MORNINGSTAR®

NVIDIA Corporation NVDA [XNAS] | ★★★

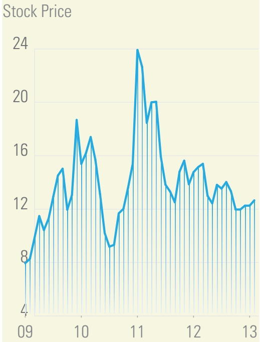
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
12.79 USD	15.00 USD	7.50 USD	26.30 USD	Very High	None	Exemplary		Semiconductors

Maintaining Fair Value Estimate After Nvidia Reports Fourth-Quarter Results

by Andy Ng
Senior Stock Analyst
Analyst covering this company do not own its stock.

Pricing as of Mar 06, 2013.
Rating as of Mar 06, 2013.

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



Analyst Note Feb. 14, 2013

Nvidia NVDA reported fiscal fourth-quarter results that were within our range of expectations. We expect to maintain our fair value estimate and our moat rating.

For the quarter, revenue was $1.11 billion, down 8% sequentially, and up from sales of $953 million in the year-ago quarter. In Nvidia's graphics processor, or GPU, segment, which primarily includes computer graphics chips, Quadro professional workstations (used in applications such as computer-aided design), and Tesla supercomputing processors, revenue fell 7% sequentially to $833 million. The drop was due to lower desktop GPU sales in the quarter, as demand returned to more normal levels following the boost seen after the initial launch of Nvidia's new Kepler-based GPUs, and a decline in Tesla-related sales after a strong third quarter. This was somewhat offset by continued strength in notebook GPU sales, which have been benefiting from Nvidia's many design wins in notebooks based on Intel's INTC Ivy Bridge processors. The firm also saw higher Quadro sales.

In the Tegra segment, which consists primarily of Tegra processors for smartphones and tablets, as well as game console graphics licensing and Icera wireless baseband chip products, sales fell 15% from the third quarter. Nvidia saw lower Tegra sales following the seasonally strong third quarter, as mobile device makers ramped down manufacturing following the production push for the holidays. On the profitability front, gross margin stayed flat sequentially at 52.9%, while operating income was $184 million.

For the first quarter, management expects revenue to come in at about $940 million, which would indicate a 15% sequential decline. Nvidia noted that softness in the PC market will affect demand for GPUs next quarter. In addition, the firm will see a decline in Tegra sales, as mobile device makers slow production of Tegra 3 based smartphones and tablets in preparation for launching products based on Nvidia's new Tegra 4 chips. Despite some uncertainties in the main GPU business, we continue to believe the firm has shown success with its diversification efforts, particularly with the Tegra product line, which will allow Nvidia to grow in the long run.

Thesis Nov. 13, 2012

Nvidia is a leading player in the graphics processor market. The firm is amid a transformation as it attempts to grow beyond graphics chips and to seek new avenues of expansion.

Nvidia is a top supplier of computer graphics processing units, or GPUs, with particular emphasis on the high end of the market. The business is competitive: The market is characterized by rapid product transitions that offer ever-advancing graphics capabilities. As a result, Nvidia must constantly innovate to battle Advanced Micro Devices AMD for technological supremacy in the industry. Intel INTC, which has historically targeted the low end of the graphics market, is another key player.

We think Nvidia will face increasing headwinds in the stand-alone graphics processor market, as its main graphics processor business faces the threat of cannibalization. Both Intel and AMD have added graphics capabilities directly onto the same silicon as their latest computer microprocessors, or CPUs. While AMD already has the graphics technology to compete with Nvidia, Intel has been working to upgrade its graphics expertise. So far, there have been no signs that combined CPU-GPUs are causing any slowdowns in demand for stand-alone graphics chips, as stand-alone GPUs still offer significant advantages in PC graphics performance. However, as on-chip graphics processors become more powerful over time, they may eventually render stand-alone graphics chips obsolete. Nvidia is in a vulnerable position, as it currently has no microprocessor offering with which to combine its graphics processors.

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Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Intel Corp	USD	107,576	53,341	14,638	11,005
Advanced Micro Devices Inc	USD	1,735	5,422	-1,056	-1,183

Nvidia has been taking steps to expand its business outside computer graphics. The firm has been a leading innovator in extending the realm of supercomputing. The mathematically intensive nature of graphics chips lends them to supercomputing applications in various scientific and industrial fields. Nvidia's Tesla product line is dedicated to this potentially massive opportunity. While Tesla has seen significant adoption, one of the more prominent applications in which the supercomputing processors can be found is the Titan supercomputer at Oak Ridge National Labs.

