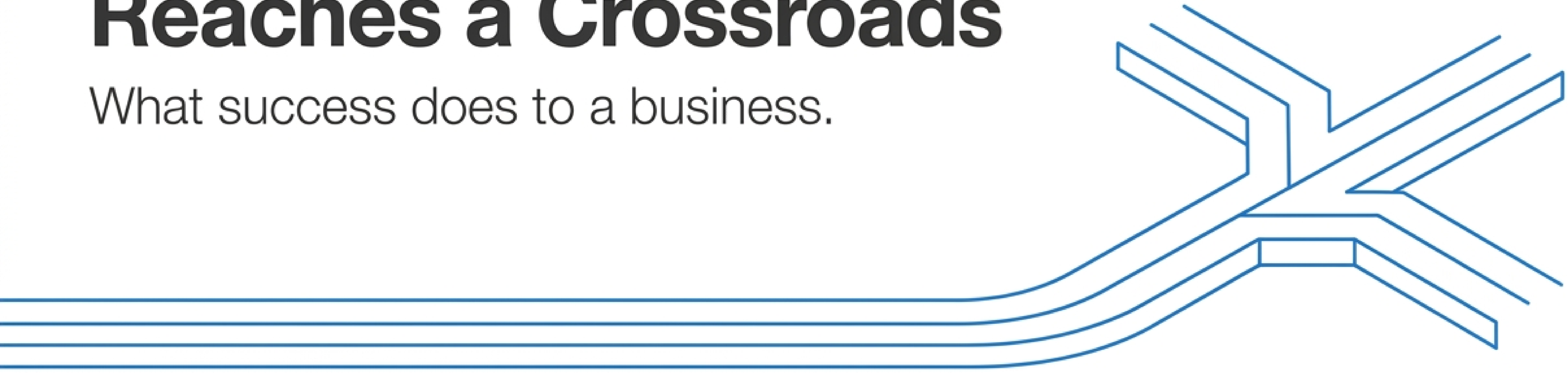
Why Every Compounder Reaches a Crossroads

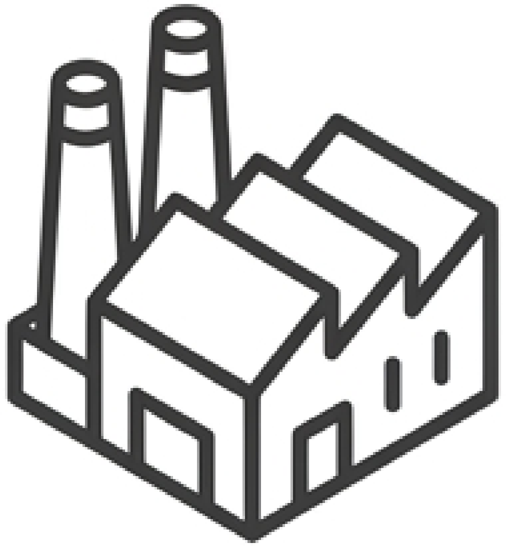
What success does to a business.



If something cannot go on forever, it will stop.

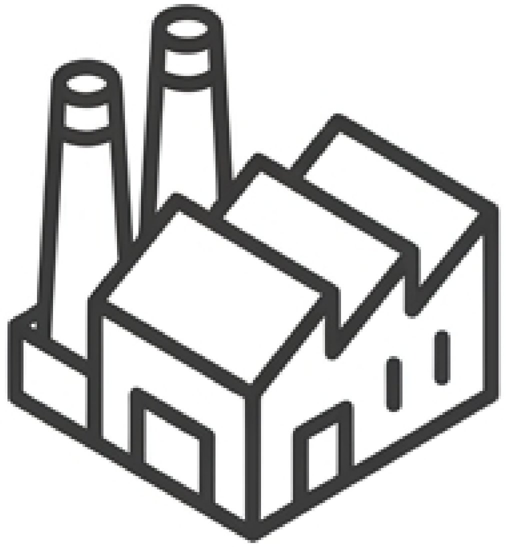
— Herbert Stein, former Chairman,
U.S. Council of Economic Advisers

Two Compounders. One World.
Same Capital Intensity.



Coca-Cola

Capital Spend: 4.4% of Revenue



PepsiCo

Capital Spend: 4.3% of Revenue

Identical labels hide entirely different economic machines.

What happened over a decade?

