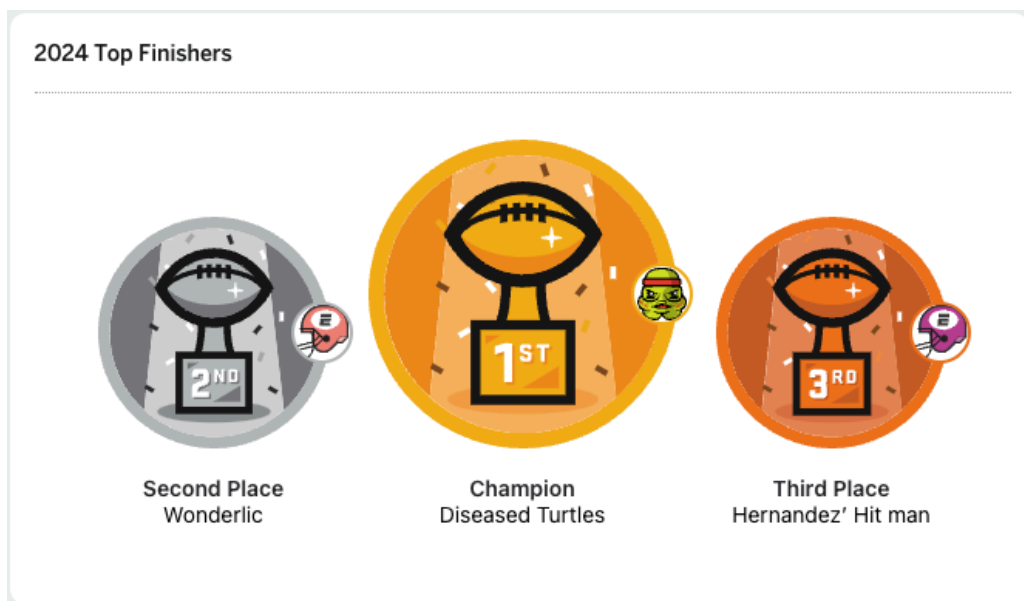# Long Pull Report: Housekeeping Items & A New Mental Model for 2025

Three quick announcements.

First, congratulations to @Darren on winning the 2024 Macro Ops Fantasy Football League! Not only did Darren win the league, he also finished tied for the best overall record (8-3).

2024 Top Finishers

Second Place
Wonderlic

Champion
Diseased Turtles

Third Place
Hernandez' Hit man

Kulok took second, and Andrea third. Don't ask me where I finished (last place).

We're sending Darren some sweet MO swag for the victory.

Which brings me to the second announcement.

I've wanted to open a small MO swag shop since I joined the team. Maybe 2-3 high-quality items to choose from, with random "merch drops" throughout the year to keep things fun.

Let me know if you would buy a sweatshirt, quarter-zip, or T-shirt, and we'll make it happen.

[MO Swag Google Survey](#)

The final announcement is that we're starting our 2025 MO Stock Picking Contest.

Members have till the end of the month to choose their stocks. This allows the most people to participate and gives new Collective members time to pick their fighters.

Performance data will start on February 1, so you can't cherry-pick the best January performer.

Same rules as last time … three stocks, no take-backs.

This year, we're adding Quarterly Prizes for the best-performing members each quarter.

Click the link below to add your stocks.

[MO 2025 Stock Picking Competition](#)

We're gonna have a fun year together.

Alright, done with housekeeping!

Debt Capacity Bargains: A New Mental Model For 2025

> *"It can scarcely be denied that the supreme goal of all theory is to make the irreducible basic elements as simple and as few as possible without having to surrender the adequate representation of a single datum of experience." - Albert Einstein*

Ben Graham was a master at distilling complex financial analysis into its simplest form, often using grade-school math.

Sanjay Bakshi explained one such Grahamian concept in his 2005 blog post, *[One Valuation Rule, Two Paradoxes](#)* (emphasis mine):

> *"Benjamin Graham gives an elegant rule on valuation of equities which I call as* **the rule of minimum valuation.** *This rule states that:*
>
> **"An equity share representing the entire business cannot be less safe and less valuable than a bond having a claim to only a part thereof."**
>
> *The wisdom of the rule of minimum valuation arises out of the fact that* **it allows you to use elementary math** *to* **prove the cheapness of a stock."**

Chop wood, carry water…

In other words, the equity of a cash-generating, debt-free business, which has a claim on 100% of the cash flows, *cannot be worth less* than the value of that company's debt, which is entitled to only a portion of the company's cash flows.

Graham further explained this idea in *The Intelligent Investor* (emphasis added):

> *"There are instances where an equity share may be considered sound because it* ***enjoys a margin of safety as large as that of a good bond.***
>
> *This will occur, for example, when a company has outstanding only equity shares that under depression conditions are* ***selling for less than the amount of the bonds that could safely be issued against its property and earning power.***
>
> *In such instances the investor can obtain the* ***margin of safety associated with a bond, plus all the chances of larger income and principal appreciation inherent in an equity share.***"

I've read both Graham books. But for some reason, it took me until *now* to realize the simplicity and power of this model.

The idea is that you assume the role of a "prudent banker" whose job is to issue debt to whatever company you're analyzing. And that total debt amount is the **minimum value** of the enterprise.

