Abbott Laboratories ABT [NYSE] | ★★★★★

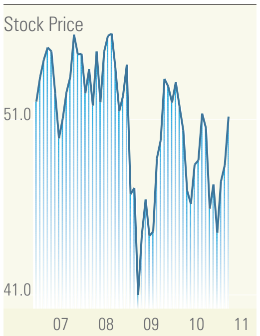
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
54.00 USD	68.00 USD	54.40 USD	85.00 USD	Low	Wide	C	JNJ	Drug Manufacturers - Major

Limited patent losses and steady growth for Humira position Abbott for strong long-term growth.

by Damien Conover, CFA
Associate Director
Analysts covering this company do not own its stock.

Pricing data through May 16, 2011.
Rating updated as of May 16, 2011.

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



Thesis May 11, 2011

On the foundation of a wide lineup of patent-protected drugs, a leading diagnostics business, a strong nutritional division, and a top-tier vascular group, Abbott Laboratories has dug a wide economic moat. We expect these operating lines will continue to generate strong returns and drive growth. Further, the company's adept skills at partnerships and acquisitions probably will add to internal growth.

Existing drugs and new pipeline products should propel long-term growth. Abbott's pharmaceutical division contains a diverse set of growing blockbusters across many therapy groups. Autoimmune agent Humira, HIV/AIDS drug Kaletra, and cardiovascular treatments Tricor and Trilipix lead the group with more than $8 billion in annual sales (27% of total sales). Humira continues to be the workhorse of the group with 19% growth in 2010, as new indications help propel the drug. The company's active research and development efforts have created the next generation of drugs, including cardiovascular drug Trilipix, which has blockbuster potential.

Outside the pharmaceutical group, Abbott runs top-tier diagnostic and nutritional segments that generate over 25% of total sales, helping to insulate the company from patent losses in the drug group. The diagnostic group is well-positioned as disease therapy becomes more patient-specific.

Complementing the pharmaceutical, diagnostic, and nutritional segments, the firm's recently expanded vascular line is poised for rapid growth. Favorable clinical data on the company's new drug-coated stent Xience versus entrenched Boston Scientific stent Taxus has resulted in fast market uptake.

In addition to strong internal operating lines, Abbott has a successful record of acquisitions and partnerships. The favorable acquisitions of Knoll and Kos Pharmaceuticals brought in Humira and Niaspan along with pipeline products. The acquisition of Guidant's vascular business opened the door to a new operating segment and Xience, a drug-eluting stent superior to an in-house stent. Additionally, the recent acquisitions of Advanced Medical Optics and the drug units from Solvay and Piramal should add value over the long term. The strong record and ample cash flow raise our confidence that external growth opportunities will probably augment internal growth.

Valuation, Growth and Profitability

We're maintaining our fair value estimate of $68 per share, which implies a 2011 price/earnings multiple of 15 times. The current forward-year industry price/earnings multiple is 10 times and we believe Abbott's industry-leading growth continues to warrant a premium multiple valuation for the company. We incorporated the recent acquisition of Piramal's drug unit into our valuation model, but acquired sales largely offset the high purchase price. Humira represents the most important driver in Abbott's valuation--we project it contributes over 20% to our estimate of the firm's total value. While competing drugs lurk in the near future, we expect Humira to post double-digit annual growth during the next several years. Overall, during the next five years, we project 6% average annual sales growth, led by Humira, Xience, and acquisitions. During the same period, we project a slight increase in operating margins as cost-containment initiatives offset patent losses on high-margin drugs. We estimate a 9% cost of equity and a similar weighted average cost of capital, which reflect the secure and robust cash flows derived from diverse operations.

Risk

While Abbott maintains diverse operations, it depends heavily on Humira and Xience for future growth. Further, the company's pipeline isn't as large as those of rivals, making any failures with late-stage candidates very costly. Also, the company faces typical industry risks including

Abbott Laboratories ABT [NYSE] | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
54.00 USD	68.00 USD	54.40 USD	85.00 USD	Low	Wide	C	JNJ	Drug Manufacturers - Major

Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Abbott Laboratories	USD	83,931	36,509	5,918	4,487
Johnson & Johnson	USD	181,930	62,129	16,361	12,284
Pfizer Inc.	USD	165,766	67,735	14,144	8,453
Baxter International Inc.	USD	34,052	13,200	2,748	2,053

Morningstar data as of May 16, 2011.

drug delays or nonapprovals, as well as an increasing aggressive generic and managed-care industry.