Coca-Cola

Revenue: +14%
ROIC: 9% →

Coca-Cola

Revenue: +14%
ROIC: 9% →

19%

PepsiCo

Revenue: +54%
ROIC: 15.5% →

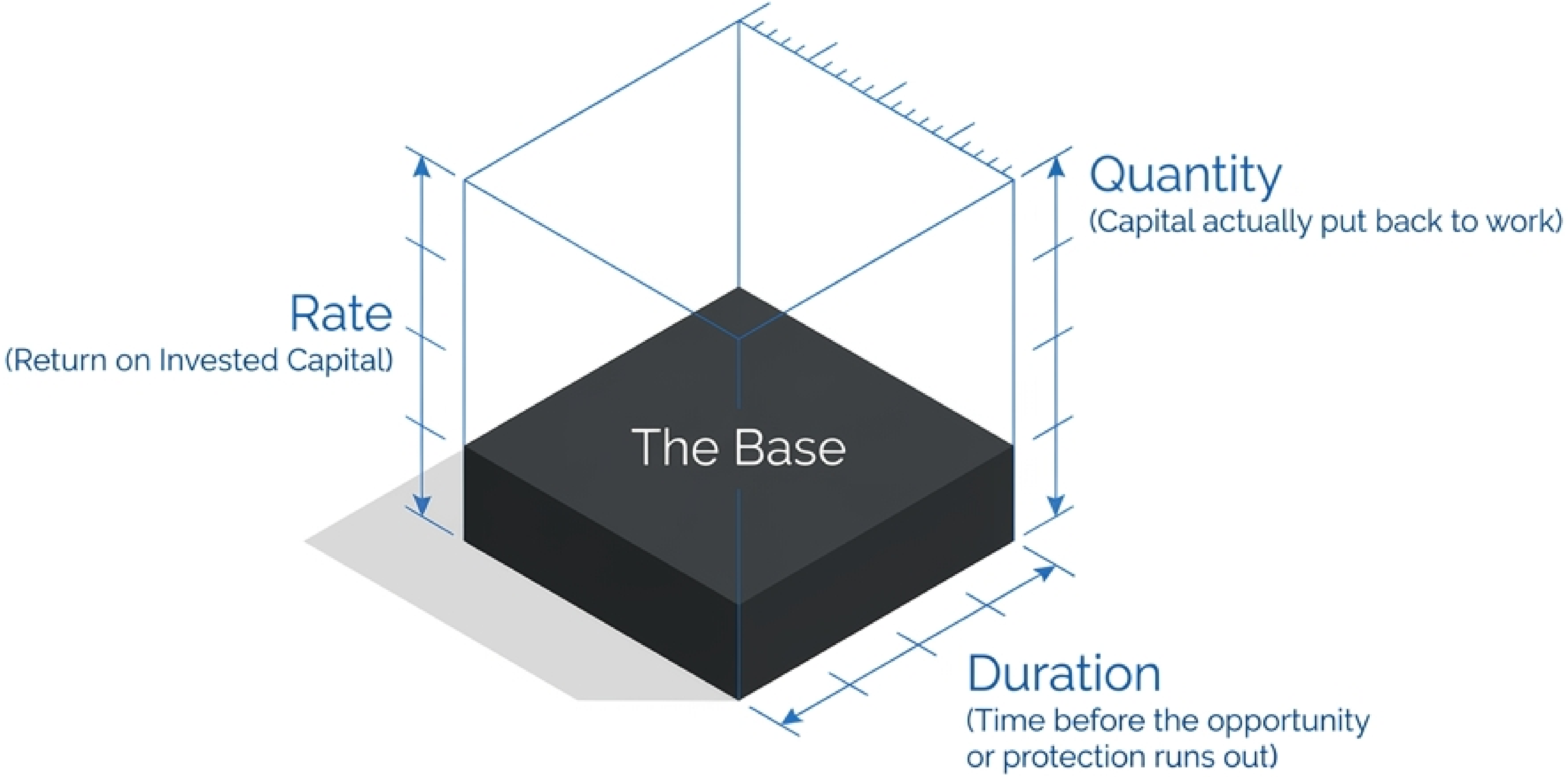
PepsiCo

Revenue: +54%
ROIC: 15.5% →

15.5%

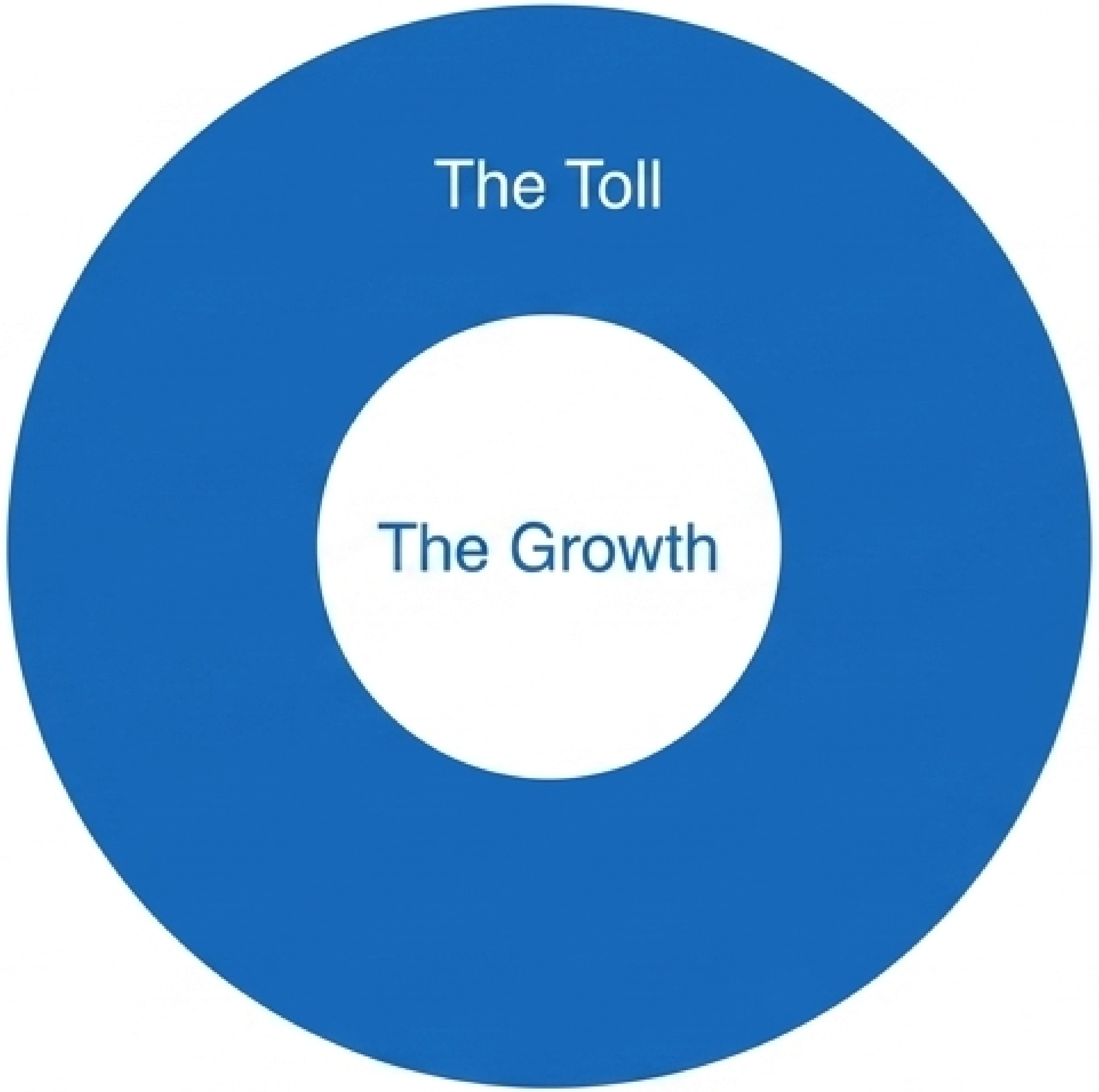
One improved earnings on a fixed base.
The other enlarged a base without improving the rate.

The Mathematics of Compounding

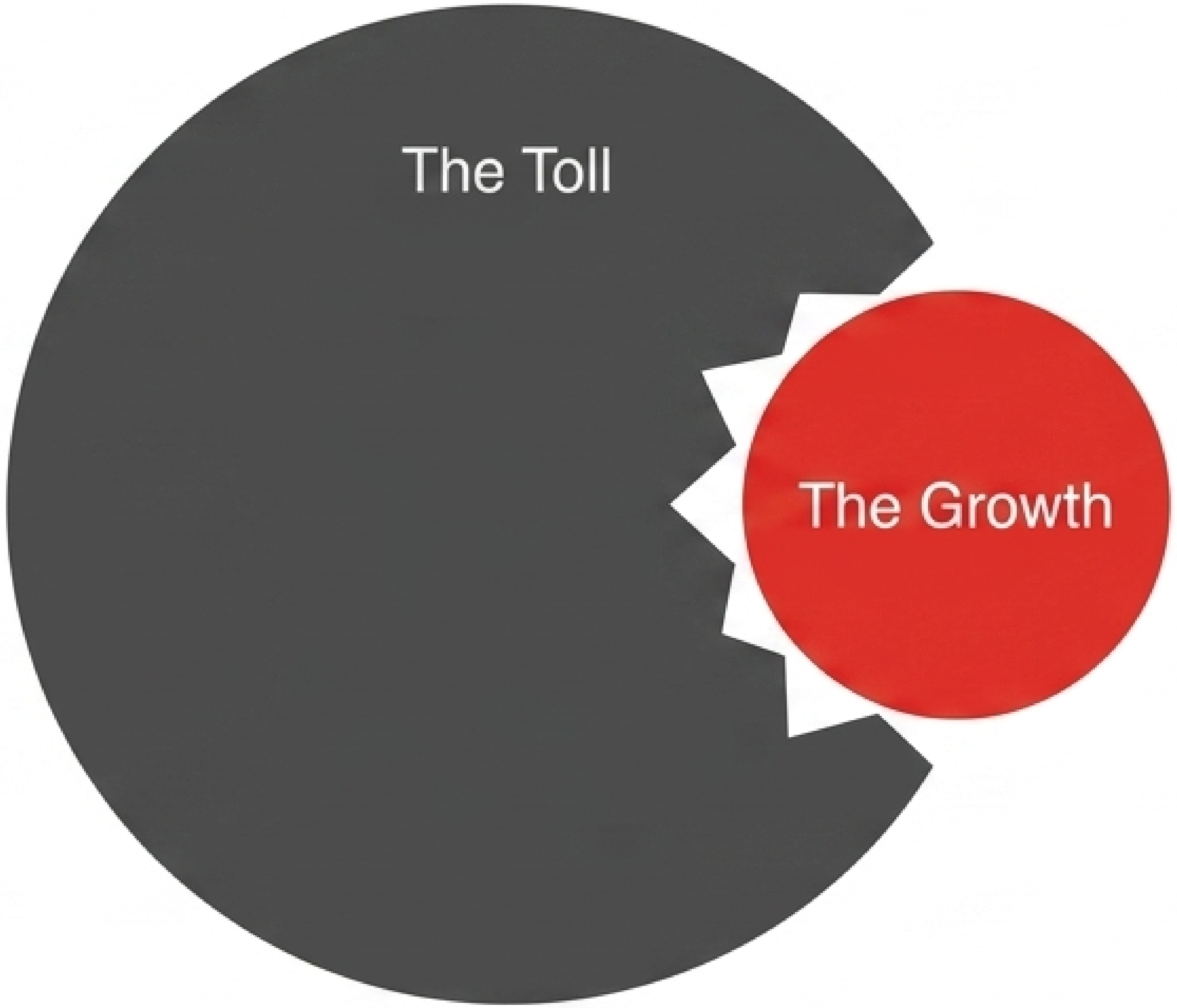


All three must multiply. No business holds all three at maximum.

