

Danaher Corporation DHR [XNYS] | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
50.83 USD	56.00 USD	33.60 USD	86.80 USD	High	Narrow		A-	Diversified Industrials

Core Revenue Growth Continues to Weaken for Danaher in First Quarter

by Daniel Holland
Senior Stock Analyst
Analyst covering this company do not own its stock.

Pricing data through Jul 17, 2012.
Rating Updated as of Jul 17, 2012.

Currency amounts expressed with "\$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Apr. 19, 2012

Danaher DHR delivered first-quarter earnings from continuing operations of \$0.73 per share, reflecting nearly 20% growth over the prior year. While the bottom-line result is impressive, core revenue growth slowing to 1.5% is a concern. In our opinion, it is becoming more evident that the global economy's woes are trickling in to our diversified universe and the higher earnings targets may be more difficult to attain this year. That said, Danaher raised the bottom end of its full-year earnings guidance to \$3.25 per share, up from \$3.20.

Total revenue grew 31% versus the prior year, with core revenues rising 1.5% and acquisitions contributing 30.5%, offset by the effects of foreign currency translation. None of the reporting segments managed to grow organic revenue more than 2.5%, which is a bit below our expectations for the firm and a bit disconcerting. Additionally, the new acquisitions have held operating margins back 165 basis points, although core operations grew 85 basis points versus the prior year. Given that there are a lot of moving parts to Danaher's quarter, we are likely to refrain from making any material changes to our operating assumptions and we think the firm needs a bit more time to drive synergies from Beckman and Esko Artwork. Additionally, the recently announced acquisition of X-rite should provide meaningful growth opportunities for the product identification segment.

While the headline numbers seemed strong for this quarter, slowing global growth clearly has bled into Danaher's businesses. The firm has done a solid job of holding onto core margin, but there is only one more quarter that Beckman will not be in the comparisons, and we think the firm may struggle a bit to find additional sources of earnings growth within its core operations. We maintain our fair value estimate at this time.

Thesis Feb. 21, 2012

Danaher has generated double-digit margins and growth through acquisitions and its proprietary business integration system. Its focus on eking out efficiencies and attacking niche markets has helped the firm build a narrow economic moat.

Danaher's path to success involves execution on two basic levels: acquiring companies in attractive markets at reasonable prices and easily integrating them into the larger organization to maximize potential efficiencies. As opposed to going into highly competitive markets, Danaher attacks niche markets and executes on the principles of the Danaher Business System, or DBS, resulting in higher operating margins and stronger cash flows. In addition, Danaher's focus on smaller markets enables it to enjoy economies of scale and helped the company build a narrow moat.

Acquisitions are the company's primary growth engine. This has had an accretive impact on the top line, but it has also caused the balance sheet to become more heavily weighted with goodwill and other intangible assets. Even though operating margins have remained strong, returns on invested capital slid 520 basis points, from 17.0% in 2004 to 12.1% in 2010. This is a combined result of the global recession in 2009 and the prices that Danaher has been paying for acquisitions. Although current returns on invested capital are higher than the firm's cost of capital, we would like to see Danaher slow acquisition spending in order to focus on stabilizing shareholder returns.

Danaher raised its exposure to the test and measurement business with the November 2007 purchase of Tektronix, its largest acquisition to date. Tektronix dominates the market for high-precision oscilloscopes used in telecom networking and helps fill out the company's electronic test platform, which already includes specialty test toolmaker Fluke. In addition, Danaher should be able to rely on its newly constituted medical technology business unit for meaningful internal revenue growth. Thanks to acquisitions like Sybron Dental, a producer of light equipment for the professional

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Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
3M Co	USD	61,741	29,786	6,234	4,327
Illinois Tool Works Inc	USD	24,106	18,062	2,777	1,934
Dover Corporation	USD	9,471	8,201	1,252	896
Ametek, Inc.	USD	8,036	3,099	667	404
Snap-on, Inc.	USD	3,480	2,896	497	291

dental market, and Leica Microsystems, a maker of high-end microscopes, the medical technology unit now represents 30% of Danaher's total sales base. In early 2011, Danaher completed the acquisition of Beckman Coulter, a leading life sciences and diagnostics firm, for \$6.8 billion. While this presents an opportunity for Danaher to push further into the medical equipment end markets, we think this will be a test of DBS and may make more acquisition growth difficult through 2012.