On the other end of the computing spectrum, the firm is targeting the mobile device market with its Tegra chips. The Tegra product line comprises processors with advanced graphics capabilities for portable gadgets, such as smartphones and tablets, which Nvidia hopes will provide another avenue for growth. After a slow start in this business, Nvidia has become one of the more formidable players and has racked up many design wins with its Tegra chips. Tegra can be found in a number high-profile devices, including the Motorola MMI Droid X2 and HTC One X smartphones, as well as the Windows RT version of Microsoft's MSFT Surface tablet. The chips can even be found in some cutting-edge, in-car infotainment systems from automakers such as Tesla Motors TSLA.

Nvidia is amid a transformation as computing technologies evolve. Despite potential threats to its main graphics processor business that may arise, the firm has taken the steps necessary to diversify. The success that Nvidia has had so far with Tesla and Tegra leads us to believe that the firm is positioned for continued growth.

Valuation, Growth and Profitability

Our fair value estimate is $15 per share. In our model, we project that Nvidia's main graphics chip business will see growth through fiscal 2014, but will begin to see revenue declines beginning in fiscal 2015, as a result of cannibalization from combined CPU-GPUs from AMD and Intel. Nonetheless, we believe that Nvidia's Tesla and Tegra opportunities will more than offset the decline in the graphics business and actually allow the firm to grow over time. Our model also takes into account the $1.5 billion that Intel will pay Nvidia over five years in a legal settlement and cross-licensing agreement that the two firms entered into in January 2011. Under the terms of the deal, Intel will have access to Nvidia's patents as Intel continues to enhance its graphics capabilities, while Nvidia will gain access to some of Intel's computer processor patents, but not all of them.

We forecast that sales will increase 7% in fiscal 2013. Business conditions in the main graphics processor segment were solid through the first three quarters of the year, thanks to the launch of Intel's new Ivy Bridge processors, which helped drive demand for computers that incorporate stand-alone graphics chips from Nvidia, and strong demand for the firm's new Kepler GPUs, helping Nvidia gain market share from AMD. However, a slowdown in the global PC market will likely affect Nvidia's GPU unit in the fourth quarter. Beyond Nvidia's core business, we expect strong growth in the Tegra product line for the year, thanks to the production ramps of smartphones and tablets that incorporate the new Tegra 3 chips. Nonetheless, there has been some weakness in the firm's professional solutions business, which provides products for professional workstations used in applications such as computer-aided design, and which also includes Tesla. Over the long run, we estimate that Nvidia will grow in the low-single digits, as growth in the mobile device and supercomputing processor opportunities is somewhat offset by long-term declines in the key GPU business. We expect operating margins to come in at 15% in fiscal 2013 and project that they will run in the midteens over the longer term.

Our fair value uncertainty rating for Nvidia is very high, given the threats facing the firm's main stand-alone GPU segment and the uncertainties surrounding the growth trajectories of Nvidia's emerging Tesla and Tegra businesses.

Risk

The firm faces tough competition from AMD. Any missteps in research and development or execution would affect growth, erode market share, and hurt profit margins. The cyclical nature of the chip industry causes fluctuations in Nvidia's financial performance.

Bulls Say

- Supercomputing processors based on Nvidia's graphics chips present the firm with a potentially massive growth opportunity.
- The growing popularity of video game consoles has been benefiting Nvidia. The firm supplies the graphics chips used in Sony's PlayStation 3.
- The increasing complexity of graphics processors provides a barrier to entry for most potential rivals, since it would be difficult to match Nvidia's large R&D budget.
- Nvidia has had a number of high-profile design wins in mobile devices with its Tegra chips.
- In January 2011, Intel agreed to pay Nvidia $1.5 billion over five years in a legal settlement and cross-licensing deal between the two firms.

Bears Say

- Rapid product cycles and heavy competition make it difficult for Nvidia to sustain its lead over AMD.
- Nvidia's Tegra processor faces plenty of competition, as numerous chipmakers have offerings targeting mobile devices.
- A majority of sales come from the maturing PC industry.

Financial Overview

Financial Health:Nvidia is in solid financial shape. The firm has $3.4 billion in cash and investments, compared with total liabilities of $1.4 billion on its balance sheet.

