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TRIVARIATE RESEARCH

COMPOUNDERS REVISITED: DOES FREE CASH FLOW MARGIN MEASURE UP?

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BACKGROUND AND RESEARCH SUMMARY

Background: Following our note on compounders last week, where we showed empirically that consistent gross margin growth resulted in better subsequent performance than price momentum, net income growth, revenue growth, or EPS growth, an investor asked us to see if free cash flow margin was a reasonable metric for measuring compounding. We define free cash flow margin as the cash flow from operations minus capital spending, all divided by revenue, and analyzed this metric for the top 2000 US equities by market cap. excluding Financials.

Performance: We looked at the subsequent stock performance of the spread of the top and bottom quintile of free cash flow margin and compared that to the performance of change in free cash flow margin. For trailing free cash flow margin, the top quintile has beaten the bottom quintile by a cumulative 250% over 26 years. Change has added no value. For forecasted free cash flow margin, the spread has been far less effective, only 100% cumulative return from the spread in over 15 years. Recently, free cash flow margin has failed since peaking at the end of May. The change in free cash flow margin, either forecasted or backward looking, has not been as effective over the last 25 years.

By style: Free cash flow margin has worked far better among growth stocks than value. However, the signal has not performed well in the last few months. Forecasted free cash flow margin has been more consistent in the mega / large cap universe over the last 25 years and less effective in the small cap. universe, though also has broadly failed over the last quarter.

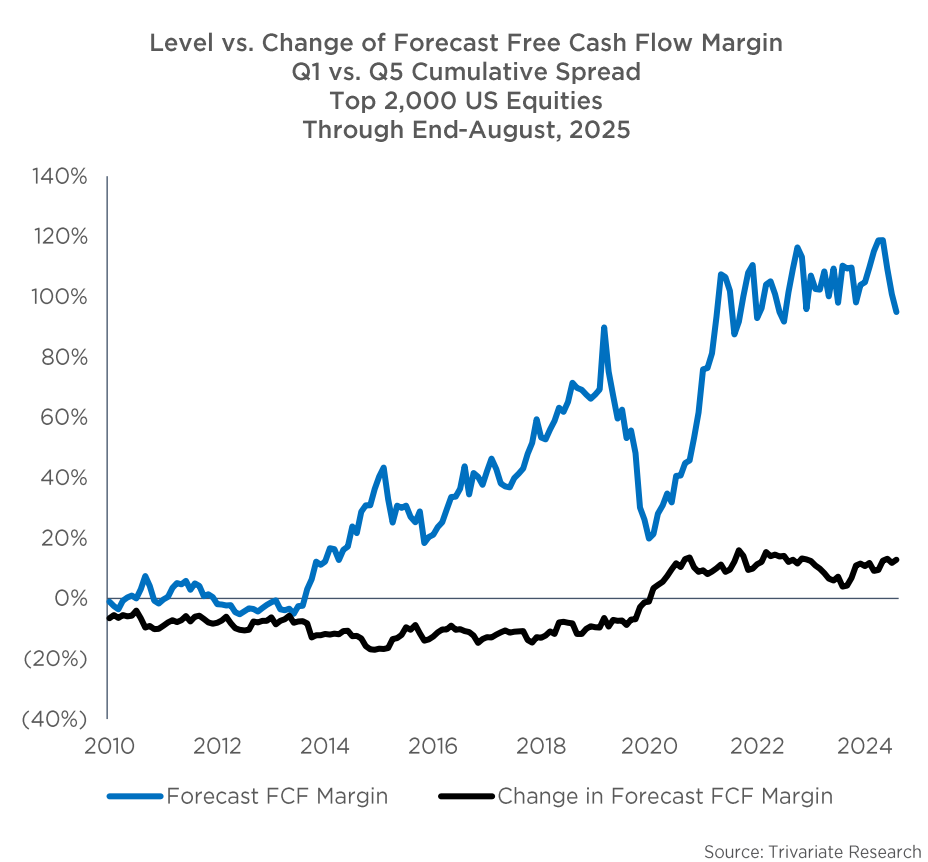
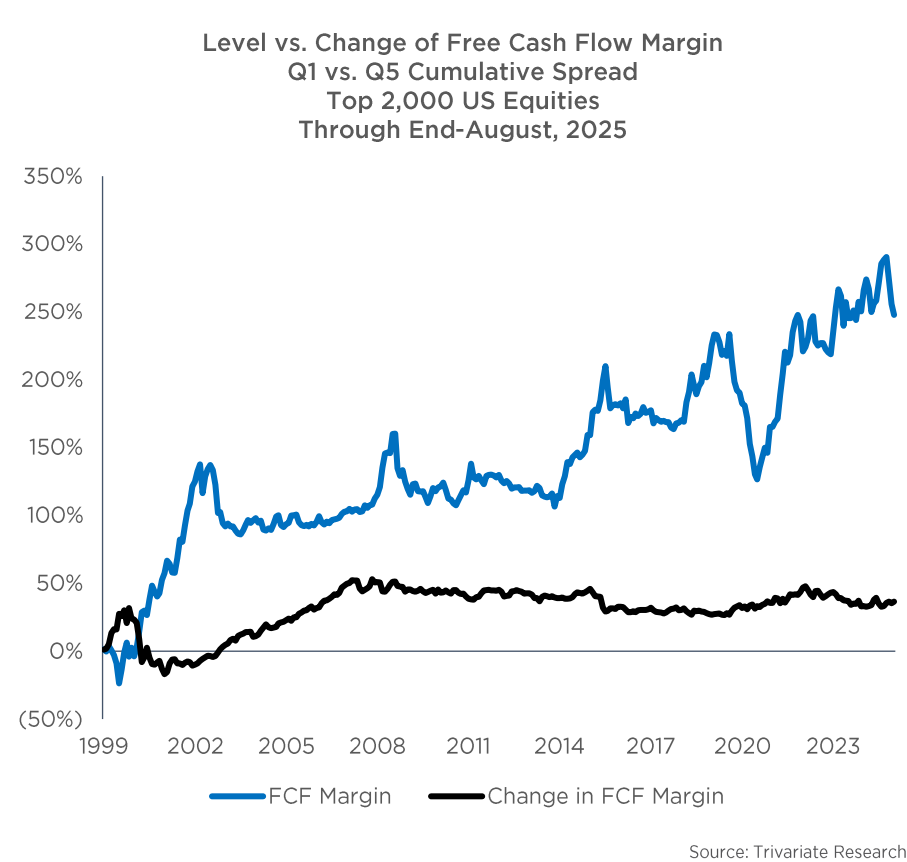
Compounders: We compared the success of free cash flow margin expanders to the other metrics we evaluated to identify compounders – something we assessed in our recent work. Consistent gross margin expanders and free cash flow margin expanders have both performed well, better than upward revisions, revenue growth, net income growth, or price momentum, and better than the S&P500 over the last 20 years.