The Direction of Quality

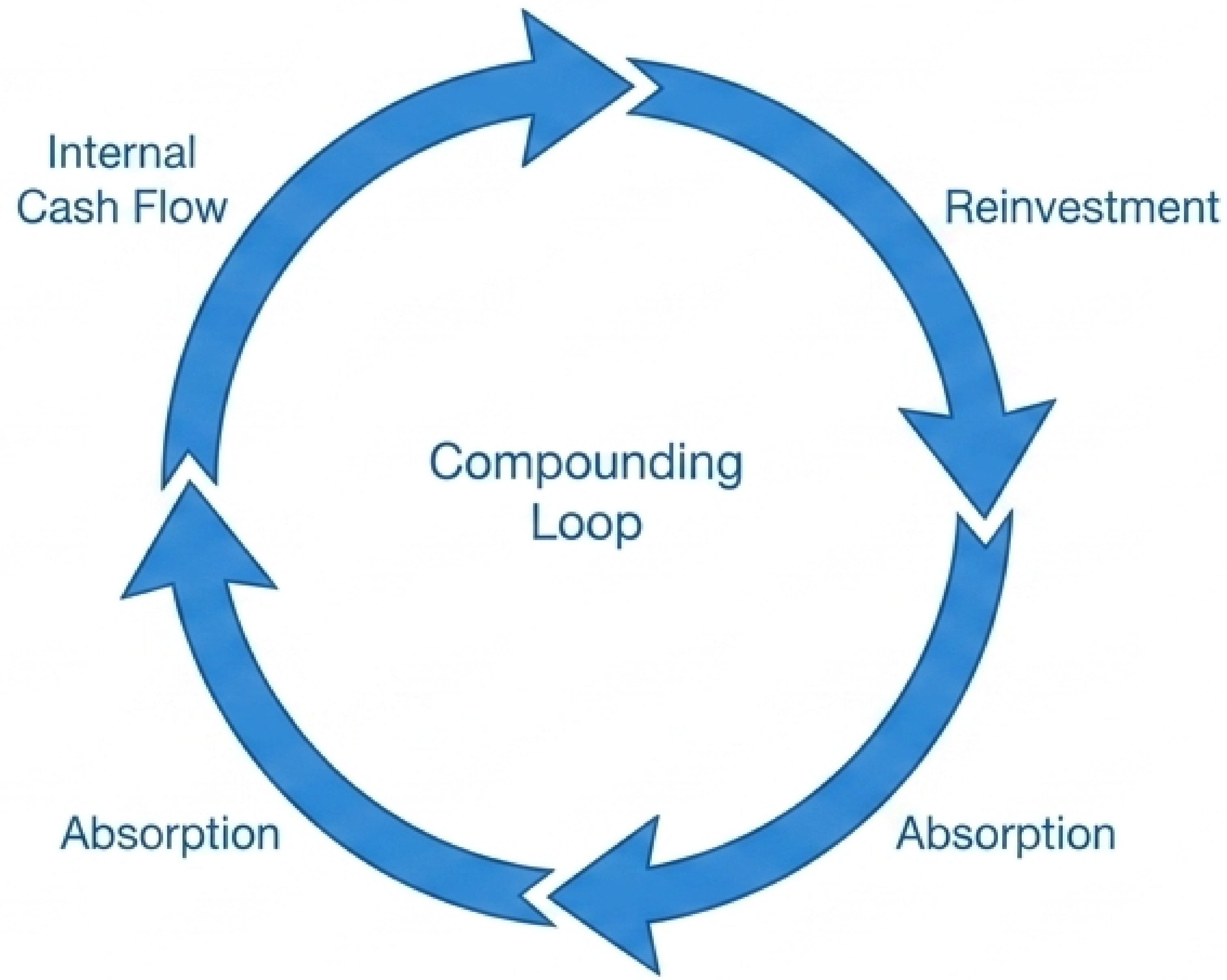


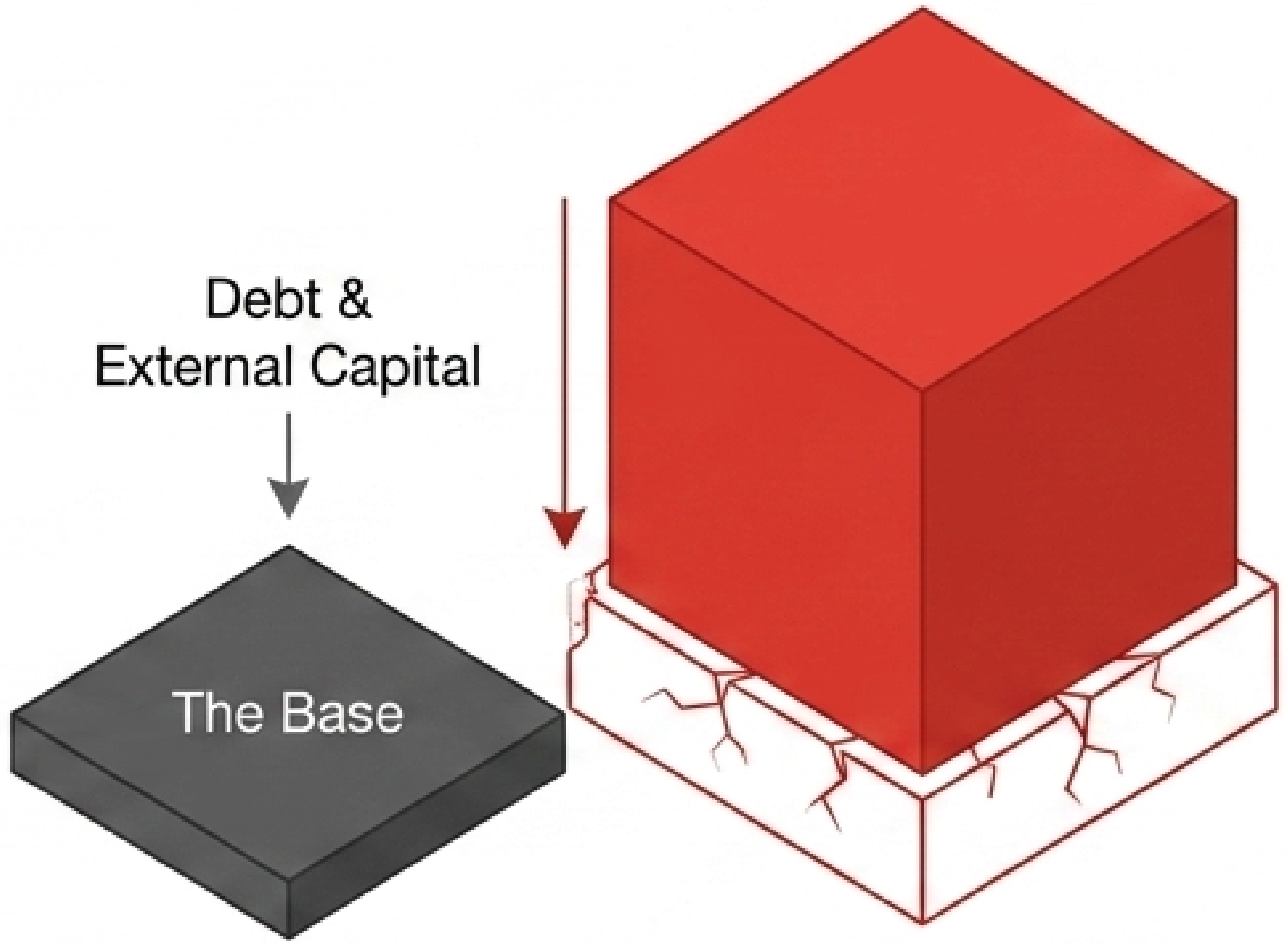
Quality: The toll absorbs the growth.
What cannot be consumed is surplus.



Deterioration: Growth devours the toll.
The business burns more than it collects.

You can borrow size, but you cannot borrow rate.





Duke Energy

Net Income: $5B

Capital Spending: **$14B**

Negative free cash flow. Dividends paid from borrowings. This is intermediation, not absorption.

Two Ways to Stall

Waste Connections

The Zero Spread

Real cash flow, wide moat. But return sits almost exactly at the cost of capital. Quantity multiplies nothing.