Valuation, Growth and Profitability

Our fair value estimate is \$56 per share, which implies a forward price/earnings multiple of 17 and an enterprise value/2012 EBITDA multiple of 9. Danaher's recent acquisition of Beckman Coulter heightens the firm's exposure to life sciences and diagnostics, further dampening the cyclical nature of Danaher's earnings. We think DBS could help increase Beckman's operating margin by around two percentage points, giving Danaher overall a better margin profile than it has ever had. Additionally, as customers reinvest in new products and research and development, we expect Danaher's test and measurement businesses and tool businesses to remain positive for the next several quarters. Even though the company is operating above past midcycle margin levels, we think Danaher can hold on to recent productivity gains and will be able to sustain 17% margins. Given the firm's tradition of growth via acquisitions, we forecast average annual revenue growth of 16% during the next five years, with 10% coming from newly acquired entities. We forecast the firm will reinvest all free cash flow into acquisitions at a price of 2.5 times target sales.

Risk

Many of the end markets that Danaher serves are sensitive to prevailing economic conditions and customer capital expenditure budgets. In addition, more than half of the firm's revenue is generated outside the United States, leaving Danaher exposed to geopolitical risks as well as some currency risk. Because of Danaher's reliance on acquisitions for growth, there is risk of overpayment and integrating acquisitions into the portfolio.

Bulls Say

- ▶ Danaher products enjoy great brand presence. For instance, Fluke is the leader in handheld electronic test equipment, and Gilbarco Veeder-Root dominates the retail petroleum dispenser market.
- ▶ Before Danaher formed its sixth strategic platform, medical technology, management studied the industry for about three years and says it conducted more than 400 customer interviews.
- ▶ Danaher and Cooper Industries announced a joint venture between their tool segments, which will be managed by Danaher, paving the way for the business to be operated as a stand-alone entity.

Bears Say

- ▶ About 75% of Danaher's sales growth during the past five years has come from acquisitions. If the well of new acquisition candidates dries up, Danaher's growth rate could slow.
- ▶ Other manufacturing companies are catching up with Danaher's processes as former Danaher managers take high-level positions outside the firm. Developing an internal talent pipeline may be difficult.

Financial Overview

Financial Health: Danaher is in fine financial condition. Debt is a manageable 110% of EBITDA, though the recent debt issuance related to the acquisition of Beckman Coulter will likely cause this ratio to deteriorate. The firm's EBITDA comfortably covers interest payments 21.2 times.

Company Overview

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Profile: Danaher is a diversified manufacturer, housing more than 40 industrial brands in three segments. The professional instrumentation segment produces electronic, medical, and water-test equipment. The industrial technology segment produces precision motors and controls, product-identification equipment, and other niche products. The tool and component division makes Sears' Craftsman line of hand tools, Matco tools for professional mechanics, and other store-branded tools.

Management: Danaher was founded by Steven and Mitchell Rales in the early 1980s. Combined, they own more than 10% of outstanding stock, and both serve as directors on the 10-member board. Steven Rales is chairman, and seven members are independent. Board members and senior management collectively own a significant chunk of the company, indicating strong alignment with minority holders. Lawrence Culp became CEO in 2001, replacing George Sherman, who led the firm's transformation from toolmaker to industrial conglomerate. While we are comforted by the fact the board is in the same boat as minority holders, we would prefer greater transparency in the incentive compensation structure. Executive officers' variable cash compensation is based on growth in earnings per share and undisclosed personal objectives. Equity awards are based on factors such as peer benchmarks, undisclosed contributions to growth, development, and success of the company, individual performance, and level of management. We'd be more comfortable if performance benchmarks were more explicitly stated and if a return on capital measure were mentioned prominently.