Attributes: In order to be in the top 10% of all companies for growth in free cash flow margin a company would need seven consecutive quarters of growth, whereas the top decile of gross margin growers have 12 consecutive quarters of gross margin expansion.

Stock ideas: Compounders based on gross margin expansion are shown on Slide 7, and compounders based on free cash flow margin expansion are shown on Slide 8.

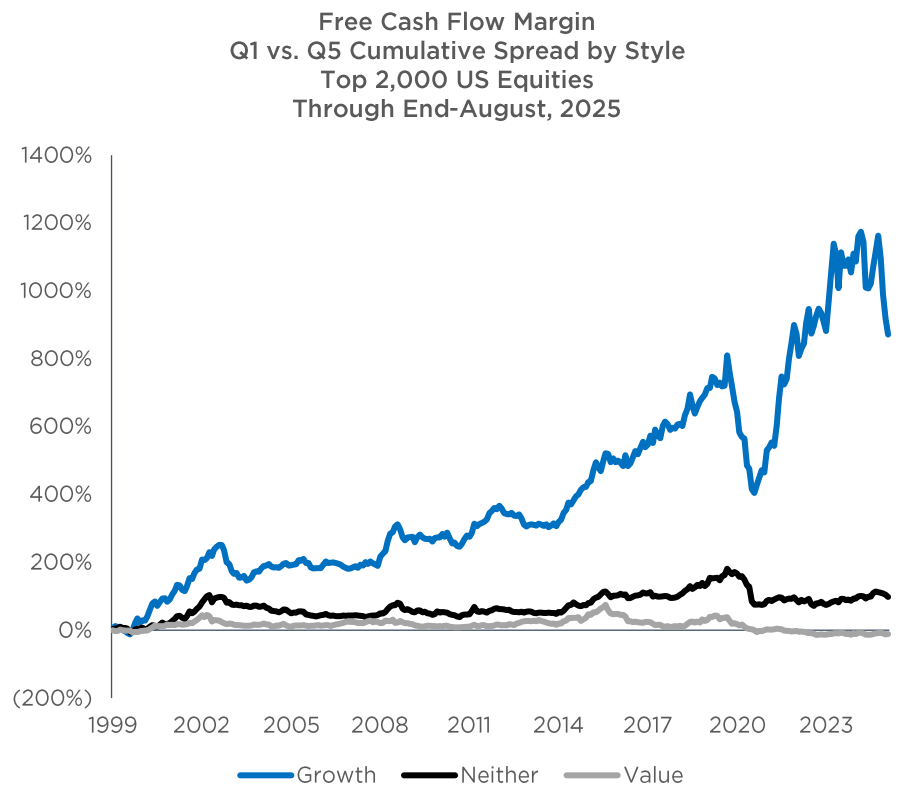
FCF MARGIN TRAILING LEVEL BETTER THAN FORECASTED CHANGE

