know, growing it organically. Broadcom is doesn't have much organic growth. They they bought VMware and they've bought a whole bunch of other companies also.

Yeah. I think the earning is coming next week for them. Who so? Broadcom. Yes.

Yeah.

Yeah. Because the last time, you know, the earning came, they got.

We were on the WhatsApp that day. I remember we, you know, I was hoping it'll go up another 20 bucks. It lost what, 7% that day. Yeah. Last company on our, it's a cyclical, it's a retail target. Target has the only real thing you got to really Keep a lookout as targets inventory. And this is 45 days of inventory is kind of sort of the norm. If they are holding more than that, merchandise is not selling. You have to be a little careful about that. Capex is the fixed assets are okay. They're not, they're large, but they're not growing too much. This is a very steady ap. It's it's a good terms with their vendors. You know, if you're gonna want to get into target, you're not gonna ask for your money fast. You'll you'll get it when they decide to pay you. Long term debt. It it doesn't need to increase it. It's just about comfortable. But again, their return on assets, return on equity is return on equity is very good because they are returning a lot of money in dividends and reducing their equity. and they are fairly well leveraged. So the equity portion is quite small. You know, it's 14 billion in equity and about 12 billion in debt. So it's 50 50. Okay. return on equity is good. Return on capital employed is is Pretty decent for a retail company, I would think, at 21%. Cash flow, the really, the main thing is there's not a significant change. This is what they do with their cash. Year after year, it all goes in paying dividends. The payout ratio is about 50, 55%. So

whatever they generate, they've generated 7 billion in you know, in operating cash, they've paid out 3 billion in capex, they paid off some debt. And then here you go, you're spending 2 billion in dividends and 1 billion in repurchasing your stock. So, you know, you, if you buy Target, you know, there's a floor that they will be buying stock at some, they have their programs which run perpet in perpetuity. So they will always be buying a stock unless it's really They've had a very bad year. So you don't see much of a downside in their stock unless they've had something really disastrous. Okay. Yeah, this is a fairly steady thing. Okay. All right. Okay. It's an interesting class, I think.

Thank you.

Sure, sure. This is not a, this is not a fun topic. I don't think, you know, you really enjoy balance sheet analysis and What essentially, if even if I'm suggesting somebody or some analyst is suggesting something, this gives you at least some basis to check an analyst or anyone suggesting something. And you don't have to go that deep, but at least you have a background to understand if the analyst is making sense or not. Yeah.

Cool. Yeah.

All right, guys, then let's look forward to the next one. I think we will talk about some of the categories of the companies. We can look at some multiples and valuations and move to that for chapter 4. Thank you, everyone. Thank you, everybody. Have a great weekend, everyone. Hopefully it doesn't snow us too much in New York. It's tomorrow's gonna be a difficult day. Thanks.

Thank you. Have a good weekend.

You too.

Thank you. Thank you. Bye.