PepsiCo, Inc. PEP [NYSE] | ★★★★

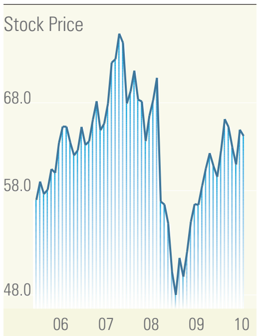
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
65.57 USD	73.00 USD	58.40 USD	91.30 USD	Low	Wide	B	AA-	Process & Packaged Goods

Gatorade Goes to Direct Store Delivery

by Philip Gorham, CFA
Stock Analyst
Analysts covering this company do not own its stock.

Pricing data through September 03, 2010.
Rating updated as of September 03, 2010.

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



Analyst Note Sept. 01, 2010
PepsiCo announced that it will distribute sports drink Gatorade on its direct store delivery platform in the convenience and dollar store channels in 2011. Although the strategy does not move the needle on our fair value estimate, we think it demonstrates that Pepsi is focused on the long-term growth of its brands, and we support the decision.

Pepsi and rival Coca-Cola deliver products to convenience stores both directly and through warehouses. Although direct store delivery is a more expensive distribution method, it allows beverage manufacturers to achieve greater flexibility in their route to market, provides a direct relationship with retailers, and allows the firms to influence in-store product displays. These factors give beverage makers a competitive advantage over rivals that use a warehouse system and help build the strength of high-volume brands. We think the switch to direct store delivery will enhance the revamping of the Gatorade brand, and we expect the brand to regain some market share in the medium term.

Thesis Jun. 04, 2010
We assign a wide economic moat to PepsiCo because of its economies of scale, its dominance in the snack category, and its effective distribution network. The direct store delivery system allows the firm to leverage its impressive portfolio of brands and should ensure that PepsiCo maintains its strong returns on invested capital over the long run.

Although long-time competitor Coca-Cola may have won the battle for the leadership of the cola industry, PepsiCo is winning the war against its competitors in the broader snack and beverage market with a group of brands that hold leading or second-place positions across several categories. Collectively, these products give Pepsi control of around 39% of the U.S. macrosnack market and a leading 23% share of the market in Western Europe. The North American snack business is Pepsi's most profitable segment, generating 35% of the firm's total revenue in 2009 but 46% of its profits.

In addition, PepsiCo has an impressive record of developing or acquiring products that are aligned with emerging consumer trends. Through bringing to market healthier baked snacks, partnering with Starbucks to distribute ready-to-drink coffees, and acquiring popular noncarbonated brands like Gatorade and Naked, PepsiCo has demonstrated an ability to recognize shifting consumer preferences and adapt its portfolio to meet those changes. Its heavy investment in research and development and marketing has helped the firm to stay one step ahead of most of its competitors, particularly in the snack industry.

One of the primary sources of PepsiCo's moat is its direct store delivery system, which acts as a barrier to new entrants because it would be costly to replicate. The firm has leveraged this extensive distribution network to broaden its offerings of non-Pepsi-Cola products and grab share in adjacent snack categories. PepsiCo has been particularly successful at doing this in its nonbeverage categories, where its strong brands have been successful in grabbing market share from weaker competitors.

Pepsi's relationships with retailers have become even more direct since taking control of its two anchor bottlers. We expect consolidation to allow Pepsi to experiment with niche products and new package sizes, giving the company the ability to more closely monitor consumer trends and adapt to them quickly. It is difficult for manufacturers to predict which of today's niche products will become tomorrow's mainstream beverages, so we think maintaining the flexibility to move with consumers' changing tastes will allow Pepsi to remain at the forefront of beverage innovation in the long term.

Valuation, Growth and Profitability

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
PepsiCo, Inc.	USD	104,318	48,546	7,567	6,170
Nestle SA	USD	183,460	99,554	13,848	9,647
Coca-Cola Company	USD	132,933	31,753	8,876	7,422
Kraft Foods, Inc.	USD	53,333	45,197	5,800	4,354

Morningstar data as of September 03, 2010.