We looked at the subsequent stock performance of the spread of the top and bottom quintile of free cash flow margin and compared that to the performance of change in free cash flow margin. For trailing free cash flow margin (left) the top quintile has beaten the bottom quintile by a cumulative 250% over 26 years, for reasonable performance. Change has added no value. For forecasted free cash flow margin (right), the spread has been far less effective, only 100% cumulative return from the spread in over 15 years. Recently, free cash flow margin has failed since peaking at the end of May. The change in free cash flow margin, either forecasted or backward looking, has not been as effective over the last 25 years.

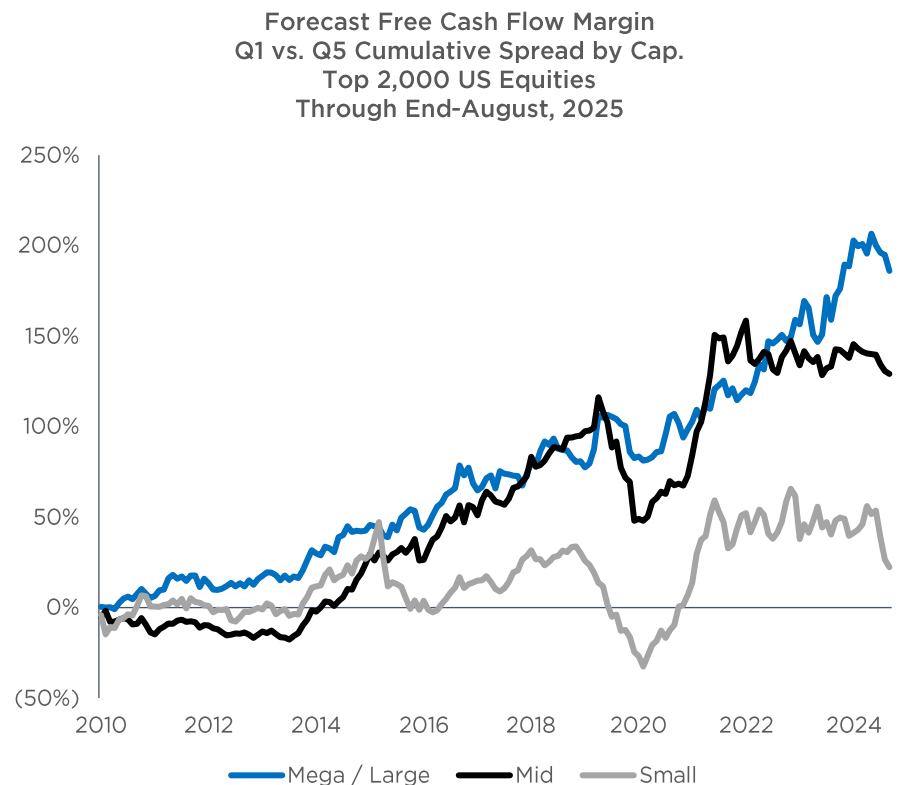


FCF MARGIN EFFICACY BEST IN GROWTH AND MEGA / LARGE CAP.