Company Overview

Profile: Nvidia is a leading designer of graphics chips that enhance the interactive experience on computing platforms. The firm's chips are used in a variety of products, including personal computers, handsets, and game consoles. The majority of Nvidia's products are sold internationally, and the company outsources all of its production.

Management: We believe that management has demonstrated itself to be exemplary stewards of shareholder capital. CEO Jen-Hsun Huang co-founded Nvidia in 1993 after stints at LSI Logic LSI and AMD. Huang continues to hold a major stake in the firm and controls about 4% of the total shares outstanding. In March 2011, Karen Burns became interim CFO following the resignation of David White from Nvidia for personal reasons. Burns was previously vice president, corporate controller and tax, at Nvidia. Management compensation appears reasonable compared with industry peers.

Nvidia's management team has shown a willingness to invest in new opportunities in the past several years outside of the firm's core PC graphics processor business. As a result, Nvidia has become a key player in the supercomputing processor market with its Tesla chips. More importantly, in the firm's Tegra products have allowed Nvidia to emerge as a leader in the fast-growing smartphone and tablet processor space. The firm has periodically made acquisitions in the past, though the deals tend to be smaller in size. The most recent acquisition was the $367 million purchase of Icera, a baseband processor firm, to complement Nvidia's foray into mobile devices. Management recently initiated a quarterly dividend to return excess cash to shareholders, and the firm currently has a stock buyback program.

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Analyst Notes

Nvidia Reports Solid 3Q Results Nov. 09, 2012

Nvidia NVDA reported solid fiscal third-quarter results, but provided a softer outlook for the fourth quarter. We will likely maintain our fair value estimate. For the quarter, revenue was $1.20 billion, up 15% sequentially, and an increase from sales of $1.07 billion in the year-ago quarter. Revenue came in at the midpoint of the outlook of $1.15 billion-$1.25 billion that was provided in August.

In Nvidia's main standalone graphics processor, or GPU, segment, sales rose 11% sequentially to $740 million, driven by continued strong demand for the firm's new Kepler GPUs. Additionally, Nvidia continued to benefit from its many design wins into notebooks based on Intel's INTC Ivy Bridge processors, which helped drive notebook GPU sales in the quarter.

In the consumer products business, which includes the Tegra processors for smartphones and tablets, revenue grew 36% sequentially to $244 million. Similar to last quarter, production ramps of smartphones and tablets based on Nvidia's Tegra 3 chips helped drive growth in the segment. This includes the recently launched Windows RT version of Microsoft's MSFT Surface tablets, which are powered by the Tegra 3. Nvidia's professional solutions business, which provides products for professional workstations used in applications such as computer-aided design, and which also includes Tesla supercomputer processors, saw revenue rise 12% sequentially to $221 million. While the firm's Quadro professional workstation products continued to be affected by difficult macroeconomic conditions, particularly in Europe, the firm saw nice growth in revenue from new Kepler-based Tesla products shipped to Oak Ridge National Labs for its new Titan supercomputer. On the profitability front, gross margin came in at 52.9%, up from 51.8% in the fiscal second quarter, thanks to a more favorable product mix toward new Kepler products. Nvidia achieved an operating profit of $252 million, compared with $140 million last quarter.

For the fiscal fourth quarter, management expects revenue to be between $1.025 billion and $1.175 billion, due to some weakness in Nvidia's markets. Some softness is anticipated in the main GPU segment, given the uncertainty surrounding the global PC market in light of current economic conditions. The firm will see lower Tegra 3 sales for tablets, as customers ramp down tablet manufacturing following the holiday season. Also, Nvidia announced that it is initiating a quarterly dividend of 7.5 cents per share starting in the fiscal fourth quarter, which would currently represent over a 2% yield. The firm's stock buyback program, which has $1.24 billion remaining, has been extended to December 2014 from May 2013. Given the significant cash pile of $3.4 billion on Nvidia's balance sheet, we applaud management's decision to return more excess cash to shareholders.

Maintaining Fair Value Estimate After Nvidia Reports Fourth-Quarter Results Feb. 14, 2013

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Analyst Notes (continued)

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NVIDIA Corporation(USD) NVDA

Last Close $	Sales $Mil	Mkt Cap $Mil	Industry	Currency
$12.66	$4,126	$7,907	Semiconductors	USD

NVIDIA Corporation is engaged in creating the graphics chips used in personal computers that bring games and home movies to life. Its three financial reporting segments: GPU Business; Professional Solutions Business; and Consumer Products Business.