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estimate at this time.

Danaher Under Review Feb. 14, 2012

We are placing Danaher DHR under review while we review corporate filings.

Internal Revenue Growth Slows in 4Q for Danaher; Beckman Making Strides Jan. 31, 2012

Danaher DHR delivered another quarter of solid earnings growth despite a weakening Europe and \$120 million of restructuring costs. The quarter's earnings of \$0.80 per share were in line with our expectations, and we do not anticipate making a material change to our fair value estimate at this time.

The company felt the impact of Europe throughout its segments, with core revenue growth slowing to 4% versus the prior year. The addition of Beckman Coulter helped lift revenue another 33%. Beckman's integration is going well by management's account, and Danaher says it has been able to uncover additional cost-saving opportunities within the firm. The company also noted that Beckman's working capital has yet to really feel the impact of the Danaher Business System, which should mean a significant boost to cash flow as the operations become leaner. We are currently sticking with our original deal model assumptions for our fair value estimate.

Consistent with the announcement last month that it would step up restructuring in the fourth quarter, the company spent \$120 million cleaning up the industrial technology and dental segments. Given the firm's experience in identifying potential areas for cost savings, we expect to see similar restructuring over the coming months, particularly in segments with pronounced exposure to Europe.

Danaher Corporation DHR

Sales USD Mil 17,115 **Mkt Cap USD Mil** 35,213 **Industry** Diversified Industrials **Sector** Industrials

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Morningstar Rating ★★ ★ **Last Price** 50.83 USD **Fair Value** 56.00 USD **Uncertainty** High **Economic Moat™** Narrow **Stewardship** per share prices in USD



Growth Rates Compound Annual					
Grade: C	1 Yr	3 Yr	5 Yr	10 Yr	
Revenue %	21.9	8.2	10.9	15.6	
Operating Income %	20.8	11.9	11.5	17.9	
Earnings/Share %	4.9	11.9	9.8	18.6	
Dividends %	12.5	14.5	17.6	16.2	
Book Value/Share %	17.7	17.0	17.9	20.2	
Stock Total Return %	-3.2	18.6	5.0	12.2	
+/- Industry	2.9	2.6	8.5	7.0	
+/- Market	-6.2	4.0	7.7	10.1	

Profitability Analysis				
Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	14.5	14.1	14.7	22.8
Return on Assets %	8.8	7.9	4.0	9.3
Fixed Asset Turns	10.4	10.7	3.9	7.7
Inventory Turns	5.3	5.6	5.0	17.0
Revenue/Employee USD K	290.1	262.2*	—	1055.7
Gross Margin %	50.6	48.1	38.0	39.7
Operating Margin %	16.2	15.4	15.6	16.6
Net Margin %	13.8	12.0	8.6	11.1
Free Cash Flow/Rev %	14.2	13.9	9.2	0.1
R&D/Rev %	6.3	0.1	—	9.5

Financial Position		
Grade: A	12-11 USD Mil	03-12 USD Mil
Cash	537	1043
Inventories	1781	1889
Receivables	3050	2996
Current Assets	6272	6543
Fixed Assets	2101	2105
Intangibles	20315	20435
Total Assets	29949	30421
Payables	1422	1466
Short-Term Debt	98	63
Current Liabilities	4172	3913
Long-Term Debt	5207	4863
Total Liabilities	13045	12598
Total Equity	16905	17823