Sanjay describes the role of the prudent banker in his 2011 blog post, *[Vantage Point: 8 Points of View For Evaluating a Stock](#)* (emphasis added):

> *"Imagine that you are an old-fashioned, prudent banker who believes in the banking dictum that one must lend money to only those borrowers who don't need it.*
>
> *How much money would you lend against the security of [a] business (not counting [any] surplus cash on the balance sheet?)*
>
> *What are the key factors that prudent bankers think about before deciding how much to lend to a borrower?*
>
> *Three factors are critical:* ***size, cyclicality,*** *and* ***interest cover***. *Other things remaining unchanged, its prudent to lend to large companies whose businesses are not cyclical. If a business is cyclical, then a prudent banker would not depend on peak earnings. Rather, he would compute average past earnings and then ask*

Chop wood, carry water…   3

for a higher interest cover on those earnings than would have been the case if those earnings were not cyclical."

I love this framework because it simplifies our analytical process into three main questions:

1) **What is the durability of the business model?**
2) **What are the normalized cash flows we should expect from this business?**
3) **Given its durability and normalized earnings power, how much could we conservatively lend to this business?**

It's all about simplifying things as much as possible, but not any simpler. These questions are simple because they don't require Excel spreadsheets or intricate DCF formulas.

Yet they're not *too simple* in that they lose the core of what we're trying to understand about the business: **the durability of earnings power over time**.

How To Find Debt Capacity Values

Our job as equity investors is to find companies trading at or below their Debt Capacity level.

Here's how:

1) Find a debt-free business with a history of positive free cash flow (ideally 3-5 years).
2) Create a normalized earnings power value by averaging the past X years' free cash flow (again, 3-5 years).
3) Use an appropriate interest coverage ratio (3x for less cyclical businesses, 5x for more cyclical businesses).
4) Use an appropriate interest rate for the company's new "debt capacity" (think of this like a discount rate in a DCF … higher numbers for more cyclical/risky businesses).
5) Divide the interest expense (from Step 3) by the Interest Rate (from Step 4).

Finally, compare the Debt Capacity value to the company's current market cap. **If the Debt Capacity is above the current market cap, you have a bargain.**

I know this sounds obvious, but it's such a powerful tool for finding *cheap* businesses, not value traps.

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Let's use two real-world examples to explain this framework.

Example 1: Nexteq (NXQ)

NXQ is a micro-cap company that manufactures gaming platforms and display solutions for the gaming and slot machine industry.

The company has a $48M market cap along with:

➢ $37M in cash
➢ $21M in inventory
➢ $23M in accounts receivable
➢ $19M in current liabilities
➢ $2M in total debt

You're buying the operating business for ~$13M. NXQ generates an average of $6M in free cash flow annually.

What interest coverage ratio should we use? Let's focus on the industry and the company's cyclicality.

NXQ sells primarily to the gaming industry. Gaming has historically been a highly cyclical industry with long sales and product cycles. The company's casino and slot gaming business is less cyclical than video games.

The company also has strong asset protection in cash, inventory, and receivables, which a lender could use as collateral.

Let's use a 3x interest coverage ratio and an 8% interest rate. The interest rate could be higher, but we're accounting for the company's collateral protection.

Here's the result:

➢ Annual interest payments: $2M
➢ **Maximum Debt Capacity: $25M ($2M / 0.08)**

We've found our **Rule of Minimum Value** for NXQ at $25M. Remember that $25M represents a claim on a third of the company's cash flows.

Since NXQ is debt-free, you can buy the equity, which has a claim on 100% of the free cash flows, for only $48M.

That doesn't include the $35M in net cash on the balance sheet, and the $6.5M in cumulative dividends shareholders have received since 2021 (13% of the current market cap).

Let's try another example.

Example 2: Francotyp-Postalia Holding AG (FPH.XTRA)

FPH develops, manufactures, rents, and sells franking systems. Think of the machines that print postage directly onto envelopes.

It also sells consumables, such as ink cartridges; and provides software solutions for cost center management and teleporto services.

This is a boring business.

The company trades at a $38M market cap with:

- ➢ $48M in cash
- ➢ $28M in receivables
- ➢ $18M in inventory
- ➢ $94M in current liabilities (probably pensions)
- ➢ $20M in total debt

Yes, the company has debt. But it's more than twice covered by cash, so we can treat these businesses as "debt-free." In fact, the company generates ~$2M in net interest income annually.

FPH generates, on a 20YR average, $13M in annual free cash flow (see below).

Revenues and cash flows are relatively predictable, and we can use 20-year averages for both (the 20-year average revenue is ~$234M).

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Much less cyclical than our first example.

Let's assume we need 2.5x interest coverage and a 7.5% interest rate on our new debt.

Here's the result:

➢ Annual interest payments: $5.2M
➢ **Maximum Debt Capacity: $69M** ($5.2 / 0.075)

FPH trades at a **45% discount to its Debt Capacity Value.** Ben Graham would buy this stock.

How cool is this framework? In a few minutes, we can create a minimum value (a Debt Capacity Bargain level) for any business. No Excel, no spreadsheets—it's the perfect amount of simplicity.

Conclusion: Sometimes It Pays To Price, Not Value

Here's another reason why I love Debt Capacity Bargains.

We're not "valuing" businesses in the traditional sense. We're finding prices at which the stock would be a "no brainer" bargain.

That bargain price is the Debt Capacity value.

It shifts our focus to downside protection and a margin of safety.

We're not left wondering, *"gee … how much could this business earn in 10 years if I'm right about 55 different variables, none of which I have any control over."* But instead, *"at what price are the shares of this company too cheap to ignore?"*

That's a much different paradigm through which to view investing.

Bruce Greenwald has a saying about DCFs … "when you mix good information with bad information, you get bad information."

What he means is good information (historical earnings power) plus bad information (future estimates of cash flows) equals bad information (an incorrect estimate of fair value).

One of my resolutions this year is to stop using Excel when pricing companies. The Debt Capacity Bargain framework allows me to do that.