Morningstar Rating	Fair Value Uncertainty	Fair Value	Economic Moat	Style	Sector
★★★ As of 03-04-2013	Very high	$15.00	None	Mid Growth	

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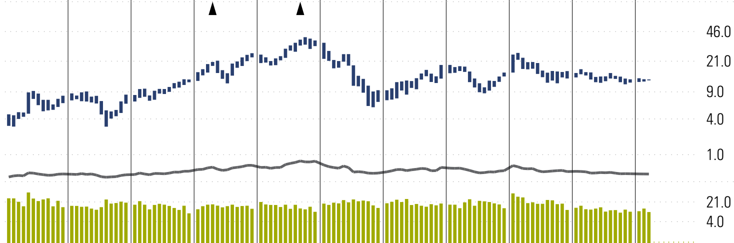
2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	YTD	
9.25	9.12	12.83	25.97	39.67	34.25	18.95	18.96	26.17	16.90	13.19	Annual Price High
3.11	3.10	6.82	11.45	18.69	5.75	7.08	8.65	11.47	11.15	11.91	Low
			2:1	3:2							Recent Splits



Price Volatility
Monthly High/Low
Rel Strength to S&P 500
52 week High/Low $
15.49-11.15
10 Year High/Low $
39.67-3.10
Trading Volume Million

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	YTD	Stock Performance
101.6	1.6	55.2	102.5	37.9	-76.3	131.5	-17.6	-10.0	-11.0	3.8	Total Return %
72.9	-9.3	50.3	86.7	32.4	-39.3	105.0	-32.6	-12.1	-27.0	-3.5	+/- Market
11.8	20.8	42.6	108.1	31.1	-31.9	66.6	-35.1	-6.1	-17.5	-2.2	+/- Industry
—	—	—	—	—	—	—	—	—	0.6	1.2	Dividend Yield %
3762	3916	6258	13159	18901	4334	10366	8947	8464	7661	7907	Market Cap $Mil

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	TTM	Financials (USD)
1909	1823	2010	2376	3069	4098	3425	3326	3543	3998	4126	Revenue $Mil
30.2	29.0	32.2	38.3	42.4	45.6	34.3	35.4	39.8	51.4	51.6	Gross Margin %
144	90	95	337	453	836	-71	-99	256	648	587	Oper Income $Mil
7.5	5.0	4.7	14.2	14.8	20.4	-2.1	-3.0	7.2	16.2	14.2	Operating Margin %
91	74	89	301	449	798	-30	-68	253	581	505	Net Income $Mil
0.18	0.14	0.19	0.55	0.77	1.31	-0.05	-0.12	0.43	0.94	0.81	Earnings Per Share $
—	—	—	—	—	—	—	—	—	—	—	Dividends $
505	518	529	549	587	607	548	550	589	616	625	Shares Mil
2.08	2.22	2.63	3.46	4.46	4.63	4.37	4.99	6.51	7.56	7.56	Book Value Per Share $
265	50	132	446	587	1270	249	488	676	909	784	Oper Cash Flow $Mil
-63	-128	-67	-80	-145	-188	-408	-78	-98	-139	-181	Cap Spending $Mil
202	-78	65	367	442	1082	-158	410	578	770	603	Free Cash Flow $Mil

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	TTM	Profitability
5.8	4.9	5.9	16.8	19.4	24.8	-0.9	-2.0	6.3	11.6	9.0	Return on Assets %
10.7	7.5	8.0	22.5	25.6	34.5	-1.2	-2.7	8.7	15.9	11.6	Return on Equity %
1.22	1.21	1.33	1.33	1.33	1.28	0.97	0.96	0.88	0.80	0.74	Asset Turnover
4.8	4.1	4.4	12.7	14.6	19.5	-0.9	-2.0	7.1	14.5	12.2	Net Margin %
1.7	1.3	1.4	1.3	1.3	1.4	1.4	1.3	1.4	1.3	1.3	Financial Leverage

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	10-12	Financial Health (USD)
300	—	—	—	—	—	—	—	—	—	—	Long-Term Debt $Mil
933	1051	1178	1496	2007	2618	2395	2665	3181	4146	4723	Total Equity $Mil
0.33	0.00	—	—	—	—	0.01	0.01	0.01	0.01	0.00	Debt/Equity
972	719	884	1112	1393	1922	1389	1696	2284	2975	3433	Working Capital $Mil