Bulls Say

- Strong clinical data from SPIRIT II and SPIRIT III give Xience a leg up in the drug-eluting stent market.
- Aggressive cost cutting plans should propel Abbott's bottom-line growth much quicker than top-line growth.
- International markets and indications in Crohn's disease and psoriasis for Humira should further propel sales growth for the company's leading pharmaceutical product.
- The recent acquisition of Piramal's drug unit increases Abbott's exposure to the rapidly growing Indian market.
- Abbott's acquisition of the pharmaceutical unit from its former partner Solvay offers strong cost savings as Abbott can eliminate several duplicate divisions.

Bears Say

- The acquisitions of Advanced Medical Optics and the drug units of Solvay and Piramal may cause integration disruptions as the company digests multiple operating lines.
- Lack of robust internal development casts a shadow on the company's ability to create blockbusters in-house.
- Clinical data on drug-eluting stents have recently presented unclear benefits versus bare-metal stents and other treatments. Stent operations and use of drug-eluting stents could fall without supportive new data.
- To prepare for more tuck-in acquisitions, Abbott is likely going to add cash to its balance sheet rather than pursue aggressive share buybacks. The investment community could react negatively toward decisions in favor of acquisitions over returning cash to shareholders via share repurchases.
- Pfizer's JAK-3 inhibitor for rheumatoid arthritis has shown strong efficacy in Phase III trials relative to Humira. If the drug holds up well in late-stage trials, it could take significant market share from Humira based on the drug's oral dosing. Also, Roche's RA drug Actemra is poised to reported head-to-head data versus Humira in late 2011 or early 2012. Strong Actemra data could translate into Humira market share losses.

Financial Overview

Financial Health: Thanks to its acquisitions, Abbott holds less cash than its peers. However, Abbott's robust and relatively stable cash flows should easily meet interest expenses with ample reserves left for share repurchases, increases to dividends, and small acquisitions.

Company Overview

Profile: Abbott manufactures and markets pharmaceuticals, medical devices, blood glucose monitoring kits, and nutritional health-care products. Products include prescription drugs, coronary and carotid stents, and nutritional liquids for infants and adults. Following the Advanced Medical Optics acquisition, Abbott also markets eye-care products. Abbott generates slightly less than 60% of revenue from pharmaceuticals.

Management: Miles White took the helm as CEO in 1998 and chairman of the board the following year. His tenure with the company dating back to 1984 provides the experience needed in wielding the many operating lines of the company. Under his leadership, the company executed several value-enhancing acquisitions. Overall, the company promotes solid stewardship. We like the policy of cumulative voting rights in the election of directors, as this gives more clout to minority shareholders. Compensation for top executives is well balanced between cash and equity and in line with industry practices. However, we would like the company to take a page from the major European pharmaceutical companies and split the roles of CEO and chairman.

Abbott Laboratories ABT [NYSE] | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
54.00 USD	68.00 USD	54.40 USD	85.00 USD	Low	Wide	C	JNJ	Drug Manufacturers - Major

Analyst Notes

Apr. 25, 2011

Key Pfizer Pipeline Drug Hits Setback, Potentially Delaying New RA Drug Competition

On April 21, Pfizer reported one drug-related death in one of its Phase III trials (ORAL Sync) for rheumatoid arthritis (RA) drug tofacitinib. While we don't expect any changes to our fair value estimate for Pfizer based on the negative news, we believe the death will increase government scrutiny of the drug during the approval process. We're slightly lowering our expected probability of approval for the drug to 55% from 60%. Nevertheless, the death rate for the drug in clinical development is still in-line with other RA drugs currently approved. Additionally, given the severity of RA, we expect greater leniency from regulators. We project sales of tofacitinib to reach over $400 million by 2015.

However, the increasingly negative side-effect profile for tofacitinib bodes well for other RA treatments including Abbott's Humira. Tofacitinib's growing side effects had already included increased liver enzyme and cholesterol levels. The new patient death, combined with already known side effects, will likely delay the tofacitinib approval until late 2012 at the earliest. The complete data from the Phase III trial ORAL Sync will be available May 27, and additional Phase III tofacitinib trials should complete later this year.