Our fair value estimate is $73 per share, which implies forward fiscal year 2010 price/earnings of 19 times, enterprise value/EBITDA of 11 times, and a free cash flow yield of 4.5%. Volume and pricing are the key drivers of our valuation, together with the level of synergies that the firm can derive from its consolidation strategy. We forecast revenue to be flat in 2010, as consumers in most markets remain cautious, but we think 2011 may be a stronger year as the economy picks up. We forecast a long-term revenue growth rate of around 4% per year from 2014. We expect the firm to generate an operating margin of 17%-18% over the next decade, roughly equal to our forecast prior to the announcement of the deals, as synergies offset the effects of consolidating less profitable activities. Pepsi has potential to grow margins in emerging markets, as greater scale and improving infrastructure should provide cost savings in distribution, but the firm could suffer margin compression from rising commodity costs.

Risk

PepsiCo's sales and profitability could be negatively affected more than we forecast in our model by volatility in commodity prices, particularly for raw materials such as sugar, corn, and oranges. In addition, its bottler acquisitions have increased the firm's exposure to energy prices. We expect almost half of Pepsi's revenue to have been generated outside the United States in 2010, so the firm is subject to currency and geopolitical risk in the overseas markets in which it operates. Some of these markets include parts of Africa and Latin America, where the political and economic climates are unstable. Finally, sales of PepsiCo's carbonated drinks and snacks could be adversely affected by negative publicity regarding the health concerns associated with junk food and soft drinks with high sugar content.

Bulls Say

- PepsiCo owns 19 global megabrands, each with annual sales of more than $1 billion, including Pepsi, Gatorade, Mountain Dew, Fritos, Lay's, Doritos, Tostitos, and Quaker.
- Through its Frito-Lay division, PepsiCo is the world's largest snack food company, controlling almost 40% of the U.S. salty snack market and around 30% of the non-U.S. market.
- The acquisition of its leading North American bottlers is likely to allow Pepsi to be more flexible in its route to market than some of its competitors.
- PepsiCo has successfully defended many of its products from competition and increased overall market share by investing heavily in marketing and research and development.
- Having already built the infrastructure for its direct store delivery system, PepsiCo's distribution system acts as a barrier to entry because it would be difficult and costly to replicate.

Bears Say

- In the carbonated beverage category, Coca-Cola is the established leader, is located in many international markets, and has proved difficult to dislodge as the number-one player.
- As the international segment, an important driver of PepsiCo's recent growth, becomes a larger piece of the business, profitability could suffer because of the lower operating margins generated overseas.
- Pepsi's bottler consolidation has increased its exposure

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to commodity prices, and increases in key input costs could have a material negative impact on Pepsi's margins.

- Bringing onto its books the assets of its less profitable bottling operations is likely to squeeze Pepsi's margins and lower its returns on invested capital slightly.
- Carbonated drinks may become the latest target for tax increases as local and national governments, struggling to balance their budgets, look for new ways to raise revenue.

Financial Overview

Financial Health: We expect the acquisitions of its bottlers to increase Pepsi's leverage, with the firm's debt/total capitalization ratio rising slightly to 0.5. However, we forecast an average of 10% of revenue to be converted to free cash flow over the next ten years, so the prospect of a default is remote.

Company Overview

Profile: PepsiCo manufactures, markets, and sells a variety of salty, convenient, sweet, and grain-based snacks, as well as carbonated and noncarbonated beverages and foods. The firm's organizational structure constitutes three primary business units: PepsiCo Americas Foods, PepsiCo Americas Beverages, and PepsiCo International. The company's broad portfolio of brands includes Pepsi, Gatorade, Tropicana, Lay's, Doritos, and Quaker.

Management: Overall, PepsiCo has a high standard of corporate governance. Chairman and CEO Indra Nooyi has been at the helm since October 2006, and in that time, the firm has created returns to shareholders that have outstripped those of its peers. We are impressed by the credentials of the directors and the level of independence in the boardroom, though we would prefer to see the roles of CEO and chairman split between two individuals, as this would allow the board to set its agenda independently from management. Executive compensation appears to be reasonable and contains a satisfactory balance of salary and incentive-based awards. The metrics used to assess executive performance are clear and, in our view, align the interests of management with those of the shareholders. PepsiCo does not have a poison-pill policy or any other takeover defenses. We further applaud the firm for its adoption of majority voting, allowing shareholders to vote against the election of a director, but we think allowing cumulative voting would further enhance the rights of the small shareholder.