By style, free cash flow margin has worked far better among growth stocks than value (left). However, the signal has not performed well in the last few months. Forecasted free cash flow margin have been more consistent in the mega / large cap universe over the last 25 years and less effective in the small cap. universe (right), though has broadly failed over the last quarter.



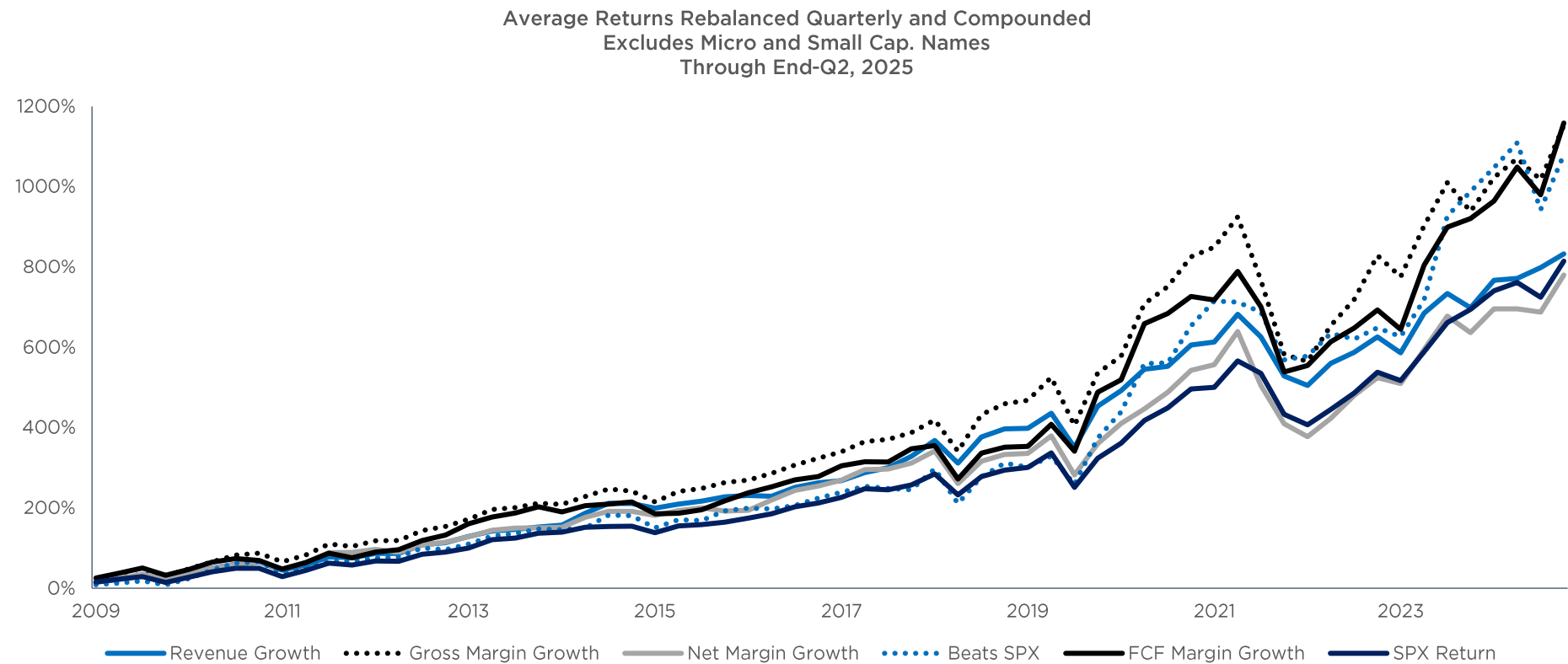
Source: Trivariate Research



Source: Trivariate Research

CONSISTENT FCF MARGIN GROWTH DOES WORK

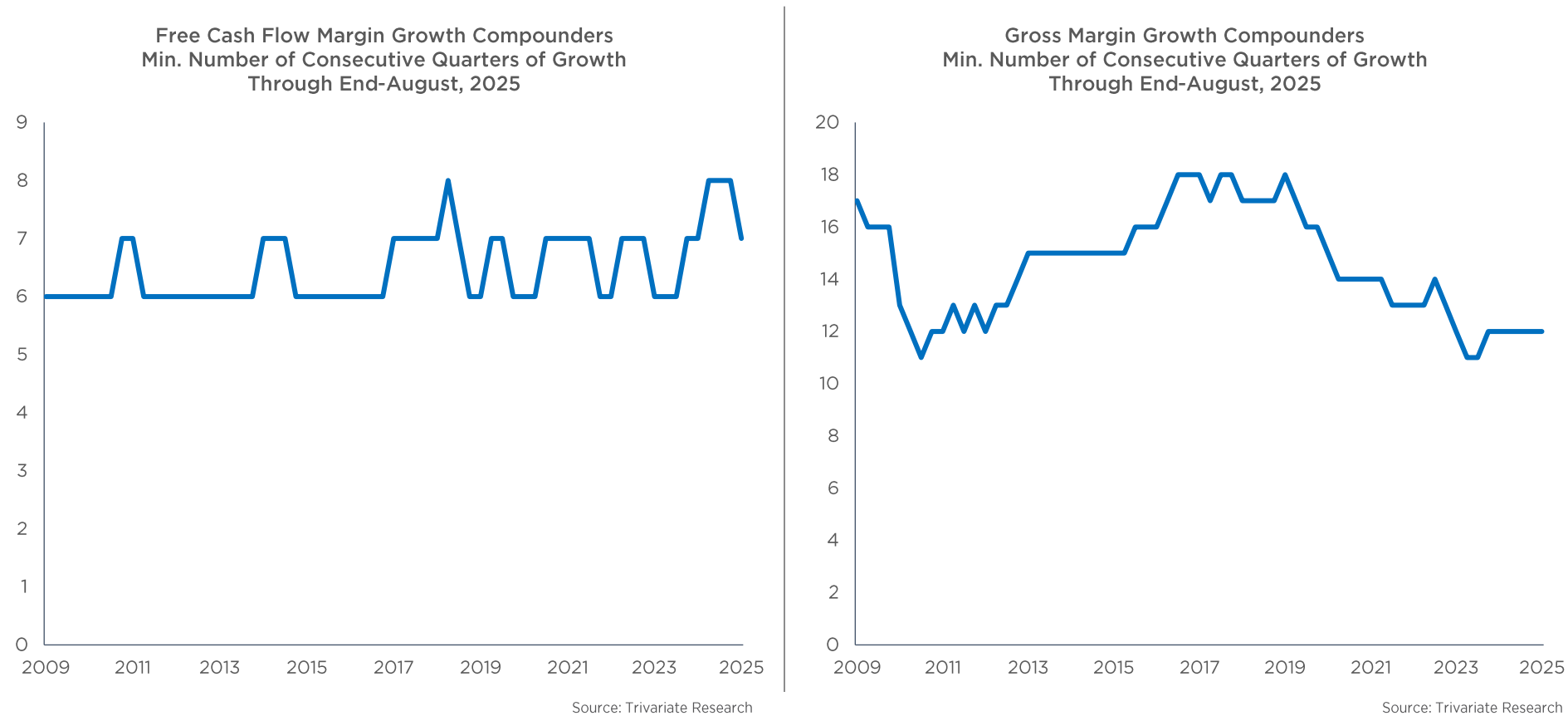
We compared the success of free cash flow margin expanders to the other metrics we evaluated to identify compounders – something we assessed in our recent work. Consistent gross margin expanders and free cash flow margin expanders have performed similarly. These include buying stocks in the top 10% of the number of consecutive quarters of year-over-year growth in gross margin or free cash flow margin.



Source: Trivariate Research

7 QUARTERS OF FCF MARGIN & 12 OF GM GROWTH IS TOP 10% IN BOTH

Below we show the minimum number of consecutive quarters of growth required to be in the top 10% of all companies for growth in free cash flow margin (left) and in gross margin growth (right) over time. The current cutoff is 7 consecutive quarters of growth in free cash flow margin and 12 consecutive quarters of growth for gross margin.



GROSS MARGIN COMPOUNDER STOCK IDEAS

Below are the suggested gross margin expansion “compounders”.