Apr. 20, 2011

Abbott Posts Solid 1Q as Humira Continues to Outperform

Abbott Laboratories reported strong first-quarter results that largely matched our expectations, and we don't expect to change our fair value estimate. Helped by acquisitions, total sales increased 16% from the prior-year period. Excluding the Solvay and Piramal acquisitions, we estimate sales increased 5% year over year, with another strong quarter of growth coming from the company's top drug, Humira. Earnings per share increased 12% year over year and Abbott maintained its full-year EPS outlook of $4.54-$4.64, which we expect it to meet.

Led by 18% year-over-year growth from immunology drug Humira, Abbott's pharmaceutical division posted strong growth of 11% operationally versus the prior-year period. Humira's growth exceeded our expectations as well as consensus targets, and we continue to believe the drug will post strong double-digit growth this year and next year. Further, despite potential competition coming from Pfizer's rheumatoid arthritis pipeline drug, tofacitinib, we believe Humira will still be able to generate steady growth because the RA and immunology markets remain significantly underpenetrated by drug treatments.

Abbott's remaining key divisions all posted steady growth, with strong international sales offsetting slowing U.S. sales. In particular, robust foreign sales in the nutritional, diabetes care, and vascular business all offset weakness in the United States. While we expect this trend to continue through 2011, we believe U.S. nutritional sales should return to steady growth as the nutritional recalls work their way through the system.

Abbott is making strong strides to improve its pipeline. It is poised to move two new drugs into Phase III development: endometriosis drug elagolix and kidney disease drug bardoxolone. We believe both of these represent blockbuster opportunities. On the device side, Abbott recently reported strong data on its bioresorbable stent and mitral regurgitation device MitraClip; we believe both devices represent key new products for the company. The ability to improve its pipeline will become more important as the company approaches Humira's 2016 patent loss. While Humira's biologic composition should reduce generic competition, a few generic versions will still probably emerge.

Analyst Notes (continued)

Earnings per share increased 12% year over year, partially supported by improved gross margins, as favorable product mix offset the costs of U.S. health-care reform and negative European pricing. For the remainder of the year, we expect improved margins as the company is implementing cost-containment efforts including a 5% workforce reduction. While many pharmaceutical firms are cutting costs, Abbott doesn't face the same patent losses as its peers, so the cost-cutting plans should net solid margin improvements.

Jan. 26, 2011

No Big Surprises in Abbott's 4Q Results; Outlook Remains Favorable

Abbott Laboratories reported fourth-quarter results that matched our expectations, and we don't expect any changes to our fair value estimate. Boosted by the Solvay and Piramal acquisitions, Abbott posted 14% year-over-year operational growth. With the exception of the nutritional business, all of Abbott's product lines posted solid results, with acquisitions adding close to 10% of the growth. Earnings per share increased 10% from the prior-year period, in line with our estimate and consensus. Abbott issued 2011 full-year EPS guidance of $4.54-$4.64, slightly below our estimate of $4.68. We continue to expect double-digit bottom-line growth for Abbott in 2011, which represents the best near-term growth in big pharma.

In the pharmaceutical division, Abbott's most important drug Humira for immunology indications continued to post strong gains, up 15% operationally from the prior-year period. We continue to expect Humira will grow at double-digit rates for the next four years, given its low penetration rate in several diseases. Cardiovascular drugs Tricor and Trilipix also posted steady increases, up 19% year over year. Based on Trilipix's superior profile in use with a statin, we continue to project Abbott will switch about 50% of Tricor patients to the recently launched Trilipix before the Tricor patent expires in mid-2012. On the new product front, the likely need for new clinical trials for psoriasis drug ABT-874 should push the drug's launch back until 2013.

Most of Abbott's remaining divisions posted steady growth, with the exception of the nutritional business. While we had expected the nutritional group to remain under pressure because of the product recalls in September, we believe Abbott's nutritional manufacturing is back on line and the company has lost some market share to lower-priced products. In 2011, we expect the nutritional business will regain some of the lost market share, thanks to Abbott's strong brand name.

Abbott's operating costs were largely flat year over year. As a percentage of revenue, gains in gross margin largely offset higher spending in research and development as well as increased marketing and administrative costs. We expect cost-cutting initiatives will slightly improve margins in 2011 with the majority of savings driven from workforce reductions related to the Solvay acquisition.