Valuation Analysis				
	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	17.6	18.9	15.0	—
Forward P/E	12.6	—	—	13.2
Price/Cash Flow	12.7	13.9	9.2	—
Price/Free Cash Flow	14.8	15.6	14.0	—
Dividend Yield %	0.2	—	2.5	2.0
Price/Book	2.0	2.2	2.2	—
Price/Sales	2.1	2.2	1.3	—
PEG Ratio	1.3	—	—	0.3

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD	Stock Performance
6.9	40.3	24.8	-2.7	30.0	21.3	-35.3	33.1	25.7	-0.1	8.2	Total Return %
30.3	13.9	15.8	-5.7	16.4	17.8	3.2	9.7	12.9	-0.1	0.3	+/- Market
32.9	3.2	8.1	-5.3	16.9	5.7	9.9	8.1	1.8	4.4	3.7	+/- Industry
0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	Dividend Yield %
10013	14139	17718	17186	22297	27928	18093	24270	30961	32286	35213	Market Cap USD Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Financials
4577	5294	6889	7985	9596	11026	12697	11185	13203	16091	17115	Revenue USD Mil
39.0	40.4	42.0	43.1	44.2	45.7	46.8	47.2	50.2	50.8	50.6	Gross Margin %
701	846	1105	1265	1518	1741	1869	1542	2166	2617	2767	Oper Income USD Mil
15.3	16.0	16.0	15.8	15.8	15.8	14.7	13.8	16.4	16.3	16.2	Operating Margin %
290	537	746	898	1122	1370	1318	1152	1793	2172	2356	Net Income USD Mil
0.47	0.84	1.15	1.38	1.74	2.10	1.98	1.73	2.64	3.11	3.33	Earnings Per Share USD
0.02	0.03	0.03	0.04	0.04	0.06	0.06	0.07	0.08	0.09	0.10	Dividends USD
634	646	655	656	651	659	672	671	683	701	708	Shares Mil
4.94	5.94	7.48	8.24	10.79	14.27	15.34	18.02	20.89	24.63	25.73	Book Value Per Share USD
710	862	1033	1204	1547	1646	1859	1801	2084	2626	2835	Oper Cash Flow USD Mil
-65	-80	-116	-121	-138	-162	-194	-189	-217	-334	-406	Cap Spending USD Mil
645	781	917	1083	1410	1484	1665	1612	1867	2292	2429	Free Cash Flow USD Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Profitability
5.3	8.3	9.7	10.2	10.2	9.0	7.5	6.2	8.6	8.3	8.8	Return on Assets %
11.1	16.1	18.1	18.5	19.1	17.4	13.9	10.7	14.2	14.2	14.5	Return on Equity %
6.3	10.1	10.8	11.2	11.7	12.4	10.4	10.3	13.6	13.5	13.8	Net Margin %
0.84	0.82	0.90	0.90	0.87	0.73	0.73	0.60	0.63	0.62	0.64	Asset Turnover
2.0	1.9	1.8	1.8	1.9	1.9	1.8	1.7	1.6	1.8	1.7	Financial Leverage

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	03-12	Financial Health
1122	1562	716	676	935	1150	1442	2460	2425	2100	2631	Working Capital USD Mil
1197	1285	926	858	2423	3396	2553	2889	2784	5207	4863	Long-Term Debt USD Mil
3010	3647	4620	5080	6645	9086	9809	11630	13711	16905	17823	Total Equity USD Mil
0.40	0.35	0.20	0.17	0.36	0.37	0.26	0.25	0.20	0.31	0.27	Debt/Equity

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Valuation
23.5	27.3	24.9	20.2	20.8	23.6	14.3	21.7	17.9	17.0	17.6	Price/Earnings
—	—	—	—	—	—	—	—	—	1.0	—	P/E vs. Market
2.3	2.8	2.7	2.3	2.5	2.6	1.5	2.3	2.4	2.0	2.1	Price/Sales
3.3	3.9	3.8	3.4	3.4	3.1	1.8	2.1	2.3	1.9	2.0	Price/Book
14.7	17.3	18.2	15.2	15.2	17.6	10.2	14.0	15.5	12.4	12.7	Price/Cash Flow