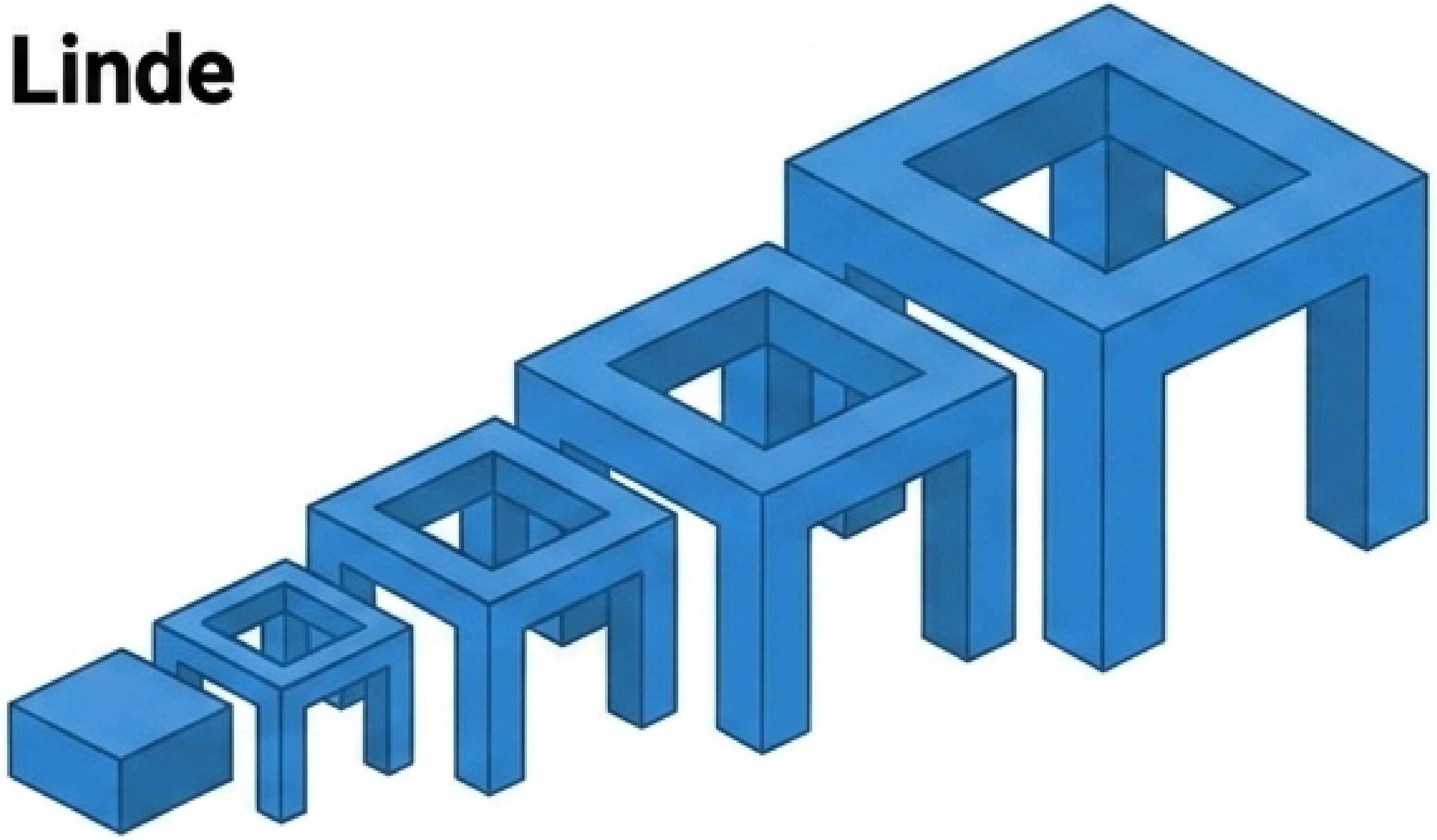
Canadian National

The Increment Trap

High average return inherited from a century-old network. New capital produces almost nothing. The average conceals the increment.

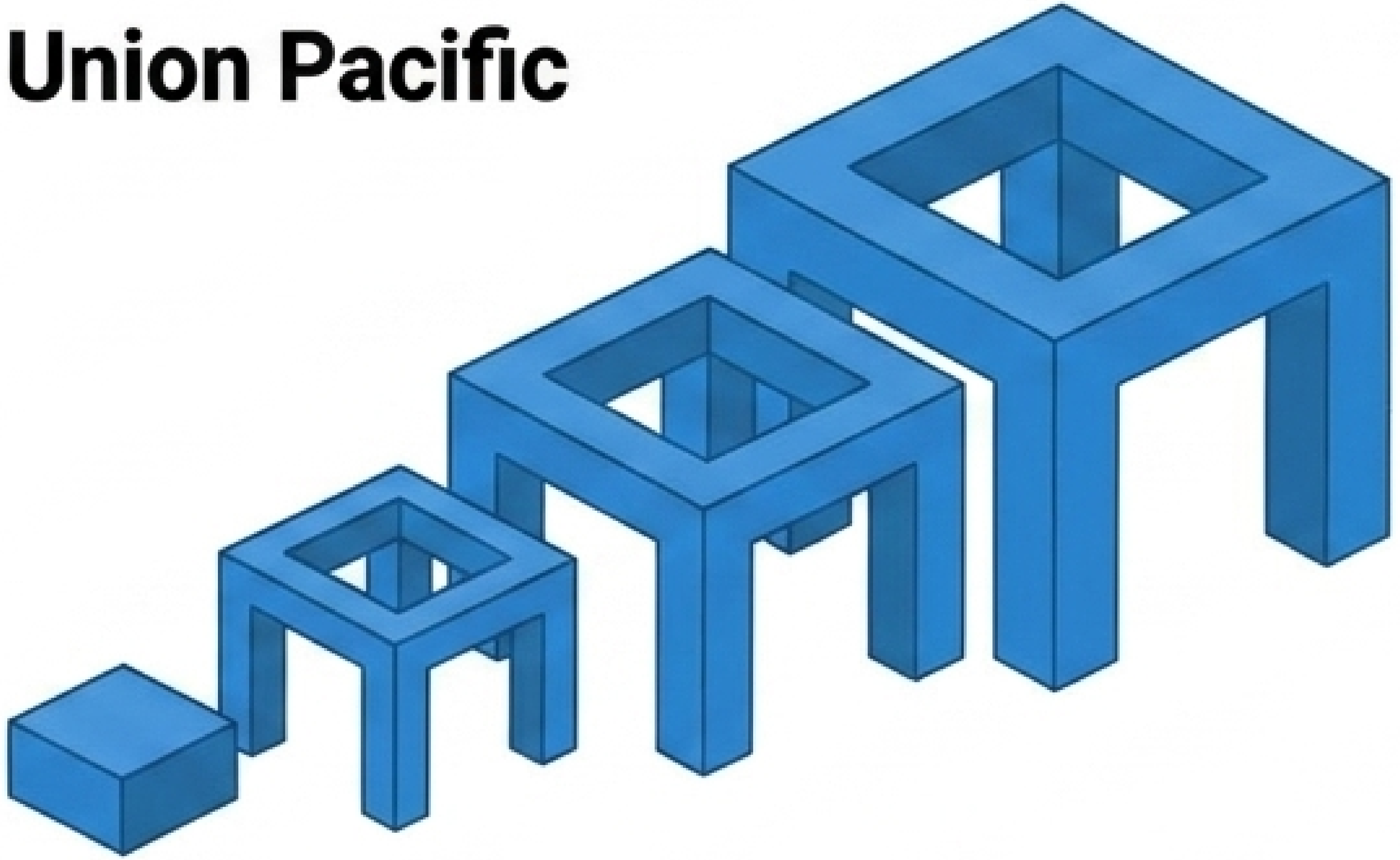
True Compounding Grows from Within

Linde



Absorbed Praxair over 6 years.
Funded entirely from operations.
Base doubled. Spread preserved.

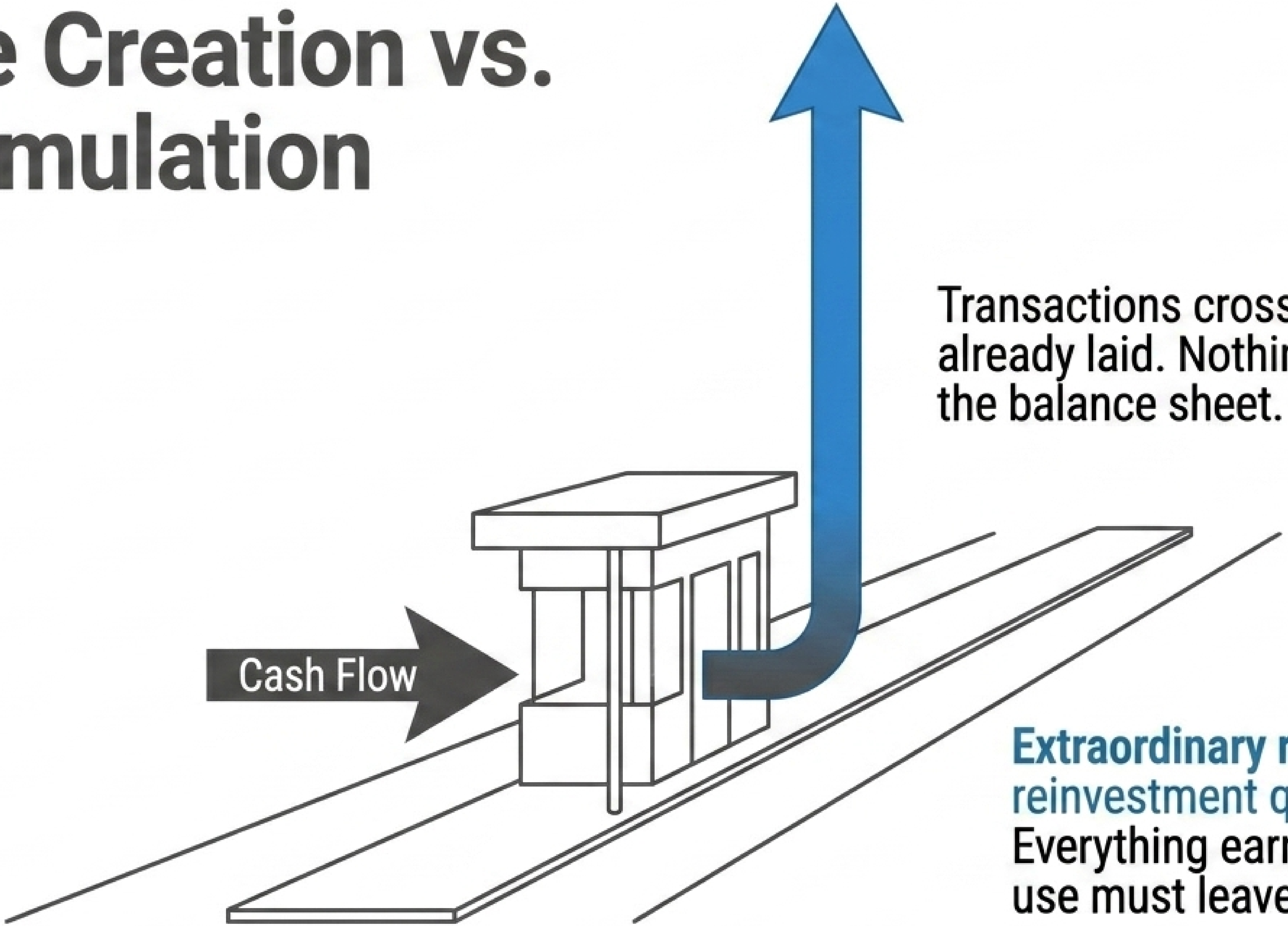
Union Pacific



Capital poured into what the 1862 corridor could carry, not more corridor.
ROIC rose from 13.4% to 16.2%.

