Free Cash Flow- Must adjust for misclassifications, extraordinary and one-time items and other expenses and events not properly accounted for in either the income statement, statement of cash flows, or footnotes. Prospective adjustments for each sovereign jurisdiction are imperative. Examples would be pension reporting vs. real requirement, cash interest and taxes, payment to non-controlling interests, capital leases, derivatives, inputs, moral obligations, clients and suppliers, and overspending in discretionary areas.

Return on Invested Capital (ROIC)-Based on free cash flow (above), as percentage of all invested capital to determine cash on cash return, ability to add value to shareholders and comparability. Free cash flows are compared to cost of equity capital over various time periods to determine margin of safety and trend. An inspection of other comprehensive income is made for adjustments as necessary

Cost of Capital- Cost of capital encompasses any metric that could impact prospective free cash flows. It is grounded on a comprehensive evaluation of cash flow, credit health and miscellaneous items, such as insurance adequacy, patents, litigation risk, yield spreads, deep supply chain, operations, commitments, components of sovereign risk, tax analysis and many other factors. Cost of capital must be accurately derived to determine the denominator of the valuation model.

Valuation- The free cash flow yield is compared to the 10 year treasury rate or inflation break-even. Very low treasury yields require a larger mark-up. A firm must also be value-adding as determined by ROIC and weighted average cost of capital. Firms must continue to add value regardless of economic and industry sector constraints.

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