Quarterly Results						
Revenue USD Mil	Jun 11	Sep 11	Dec 11	Mar 12		
Most Recent Period	3711.7	4518.1	4515.1	4316.2		
Prior Year Period	3310.9	3190.2	3609.3	3345.7		
Rev Growth %	Jun 11	Sep 11	Dec 11	Mar 12		
Most Recent Period	12.1	41.6	25.1	29.0		
Prior Year Period	23.8	16.0	15.2	8.2		
Earnings Per Share USD	Jun 11	Sep 11	Dec 11	Mar 12		
Most Recent Period	0.94	0.74	0.80	0.86		
Prior Year Period	0.55	0.95	0.69	0.63		

Industry Peers by Market Cap				
	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Danaher Corporation	35213	17115	17.6	14.5
3M Co	61741	29786	14.7	26.5
Illinois Tool Works	24106	18062	13.2	18.9

Major Fund Holders		% of shares
		—
		—
		—

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

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Morningstar's Approach to Rating Stocks

Our Key Investing Concepts

- ▶ Economic Moat™ Rating
- ▶ Discounted Cash Flow
- ▶ Discount Rate
- ▶ Fair Value
- ▶ Uncertainty
- ▶ Margin of Safety
- ▶ Consider Buying/Consider Selling
- ▶ Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based

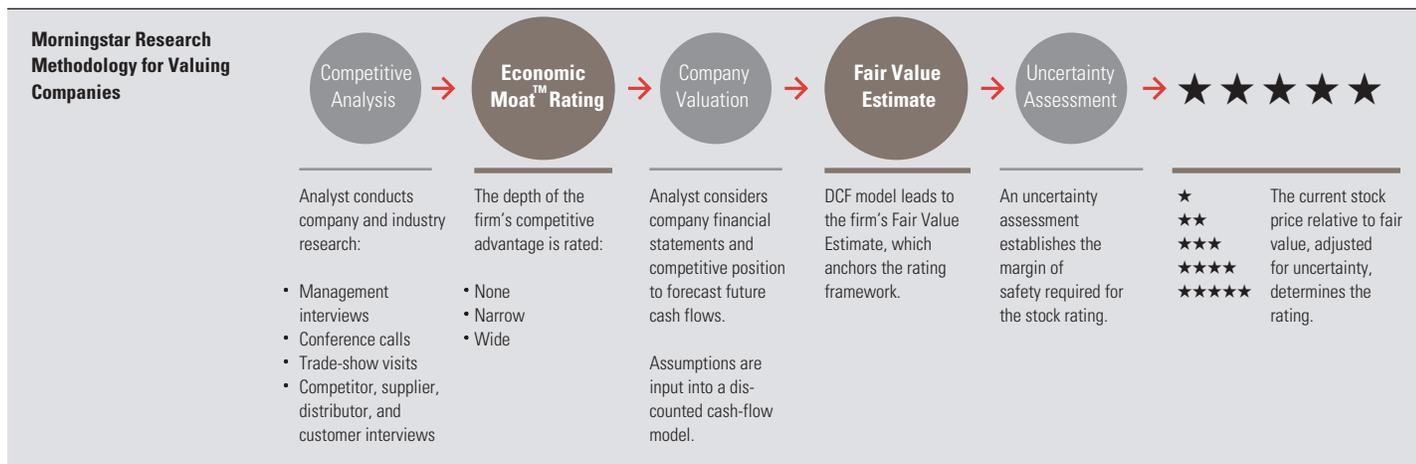
just on movement in the share price. If we think a stock's fair value is \$50, and the shares decline to \$40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at \$40 than they were at \$50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such



Morningstar's Approach to Rating Stocks (continued)

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow

This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate

We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value

This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty

To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High,

Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety

This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth. The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling

The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.