Value Creation vs. Accumulation

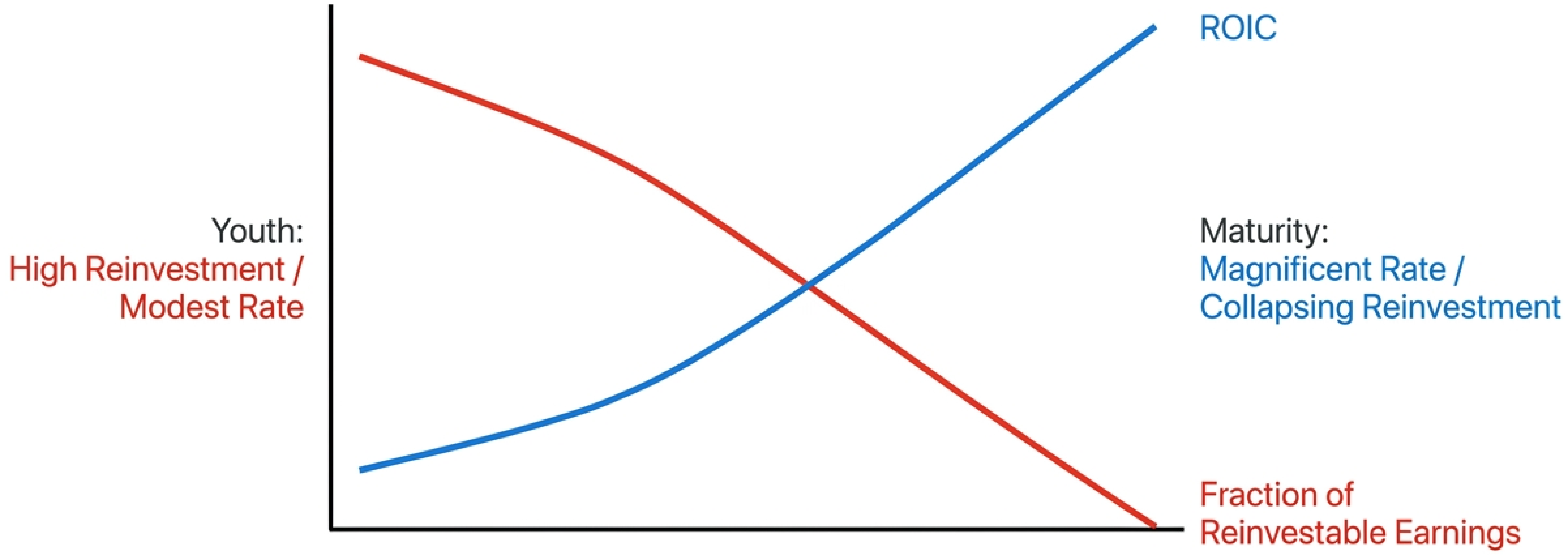
Visa



Transactions cross rails already laid. Nothing lands on the balance sheet.

Extraordinary rate. Zero reinvestment quantity. Everything earned beyond use must leave.