Abbott Laboratories ABT

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
36,509	83,931	Drug Manufacturers - Major	Healthcare

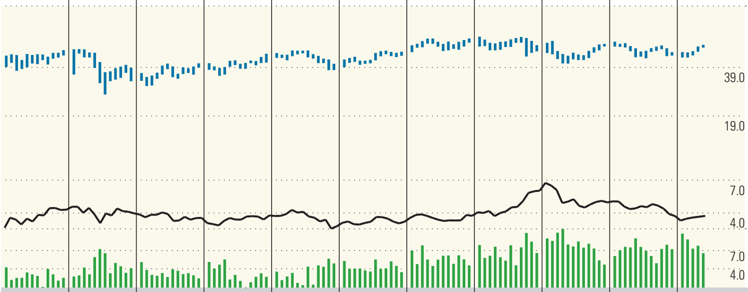
Abbott manufactures and markets pharmaceuticals, medical devices, blood glucose monitoring kits, and nutritional health-care products. Products include prescription drugs, coronary and carotid stents, and nutritional liquids for infants and adults. Following the Advanced Medical Optics acquisition, Abbott also markets eye-care products. Abbott generates slightly less than 60% of revenue from pharmaceuticals.

100 Abbott Park Road
Abbott Park, IL 60064-6400
Phone: 1 847 937-6100Website: http://www.abbott.com

Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship Grade
★★★★★	54.00	68.00	Low	Wide	C

per share prices in USD

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	YTD	
50.26	50.99	41.45	47.63	50.00	49.87	59.50	61.09	57.39	56.79	54.24	Annual Price High
37.14	26.20	29.67	34.53	37.50	39.18	48.75	45.75	41.27	44.59	45.07	Low
											Recent Splits



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

52 week High/Low
54.24 - 44.59

10 Year High/Low
61.09 - 26.20

Bear-Market Rank
10 (10=worst)

Trading Volume Million

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	YTD	Stock Performance
9.9	-26.5	19.1	16.4	-13.2	26.5	17.9	-2.5	4.1	-8.1	14.6	Total Return %
22.9	-3.1	-7.3	7.4	-16.2	12.9	14.4	36.0	-19.3	-20.9	8.9	+/- Market
21.9	-14.8	4.8	20.5	-15.7	12.1	13.7	14.7	-7.6	-9.8	1.7	+/- Industry
1.6	2.4	2.2	2.2	2.8	2.4	2.3	2.6	2.9	3.6	3.3	Dividend Yield %
76076	54938	64033	72652	61165	74763	86767	82808	83748	74116	83931	Market Cap USD Mil

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM	Financials
16285	17685	19681	19680	22338	22476	25914	29528	30765	35167	36509	Revenue USD Mil
52.4	51.9	51.9	54.9	52.4	56.3	55.9	57.3	57.1	58.3	58.4	Gross Margin %
1894	3530	3323	3898	4362	2042	4579	5694	6236	6088	5918	Oper Income USD Mil
11.6	20.0	16.9	19.8	19.5	9.1	17.7	19.3	20.3	17.3	16.2	Operating Margin %
1550	2794	2753	3236	3372	1717	3606	4881	5746	4626	4487	Net Income USD Mil
0.99	1.78	1.75	2.06	2.16	1.12	2.31	3.12	3.69	2.96	2.88	Earnings Per Share USD
0.82	0.92	0.97	1.03	1.09	1.16	1.27	1.41	1.56	1.72	1.76	Dividends USD
1566	1573	1572	1571	1564	1537	1560	1561	1547	1556	1555	Shares Mil
5.84	6.83	8.36	9.20	9.29	9.16	11.51	11.27	14.73	14.47	15.85	Book Value Per Share USD
3567	4183	3746	4408	5174	5329	5184	7344	7275	8736	9224	Oper Cash Flow USD Mil
-1164	-1296	-1247	-1292	-1207	-1338	-1656	-1288	-1089	-1015	-1162	Cap Spending USD Mil
2403	2887	2500	3116	3967	3991	3528	6056	6186	7721	8063	Free Cash Flow USD Mil

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM	Profitability
8.0	11.8	10.8	11.7	11.7	5.3	9.5	11.9	12.1	8.3	7.8	Return on Assets %
17.6	28.3	23.2	23.6	23.5	12.1	22.7	27.7	28.5	20.4	19.7	Return on Equity %
9.5	15.8	14.0	16.4	15.1	7.6	13.9	16.5	18.7	13.2	12.3	Net Margin %
0.84	0.74	0.77	0.71	0.77	0.69	0.68	0.72	0.65	0.63	0.63	Asset Turnover
2.6	2.3	2.0	2.0	2.0	2.6	2.2	2.4	2.3	2.7	2.5	Financial Leverage