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	TTM	Valuation
39.1	54.3	26.1	36.5	29.7	12.8	-29.3	41.8	13.3	15.2	15.7	Price/Earnings
0.0	0.0	—	—	0.0	0.0	0.0	0.0	—	0.0	1.0	P/E vs. Market
2.2	2.2	2.9	5.0	5.5	1.2	3.6	2.4	2.2	1.9	1.9	Price/Sales
3.7	3.5	4.6	7.1	7.6	1.7	4.3	3.1	2.1	1.6	1.7	Price/Book
22.6	129.9	20.6	24.0	16.7	9.2	25.5	28.7	9.1	9.8	10.1	Price/Cash Flow

Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	12.8	5.3	5.4	11.3
Operating Income %	153.5	—	7.4	10.4
Earnings/Share %	118.6	—	4.2	10.6
Dividends %	—	—	—	—
Book Value/Share %	25.3	15.0	12.5	14.4
Stock Total Return	-16.7	-8.4	-9.4	12.1
+/- Industry	-16.3	-17.8	-16.8	5.0
+/- Market	-30.7	-21.5	-14.5	3.5

Profitability Analysis

Grade: D	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	11.6	11.0	20.2	19.7
Return on Assets %	9.0	8.0	12.8	8.2
Revenue/Employee $K	729.8	637.0	—	1041.6
Fixed Asset Turns	7.4	7.8	2.8	7.0
Inventory Turns	5.3	5.6*	4.7	12.1
Gross Margin %	51.6	41.3	51.5	43.2
Operating Margin %	14.2	7.8	22.7	18.6
Net Margin %	12.2	7.6	17.1	13.1
Free Cash Flow/Rev %	14.6	—	13.5	11.7
R&D/Rev %	25.1	23.6	14.9	—

Financial Position (USD)

Grade: B	01-12 $Mil	10-12 $Mil
Cash	668	525
Inventories	340	429
Receivables	336	445
Current Assets	3905	4425
Fixed Assets	560	567
Intangibles	967	972
Total Assets	5553	6075
Payables	335	401
Short-Term Debt	—	—
Current Liabilities	930	991
Long-Term Debt	—	—
Total Liabilities	1407	1352
Total Equity	4146	4723

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	15.7	10.8	23.8	16.2
Forward P/E	12.3	—	—	13.5
Price/Cash Flow	10.1	16.4	9.3	9.4
Price/Free Cash Flow	13.1	30.9	21.7	27.2
Dividend Yield %	1.2	—	2.2	2.3
Price/Book	1.7	2.6	2.6	2.2
Price/Sales	1.9	2.2	2.4	2.6
PEG Ratio	1.1	—	—	2.2

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

Quarterly Results (USD)

Revenue $Mil	Jan	Apr	Jul	Oct
Most Recent	953.0	924.0	1044.0	1204.0
Previous	886.0	962.0	1016.0	1066.0
Rev Growth %	**Jan**	**Apr**	**Jul**	**Oct**
Most Recent	7.5	-3.9	2.7	12.9
Previous	-9.8	-4.0	25.3	26.3
Earnings Per Share $	**Jan**	**Apr**	**Jul**	**Oct**
Most Recent	0.18	0.10	0.19	0.33
Previous	0.29	0.22	0.25	0.29

Close Competitors

	Mkt Cap $Mil	Rev $Mil	P/E	ROE%
Intel Corp	105201	53341	10.0	22.7
Advanced Micro Devices Inc	1714	5422	-1.5	-111.2

Major Fund Holders

	% of shares
Fidelity Growth Company	7.99
Fidelity OTC	2.16
Vanguard Total Stock Mkt Idx	1.33

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 Research Methodology for Valuing Companies

Competitive Analysis → **Economic Moat™ Rating** → Company Valuation → **Fair Value Estimate** → Uncertainty Assessment → ★★★★★

Competitive Analysis
Analyst conducts company and industry research:
- Management interviews
- Conference calls
- Trade-show visits
- Competitor, supplier, distributor, and customer interviews

Economic Moat™ Rating
The depth of the firm's competitive advantage is rated:
- None
- Narrow
- Wide

Company Valuation
Analyst considers company financial statements and competitive position to forecast future cash flows.

Assumptions are input into a discounted cash-flow model.

Fair Value Estimate
DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework.

Uncertainty Assessment
An uncertainty assessment establishes the margin of safety required for the stock rating.

★★★★★
★
★★
★★★
★★★★
★★★★★

The current stock price relative to fair value, adjusted for uncertainty, determines the rating.

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.