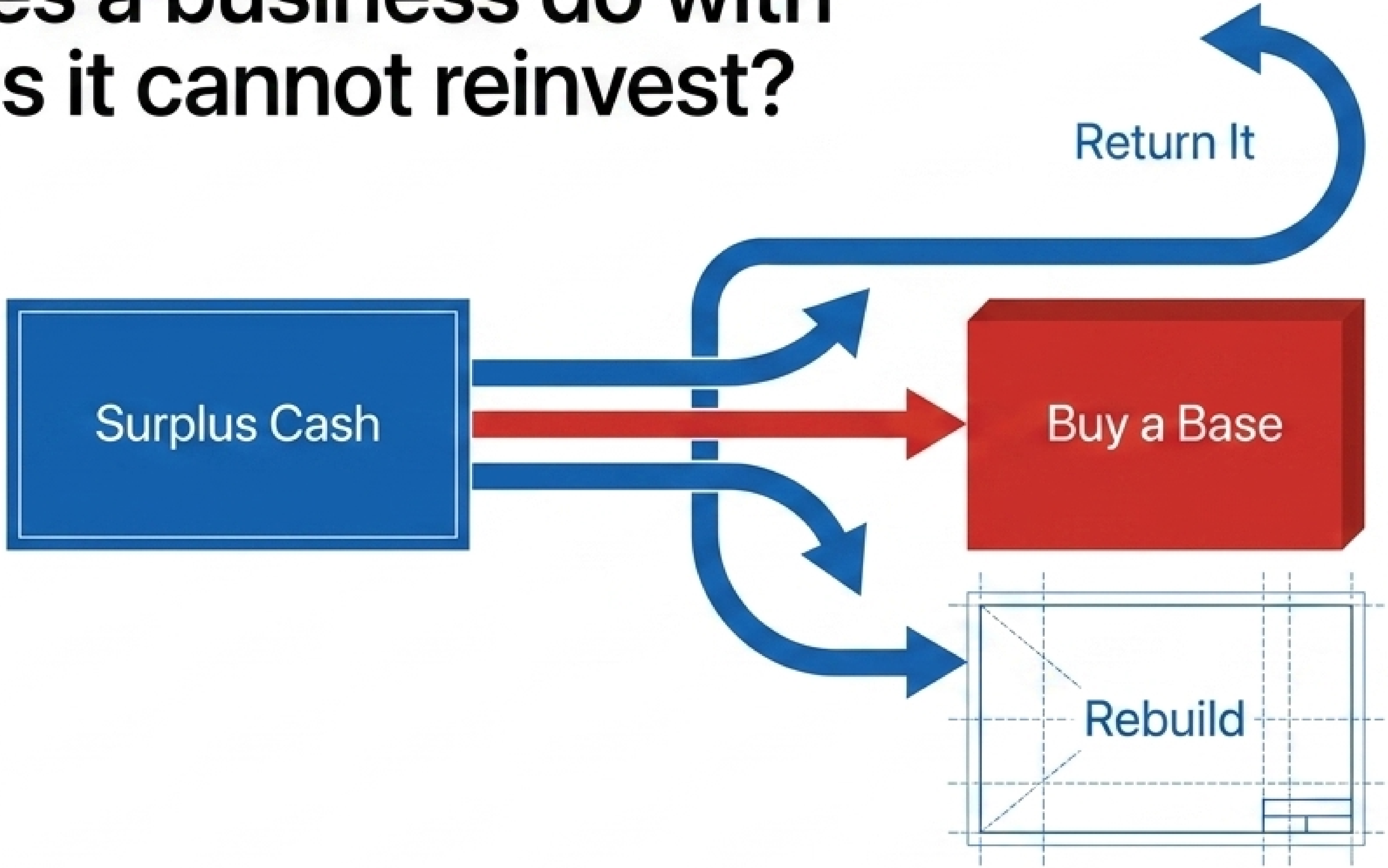
Why Compounding Stops



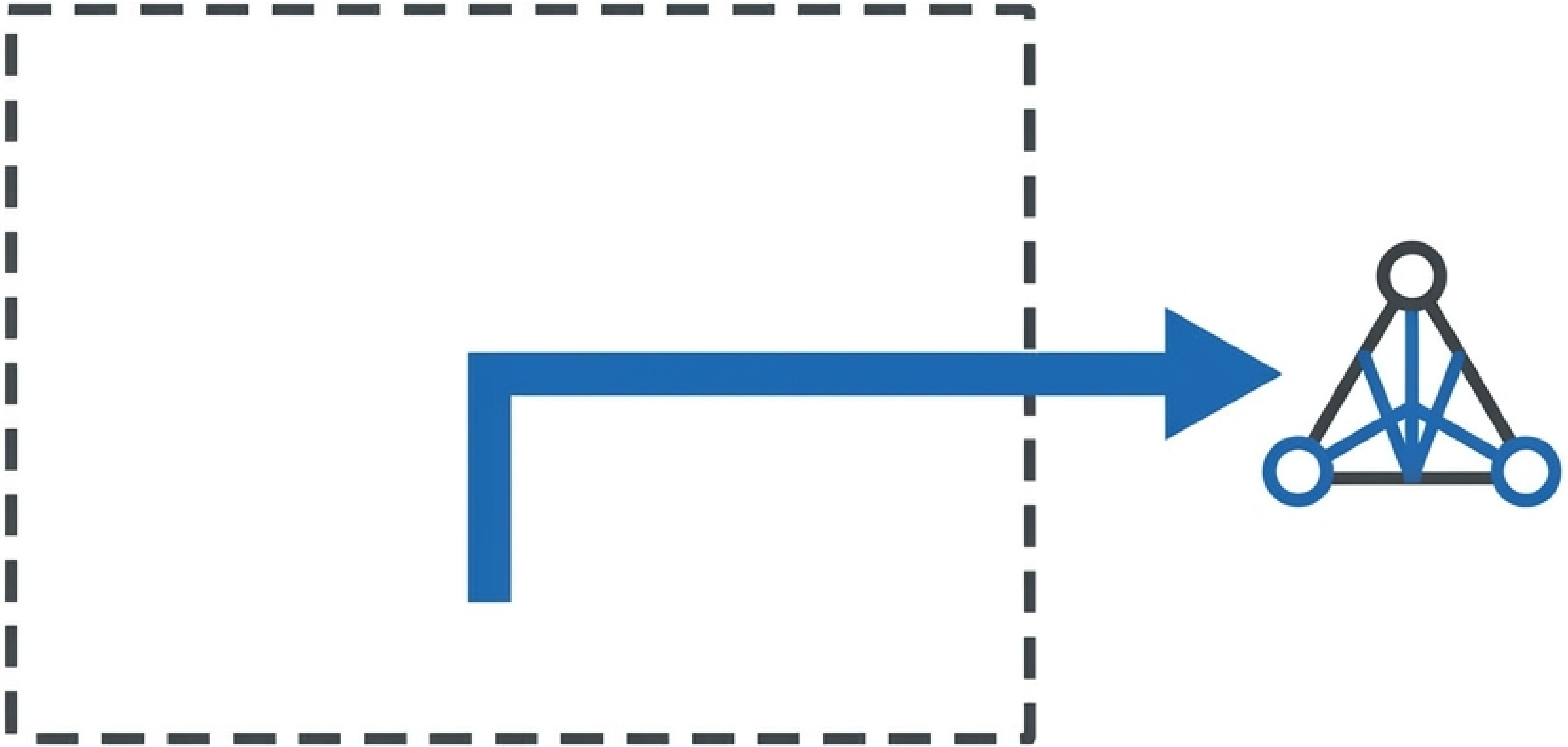
The engine doesn't lose power. It runs out of anything to turn.

The Inevitable Question

What does a business do with a surplus it cannot reinvest?



Option 1: Acknowledge and Return



MSCI:
Persistent repurchases
(Equity consumed below zero)

Coca-Cola:
~66% payout ratio

Visa:
Distribute and repurchase

Compounding doesn’t end; it is externalized to the owner.
It arrives taxed, and relies on the owner to redeploy it.

Option 2: Deny It (Buy a Base)

S&P Global
(bought IHS Markit for $44B)

57% → 10%

ROIC: 57% → 10%

Canadian Pacific
(bought Kansas City Southern for $31B)

16.6% → 6.7%

ROIC: 16.6% → 6.7%

The arithmetic of premiums: Irreplaceability is exactly what makes the premium expensive.

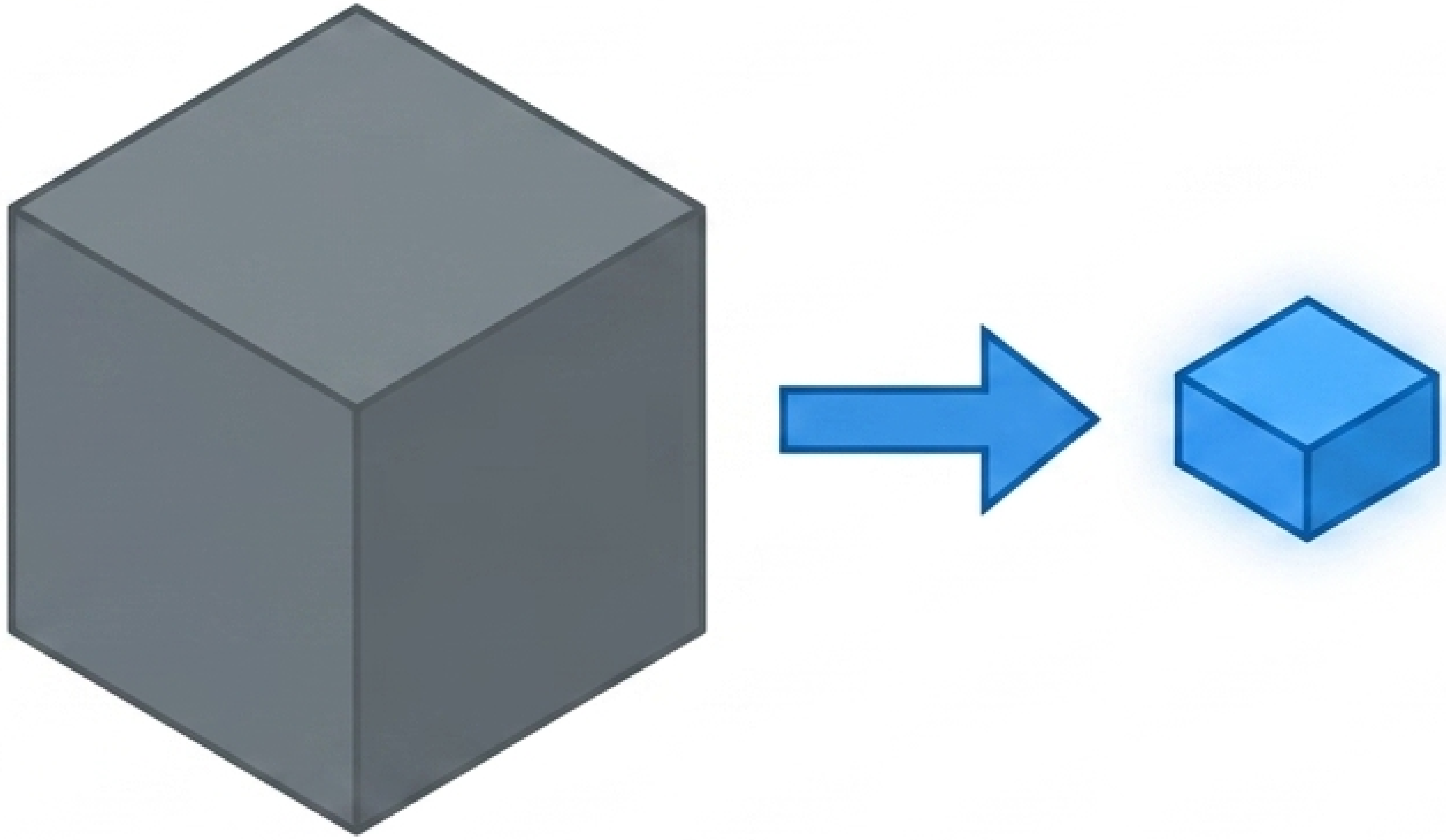
Option 3: Rebuild the Machine

Coca-Cola (2015-2018)

Action: Sold bottling operations.

A deliberate decade-long retreat.

Revenue fell by 25%.