Gross Margin Growth Compounders As of September 8th, 2025

Ticker	Company	Industry	Market Cap. (US\$ Bil.)	Gross Margin (Trailing 4Q)	Gross Margin (1yr Forecast)	3-Month Total Return
AMZN	Amazon.com, Inc.	Broadline Retail	2,515.21	49.6%	50.2%	9.8%
TMUS	T-Mobile US, Inc.	Wireless Telecommunication Services	273.36	63.6%	63.8%	2.4%
ETN	Eaton Corporation plc	Electrical Equipment	136.06	38.3%	38.7%	7.2%
ADP	Automatic Data Processing, Inc.	Professional Services	120.88	48.4%	46.4%	(6.2%)
APH	Amphenol Corporation	Electronic Equip., Instruments & Comp.	134.96	35.2%	35.9%	25.9%
TDG	TransDigm Group Incorporated	Aerospace & Defense	72.87	59.7%	60.3%	(3.9%)
ABNB	Airbnb, Inc.	Hotels, Restaurants & Leisure	76.30	83.2%	83.4%	(10.9%)
CPNG	Coupang, Inc.	Broadline Retail	57.43	29.9%	30.3%	13.6%
SLB	Schlumberger Limited	Energy Equipment & Services	53.45	20.0%	19.8%	5.7%
EA	Electronic Arts Inc.	Entertainment	42.05	79.1%	81.1%	13.1%
HUBS	HubSpot, Inc.	Software	26.27	84.6%	85.6%	(17.1%)
EXPE	Expedia Group, Inc.	Hotels, Restaurants & Leisure	26.87	89.6%	89.9%	23.5%
NTNX	Nutanix, Inc.	Software	20.10	86.8%	87.9%	0.4%
CSL	Carlisle Companies Incorporated	Building Products	16.75	36.9%	37.1%	1.1%
ACM	AECOM	Construction & Engineering	16.81	7.3%	16.5%	12.3%
FTI	TechnipFMC plc	Energy Equipment & Services	16.14	21.1%	22.8%	23.2%
ATI	ATI Inc.	Aerospace & Defense	10.68	21.7%	22.0%	(11.5%)
LECO	Lincoln Electric Holdings, Inc.	Machinery	13.42	36.5%	36.6%	18.1%
ARMK	Aramark	Hotels, Restaurants & Leisure	10.07	15.6%	9.0%	(2.4%)
KD	Kyndryl Holdings, Inc.	IT Services	7.66	21.0%	21.6%	(18.9%)
RRX	Regal Rexnord Corporation	Electrical Equipment	9.54	37.2%	38.9%	0.5%
APG	APi Group Corporation	Construction & Engineering	14.64	31.1%	31.8%	9.4%

Source: Trivariate Research

FREE CASH FLOW MARGIN COMPOUNDER STOCK IDEAS

Below are the suggested free cash flow margin expansion “compounders”.

Free Cash Flow Margin Growth Compounders
As of September 8th, 2025

Ticker	Company	Industry	Market Cap. (US\$ Bil.)	FCF Margin (Trailing 4Q)	FCF Margin (1yr Forecast)	3-Month Total Return
UBER	Uber Technologies, Inc.	Ground Transportation	196.78	18.0%	17.7%	9.6%
SHOP	Shopify Inc.	IT Services	190.04	18.1%	18.2%	33.1%
ETN	Eaton Corporation plc	Electrical Equipment	136.06	12.6%	14.6%	7.2%
RBLX	Roblox Corporation	Entertainment	89.06	23.4%	20.1%	41.1%
RMD	ResMed Inc.	Health Care Equipment & Supplies	40.78	32.3%	28.4%	11.5%
GDDY	GoDaddy Inc.	IT Services	20.50	30.6%	32.9%	(17.1%)
GWRE	Guidewire Software, Inc.	Software	22.05	24.5%	23.9%	(0.5%)
FFIV	F5, Inc.	Communications Equipment	18.42	31.6%	31.3%	10.4%
U	Unity Software Inc.	Software	19.22	19.9%	18.7%	84.3%
ESTC	Elastic N.V.	Software	9.81	20.2%	18.7%	6.4%
WIX	Wix.com Ltd.	IT Services	8.52	29.5%	30.3%	8.5%
BROS	Dutch Bros Inc.	Hotels, Restaurants & Leisure	8.16	5.0%	2.1%	(10.5%)
LYFT	Lyft, Inc.	Ground Transportation	7.20	16.2%	11.5%	17.7%

Source: Trivariate Research

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