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Analyst Notes

Sept. 01, 2010

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Jul. 20, 2010

Signs of Life in Pepsi's 2Q

PepsiCo's second-quarter results support our view that the acquisition of its bottlers will make the firm more efficient in its route to market, and we are maintaining our fair value estimate.

Reported second-quarter revenue grew 37% year over year and on a constant currency basis, driven primarily by the bottler acquisitions and by volume growth across the portfolio in emerging markets. Revenue in Asia, the Middle East, and Africa grew 17%, as per capita consumption of snacks and beverages continued to rise because of growing affluence in the region. Even in developed markets, where Pepsi has struggled to increase volume in recent quarters, there were signs of market share stabilization. Internal volume increased 4% in Europe and declined 1% in North America, a sequential improvement of 4.5 percentage points thanks to a strong performance by Gatorade and Lipton ready-to-drink teas. Once again, the weak spot was Quaker Foods North America, where volume fell 2%.

With unemployment still high and costs likely to steadily increase, we see challenges for Pepsi throughout the remainder of 2010. In addition, Coca-Cola is integrating its own bottler acquisition, and we expect any competitive advantages gained by Pepsi in the route to market to be relatively short-lived. We forecast an adjusted operating margin of 17% for 2010, slightly above the 16.5% generated in 2009. Longer term, Pepsi has significant room for growth in key growth markets such as China, and we expect its investment in infrastructure to fuel double-digit growth in Asia for several quarters to come.

Apr. 22, 2010

Emerging Markets Drive Pepsi's 1Q

PepsiCo's first-quarter results support our view that the company faces a performance dichotomy between mature and developing markets. We think the acquisition of its bottlers will boost Pepsi's performance in North America for the rest of the year, and we are maintaining our fair value estimate.

First-quarter revenue grew 11% year over year and on a constant currency basis, thanks to higher prices. Revenue in

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Analyst Notes (continued)

Asia, the Middle East, and Africa grew 18%, as per capita consumption of snacks and beverages continued to rise in the region. The story was different in developed markets, with revenue in Europe declining 3%, as economic turbulence in the region continued. Another weak spot was Quaker Foods North America, where volume fell 1%. We think Pepsi's plans to put the division back on track through whole-grain products will align the brand with increasing consumer demand for health and wellness products, but if the strategy fails, we would not be surprised to see Pepsi sell the Quaker brand.

With unemployment still high and costs likely to rise, we see challenges ahead for Pepsi throughout the remainder of 2010. However, we think the move to consolidate its bottlers will provide a catalyst for higher volume later in the year. Furthermore, Pepsi has significant room for growth in key growth markets such as China, and we expect the firm's investment in infrastructure to fuel double-digit growth in Asia for several quarters to come.

PepsiCo, Inc. PEP

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
48,546	104,318	Process & Packaged Goods	Consumer Goods

PepsiCo manufactures, markets, and sells a variety of salty, convenient, sweet, and grain-based snacks, as well as carbonated and noncarbonated beverages and foods. The firm's organizational structure constitutes three primary business units: PepsiCo Americas Foods, PepsiCo Americas Beverages, and PepsiCo International. The company's broad portfolio of brands includes Pepsi, Gatorade, Tropicana, Lay's, Doritos, and Quaker.

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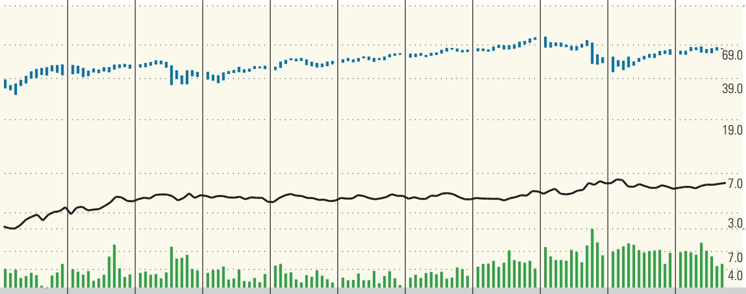
Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship Grade
★★★★	65.57	73.00	Low	Wide	B

per share prices in USD

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD	
49.94	50.46	53.50	48.87	55.71	60.34	65.99	79.00	79.79	64.48	67.61	Annual Price High
29.69	40.25	35.15	36.32	45.30	51.34	56.00	61.89	49.74	43.78	58.75	Low
											Recent Splits