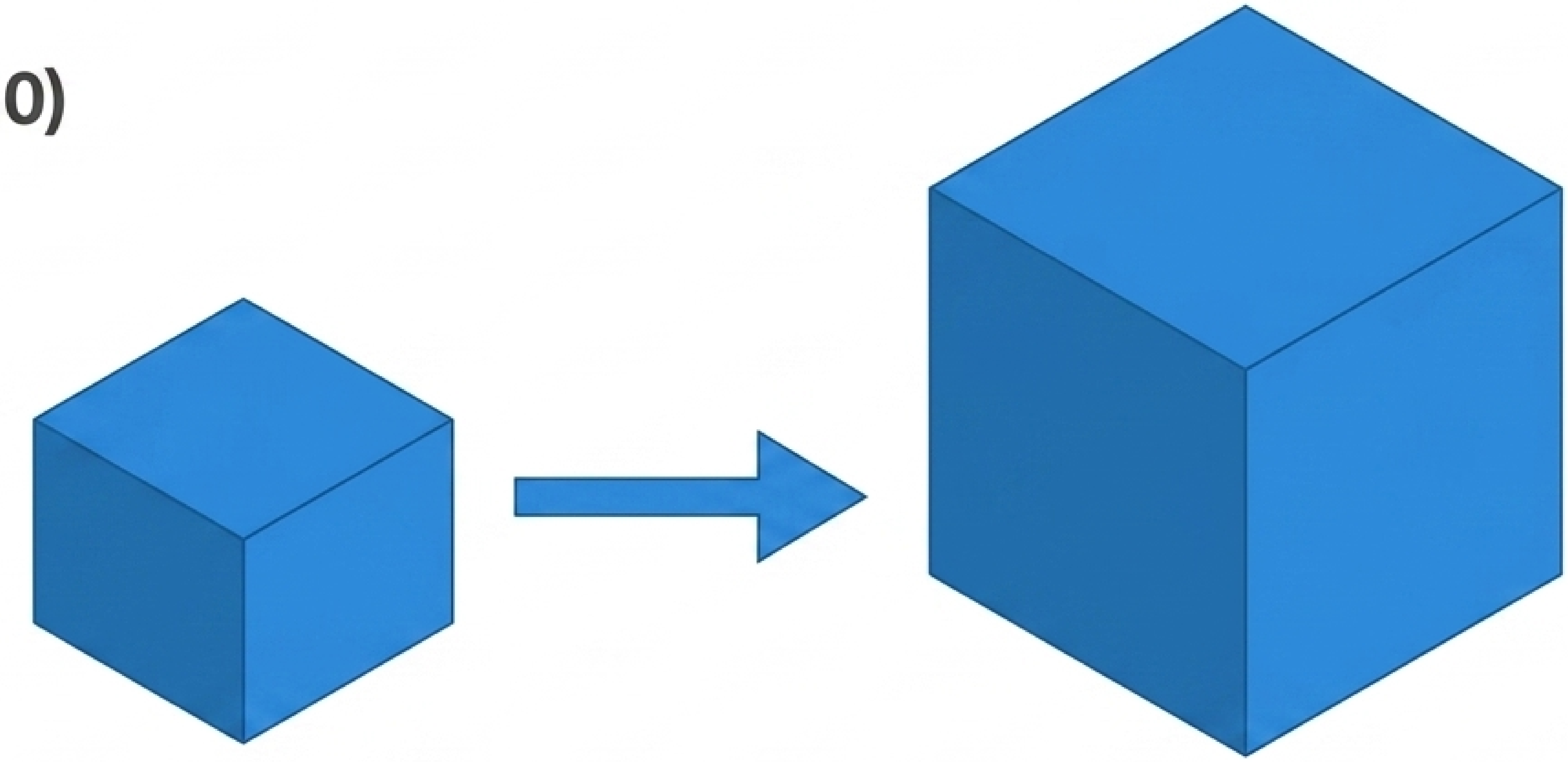
Result: Margins rose (22.4% → 31.1%).

Capital spend plummeted.

ROIC doubled.

The Opposite Choice

PepsiCo (2010)

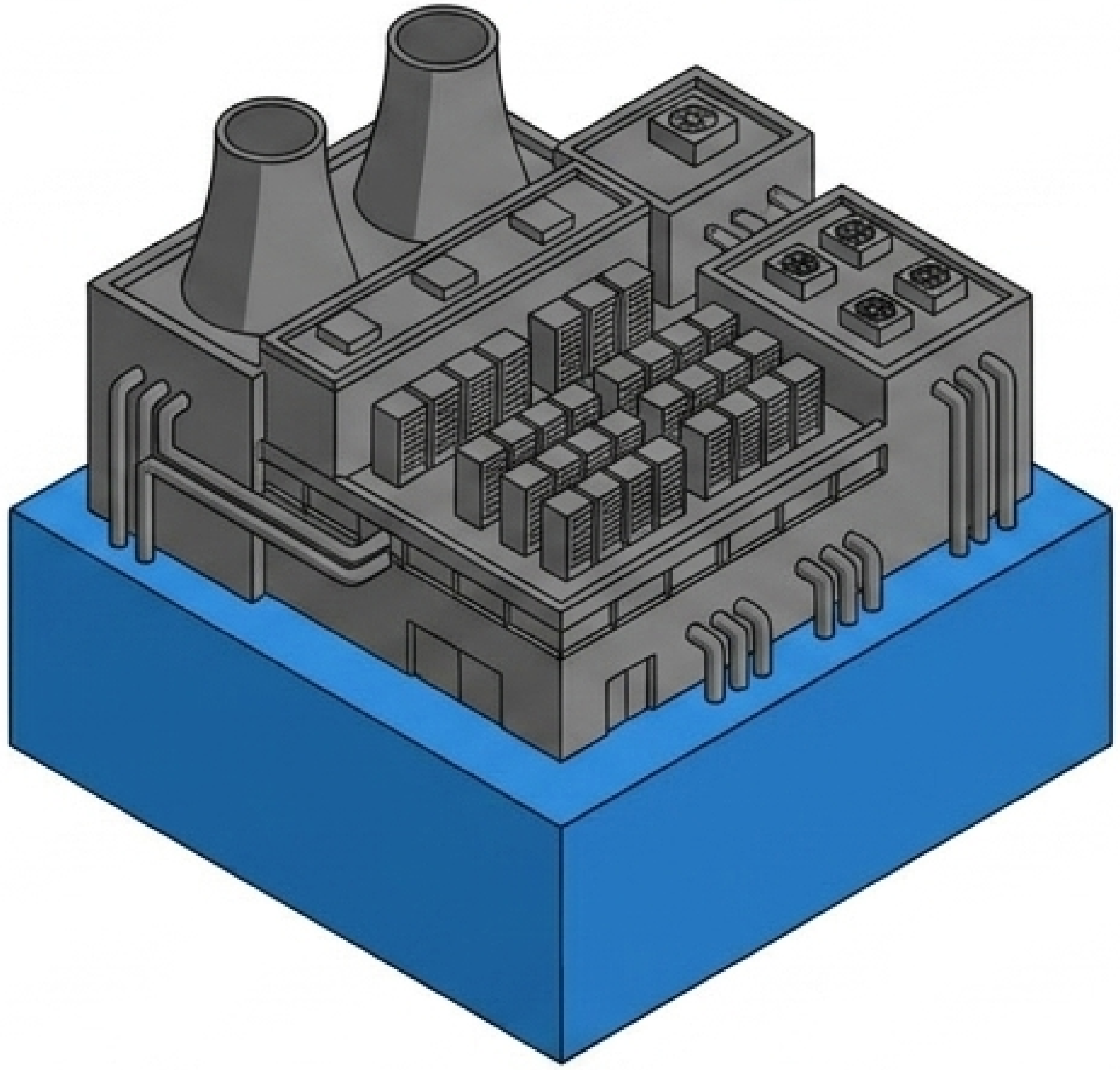


Action: Bought bottlers back.
Kept direct-delivery network.

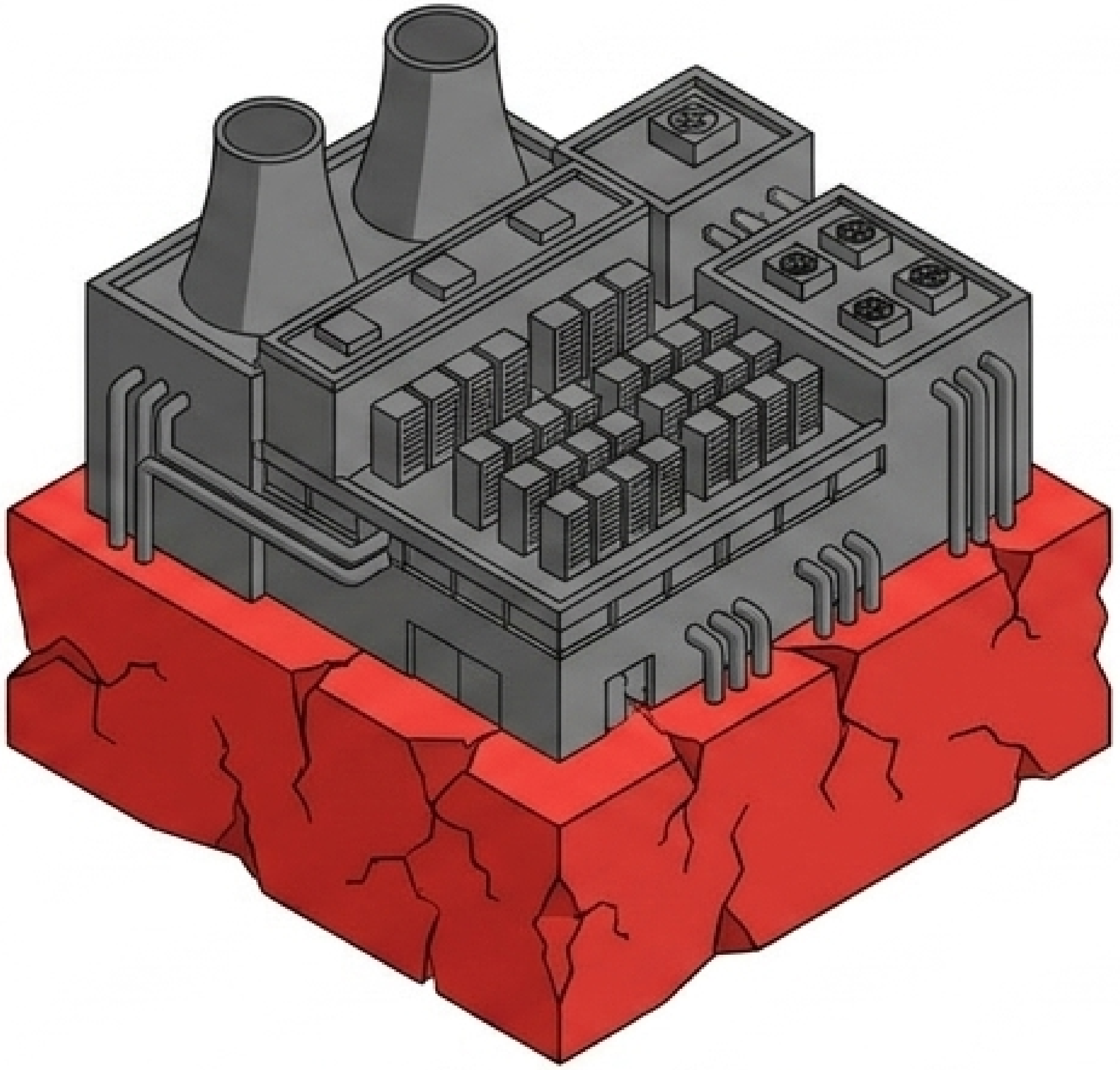
Result: Rate held steady at **15.5%.**
Base grew by **>50%.**

