

## **Look for attractively valued free-cash-flow growers**

The ratio of share price to free cash flow per share ranks among the most effective stock-picking metrics since 1990, and the trend in free cash flow is among our favorite indicators of company operating momentum.

With Wall Street seeking bona fide growers but wary of overpaying, all five represent attractive picks for 12-month gains. Free cash flow (FCF) equals cash provided by operations minus capital spending and dividends.

Cash provided by operations, found on the statement of cash flows, can differ considerably from net income. Such noncash expenses as depreciation and amortization reduce net income but do not impact cash provided by operations. Conversely, an increase in accounts receivable or inventory will reduce cash provided by operations — but has no impact on net income.

FCF, a volatile measure, is not necessarily a better indicator of company performance than net income. But FCF tends to be less influenced by accounting manipulations. And by comparing share price to the discretionary cash flow management can spend on dividend increases, share repurchases, or expansion efforts, the price/FCF ratio does a good job of identifying undervalued stocks.