Price Volatility
Monthly High/Low
Rel Strength to S&P 500

52 week High/Low
67.61 - 56.00

10 Year High/Low
79.79 - 29.69

Bear-Market Rank
2 (10=worst)

Trading Volume Million

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD	Stock Performance
42.2	-0.6	-12.1	11.9	13.8	15.1	7.8	23.6	-25.7	14.3	10.2	Total Return %
52.3	12.4	11.3	-14.5	4.8	12.1	-5.8	20.1	12.8	-9.1	11.1	+/- Market
22.3	-3.3	-8.7	2.9	1.2	12.1	-9.1	6.0	-1.1	-11.0	8.4	+/- Industry
1.1	1.2	1.4	1.4	1.6	1.7	1.9	1.9	3.0	2.9	2.8	Dividend Yield %
71549	85188	72916	80035	87930	98025	102712	122176	85064	95152	104318	Market Cap USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Financials
20438	26935	25112	26971	29261	32562	35137	39474	43251	43232	48546	Revenue USD Mil
65.2	60.1	54.2	54.1	54.2	56.5	55.1	54.3	52.9	53.5	53.3	Gross Margin %
3225	4021	4730	4781	5259	5922	6439	7170	6935	8044	7567	Oper Income USD Mil
15.8	14.9	18.8	17.7	18.0	18.2	18.3	18.2	16.0	18.6	15.6	Operating Margin %
2183	2662	3309	3565	4209	4076	5631	5646	5142	5946	6170	Net Income USD Mil
1.48	1.47	1.85	2.05	2.44	2.39	3.34	3.41	3.21	3.77	3.85	Earnings Per Share USD
0.56	0.58	0.60	0.63	0.85	1.01	1.16	1.43	1.65	1.78	1.83	Dividends USD
1475	1807	1789	1739	1729	1669	1689	1659	1602	1577	1602	Shares Mil
5.02	4.94	5.38	6.93	8.06	8.63	9.41	10.76	7.86	10.71	12.40	Book Value Per Share USD
3911	4201	4627	4328	5054	5852	6084	6934	6999	6796	7746	Oper Cash Flow USD Mil
-1067	-1324	-1437	-1345	-1387	-1736	-2068	-2430	-2446	-2128	-2361	Cap Spending USD Mil
2844	2877	3190	2983	3667	4116	4016	4504	4553	4668	5385	Free Cash Flow USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Profitability
12.2	13.3	14.7	14.6	15.8	13.7	18.3	17.5	14.6	15.7	12.1	Return on Assets %
30.9	33.5	36.9	33.6	33.0	29.2	37.8	34.5	34.8	41.1	36.5	Return on Equity %
10.7	9.9	13.2	13.2	14.4	12.5	16.0	14.3	11.9	13.8	12.7	Net Margin %
1.14	1.35	1.11	1.11	1.10	1.09	1.14	1.22	1.22	1.14	0.95	Asset Turnover
2.5	2.5	2.5	2.1	2.1	2.2	1.9	2.0	3.0	2.4	3.3	Financial Leverage

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	06-10	Financial Health
669	855	361	515	1887	1048	2270	2398	2019	3815	2171	Working Capital USD Mil
2346	2651	2187	1702	2397	2313	2550	4203	7858	7400	19586	Long-Term Debt USD Mil
7249	8648	9298	11896	13572	14320	15447	17325	12244	16804	19732	Total Equity USD Mil
0.32	0.31	0.24	0.14	0.18	0.16	0.17	0.24	0.64	0.44	0.99	Debt/Equity

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Valuation
33.4	33.1	22.8	22.7	21.6	24.7	18.7	22.3	17.1	16.1	17.0	Price/Earnings
—	—	—	—	—	—	—	—	—	0.9	1.1	P/E vs. Market
3.6	3.3	3.0	3.0	3.1	3.1	3.0	3.2	2.0	2.2	2.2	Price/Sales
9.9	9.8	7.8	6.7	6.5	6.8	6.7	7.0	7.0	5.7	5.3	Price/Book
18.7	21.0	16.3	18.7	17.9	17.2	17.0	18.1	12.5	14.1	13.6	Price/Cash Flow

Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	0.0	7.2	8.1	7.8
Operating Income %	16.0	7.7	8.9	10.8
Earnings/Share %	17.4	4.1	9.4	10.7
Dividends %	7.6	15.2	15.9	12.7
Book Value/Share %	36.3	4.4	5.9	8.7
Stock Total Return %	19.1	1.5	6.1	5.8
+/- Industry	2.5	-0.6	0.1	-1.3
+/- Market	9.0	10.7	8.0	9.4

Profitability Analysis

Grade: A	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	36.5	35.5	7.6	22.0
Return on Assets %	12.1	15.9	2.5	8.4
Fixed Asset Turns	3.2	3.8	4.5	7.0
Inventory Turns	7.0	8.5	7.2	13.8
Revenue/Employee USD K	239.1	214.9*	—	845.6
Gross Margin %	53.3	54.5	31.0	40.2
Operating Margin %	15.6	17.9	12.6	14.1
Net Margin %	12.7	13.7	2.4	9.3
Free Cash Flow/Rev %	11.1	11.4	9.8	0.1
R&D/Rev %	—	—	—	10.2

Financial Position

Grade: B	12-09 USD Mil	06-10 USD Mil
Cash	3943	4529
Inventories	2618	3530
Receivables	4624	6880
Current Assets	12571	16743
Fixed Assets	12671	18396
Intangibles	9157	27481
Total Assets	39848	65074
Payables	8292	10079
Short-Term Debt	464	4493
Current Liabilities	8756	14572
Long-Term Debt	7400	19586
Total Liabilities	23044	45342
Total Equity	16804	19732

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	17.0	19.8	17.2	15.0
Forward P/E	14.1	—	—	13.0
Price/Cash Flow	13.6	15.8	11.1	6.9
Price/Free Cash Flow	19.5	23.6	15.4	14.7
Dividend Yield %	2.8	—	3.1	2.0
Price/Book	5.3	6.6	4.5	2.0
Price/Sales	2.2	2.7	1.5	1.2
PEG Ratio	1.4	—	—	1.5

Quarterly Results

Revenue USD Mil	Sep 09	Dec 09	Mar 10	Jun 10
Most Recent Period	11080.0	13297.0	9368.0	14801.0
Prior Year Period	11244.0	12729.0	8263.0	10592.0

Rev Growth %	Sep 09	Dec 09	Mar 10	Jun 10
Most Recent Period	-1.5	4.5	13.4	39.7
Prior Year Period	10.6	3.1	-0.8	-3.2

Earnings Per Share USD	Sep 09	Dec 09	Mar 10	Jun 10
Most Recent Period	1.09	0.90	0.89	0.98
Prior Year Period	0.99	0.47	0.72	1.06

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
PepsiCo, Inc.	104318	48546	17.0	36.5
Nestle SA	183460	99554	18.4	20.9
Coca-Cola Company	132933	31753	18.1	30.6

Major Fund Holders

	% of shares
Vanguard Total Stock Mkt Idx	1.03
Vanguard 500 Index Investor	0.95
American Funds Invmt Co of Amer A	0.89

*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.

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	Economic Moat™ Rating	Company Valuation	Fair Value Estimate	Uncertainty Assessment	★★★★★
Analyst conducts company and industry research: • Management interviews • Conference calls • Trade-show visits • Competitor, supplier, distributor, and customer interviews	The depth of the firm's competitive advantage is rated: • None • Narrow • Wide	Analyst considers company financial statements and competitive position to forecast future cash flows. Assumptions are input into a discounted cash-flow model.	DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework.	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

We evaluate the commitment to shareholders demonstrated by each firm's board and management team by assessing transparency, shareholder friendliness, incentives, and ownership. We aim to identify firms that provide investors with insufficient or potentially misleading financial information, seek to limit the power of minority shareholders, allow management to abuse its position, or which have management incentives that are not aligned with the interests of long-term shareholders. The grades are assigned on an absolute scale--not relative to peers--and can be interpreted as follows: A means "Excellent," B means "Good," C means "Fair," D means "Poor," and F means "Very Poor."