Insight: Coca-Cola kept the rate; PepsiCo retained the capacity to absorb capital.

They look the same from the outside.



Building a base



Buying a base

The Trap: Both commit enormous sums. Both compress reported returns. Both are sold to the market as "growth."

How to Tell the Difference

1. Financing: Generated from within out of cash flow, or raised from debt/equity markets?

2. Billing: Does the new base bill third parties, or just serve its owner as a cost center?

3. Time & Tone: A decade-long programme announced as a retreat, or a quarterly transaction announced as growth?

The Infrastructure Build-Out

Microsoft

- $170B cash flow vs $97B Capex.
- Capacity contracted ahead of delivery.

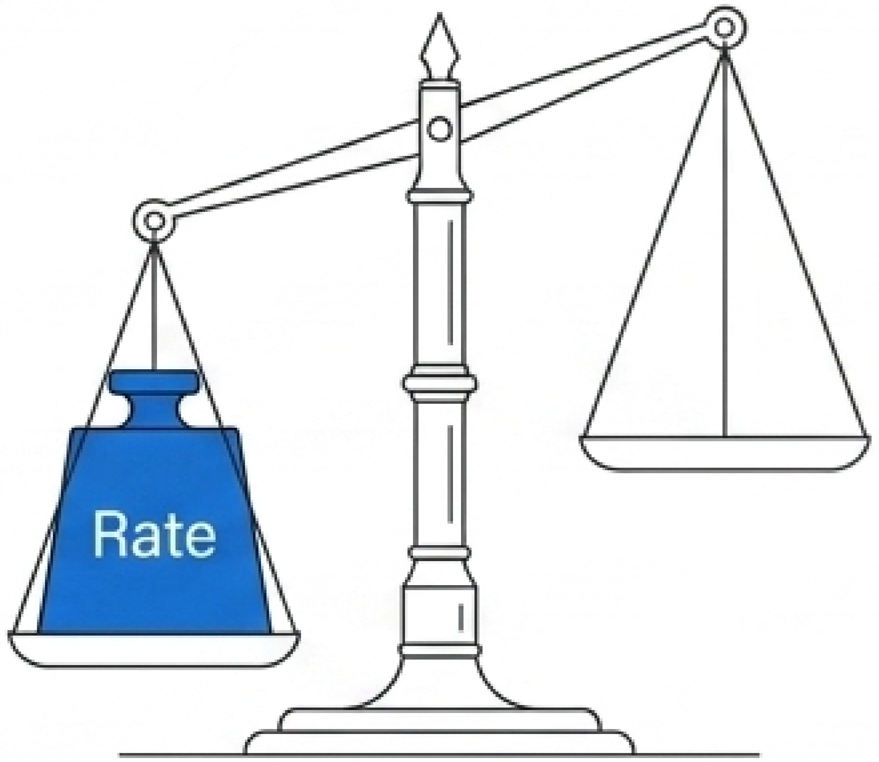
Alphabet

- Negative free cash flow; raising notes and equity.

Meta

- Infrastructure consumed internally; bills no one. Held off balance sheet.

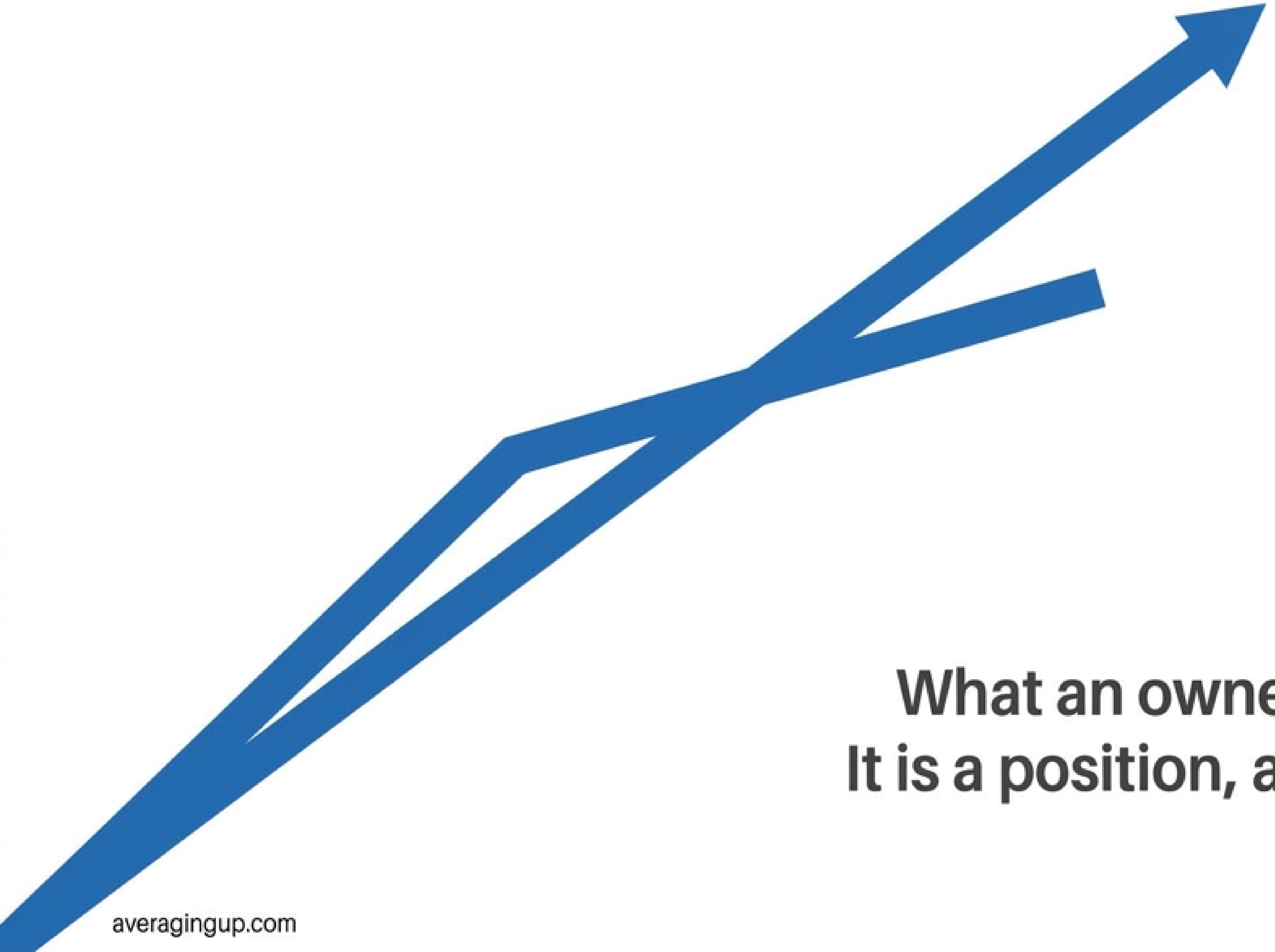
Your Constraint is Size



Small Capital: Constrained by Rate. Money goes where returns are highest.

Massive Capital: Constrained by Quantity. A modest return on a massive base beats a magnificent return on a base too small to matter.

The Edge: The positions closed to the largest investors remain open to you.



What an owner buys is never a rate of return.
It is a position, at a moment, already travelling.

The content of this presentation reflects a personal analytical framework and is intended solely for educational purposes. It does not constitute financial or investment advice.