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	03-11	Financial Health
492	2120	2651	3909	3971	-669	4939	5451	10264	5055	6422	Working Capital USD Mil
4335	4274	3452	4788	4572	7010	9488	8713	11266	12524	12530	Long-Term Debt USD Mil
9059	10665	13072	14326	14415	14054	17779	17480	22856	22388	24630	Total Equity USD Mil
0.48	0.40	0.26	0.33	0.32	0.50	0.53	0.50	0.49	0.56	0.51	Debt/Equity

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM	Valuation
52.9	21.1	25.0	23.1	18.3	43.5	24.3	17.6	14.6	16.2	18.7	Price/Earnings
—	—	—	—	—	—	—	—	—	0.9	1.2	P/E vs. Market
5.0	3.3	3.5	3.7	2.8	3.3	3.4	2.8	2.7	2.1	2.3	Price/Sales
9.0	5.5	5.2	5.1	4.2	5.3	4.9	4.7	3.7	3.3	3.4	Price/Book
23.0	14.1	18.4	16.6	11.9	14.1	16.9	11.3	11.5	8.5	9.1	Price/Cash Flow

Growth Rates Compound Annual

Grade: B	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	14.3	10.7	9.5	9.8
Operating Income %	-2.4	10.0	6.9	6.0
Earnings/Share %	-19.8	8.6	6.5	5.2
Dividends %	10.3	10.6	9.7	8.8
Book Value/Share %	-1.8	8.0	9.3	10.1
Stock Total Return %	15.1	2.5	7.6	4.7
+/- Industry	-9.4	-2.3	4.9	3.2
+/- Market	-2.0	4.8	7.0	3.8

Profitability Analysis

Grade: B	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	19.7	22.3	13.0	23.1
Return on Assets %	7.8	9.4	6.3	8.8
Fixed Asset Turns	4.5	3.9	3.6	7.3
Inventory Turns	4.5	4.2	2.5	14.7
Revenue/Employee USD K	405.7	413.4*	—	942.0
Gross Margin %	58.4	57.0	71.6	39.4
Operating Margin %	16.2	16.7	18.7	15.3
Net Margin %	12.3	14.0	12.4	10.3
Free Cash Flow/Rev %	22.1	18.8	21.0	0.1
R&D/Rev %	10.8	0.1	—	9.9

Financial Position

Grade: A	12-10 USD Mil	03-11 USD Mil
Cash	3648	2740
Inventories	3189	3401
Receivables	7184	7160
Current Assets	22318	23647
Fixed Assets	7971	8078
Intangibles	28082	28837
Total Assets	59462	61651
Payables	3524	3596
Short-Term Debt	6395	6252
Current Liabilities	17262	17225
Long-Term Debt	12524	12530
Total Liabilities	37074	37022
Total Equity	22388	24630

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	18.7	23.3	19.8	15.7
Forward P/E	10.9	—	—	13.5
Price/Cash Flow	9.1	12.5	10.9	8.8
Price/Free Cash Flow	10.4	16.1	12.6	18.2
Dividend Yield %	3.3	—	3.2	1.8
Price/Book	3.4	4.4	2.8	2.2
Price/Sales	2.3	2.9	2.6	1.4
PEG Ratio	1.0	—	—	1.6

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

Quarterly Results

Revenue USD Mil	Jun 10	Sep 10	Dec 10	Mar 11
Most Recent Period	8826.0	8674.5	9967.9	9040.9
Prior Year Period	7494.9	7761.3	8790.1	7698.4

Rev Growth %	Jun 10	Sep 10	Dec 10	Mar 11
Most Recent Period	17.8	11.8	13.4	17.4
Prior Year Period	2.5	3.5	10.6	14.6

Earnings Per Share USD	Jun 10	Sep 10	Dec 10	Mar 11
Most Recent Period	0.83	0.57	0.93	0.55
Prior Year Period	0.83	0.95	0.99	0.64

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Abbott Laboratories	83931	36509	18.7	19.7
Johnson & Johnson	181930	62129	15.0	21.8
Pfizer Inc.	165766	67735	20.0	9.4

Major Fund Holders

	% of shares
Pioneer Cullen Value A	0.19
Aston/Montag & Caldwell Growth N	0.18
Fidelity Advisor New Insights I	0.16

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

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

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."