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

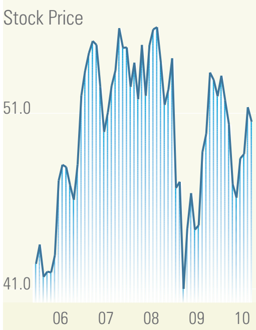
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
48.16 USD	68.00 USD	54.40 USD	85.00 USD	Low	Wide	C	AA+	Drug Manufacturers - Major

Abbott Posts In-Line 3Q

by Damien Conover, CFA
Senior Stock Analyst
Analysts covering this company do not own its stock.

Pricing data through November 15, 2010.
Rating updated as of
November 15, 2010.

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



Analyst Note Oct. 20, 2010

Abbott Laboratories reported third-quarter results that largely matched our expectations and we don't expect any changes to our fair value estimate. Total sales grew 13% operationally versus the prior-year period, slightly below our expectations. A strong improvement in the gross margin led to 14% year-over-year growth in earnings per share, just above our expectations. Abbott increased the bottom end of its full-year earnings per share outlook to $4.16-$4.18, which we expect it will meet.

The pharmaceutical division posted 23% year-over-year growth, led by immunology drug Humira and recently added drugs from the Solvay acquisition, which closed in February. Humira grew 16% operationally versus the prior-year period, in line with our expectations. We project an average of 14% growth annually for Humira over the next three years, largely driven by international markets, where penetration remains low. Cardiovascular drugs Trilipix and Tricor posted strong gains, up 22% year over year, but we expect the 2012 patent loss on Tricor will lead to a 30% decline for these drugs over the next two years.

Abbott's vascular division also posted strong gains in the quarter, up 20% operationally versus the prior-year period. Driving this growth, drug-eluting stent Xience, launched in Japan in February, has already gained more than 70% of that market. While we expect the vascular division's growth will slow over the next few years as Xience has now been launched in most major markets, we still project an average 9% annual growth rate for this group over the next three years.

Both nutritional and diagnostic sales posted weak results, with close to flat sales growth versus the prior-year period. The nutritional group was hurt by a $100 million product recall in the quarter. With the repairs already completed at the manufacturing site that produced the recalled products, we expect the nutritional group will return to high-single-digit growth over the next several quarters.

Significant improvements in the gross margin more than offset increased marketing and research and development spending. As a percentage of total sales, costs of goods sold fell 450 basis points year over year. We believe a more favorable mix of products, including the Solvay products and increased vascular sales, largely drove the gross margin increase. Further, while marketing costs as a percentage of sales increased by 200 basis points versus the prior-year period, we expect Abbott's recently announced 3% workforce cut will improve its marketing efficiency. Lastly, Abbott increased its research and development spending as a percentage of sales by almost 200 basis points year over year as it is making good strides to improve its relatively weak pipeline.

Thesis May 28, 2010

On the foundation of a wide lineup of patent-protected drugs, a leading diagnostics business, a strong nutritional division, and an emerging 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 will probably add to internal growth.

Existing drugs and new pipeline products should propel long-term growth, despite the 2008 patent loss on blockbuster epilepsy drug Depakote. 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 (26% of total sales). Humira continues to be the workhorse of the group with over 20% growth in 2009, as new indications help propel the drug. The company's active research and development efforts have created the next generation of drugs, including psoriasis treatment ABT-874 and cardiovascular drug Trilipix, both of which have blockbuster potential.

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Abbott Laboratories	USD	74,447	33,989	6,121	4,724
Johnson & Johnson	USD	176,145	62,494	15,409	13,598
Pfizer Inc.	USD	134,167	66,785	11,752	6,134
Baxter International Inc.	USD	29,975	12,815	2,346	1,569

Morningstar data as of November 15, 2010.

Outside the pharmaceutical group, Abbott runs top-tier diagnostic and nutritional segments that generate over 30% 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 should result in fast market uptake. The recent successful U.S. launch of Xience is helping to moderate the 2008 Depakote patent loss.

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. 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 just north of 20% to our estimate of the firm's total value. While competing drugs lurk in the near future, we continue to expect Humira to post double-digit annual growth over the next several years. Overall, over the next 10 years, we project 5% average annual sales growth, led by Humira, Xience, and acquisitions. Over the same period, we project flat 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 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.
- Xience significantly outperformed another of Abbott's drug-eluting stents, Zomaxx, which used the same drug coating as Medtronic's MDT new Endeavor stent. Thus, Xience could outperform Endeavor.
- 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.
- The acquisition of Solvay's pharmaceutical unit brings

in several new drugs, which could see dramatically increased sales potential with Abbott's powerful salesforce behind it.

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.
- In an increasingly strict regulatory environment, the company's weak pipeline lacks the high number of shots on goal needed to increase the success probability of new product approvals.
- Pfizer's JAK-3 inhibitor for rheumatoid arthritis has shown strong efficacy in Phase II trials relative to Humira. If the drug holds up well in late-stage trials, it could take significant market share from Humira.

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.

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Aug. 18, 2010

New Credit Rating: Abbott Laboratories

We're raising our credit rating for Abbott Laboratories to AA+ from AA to reflect its improving financial position in the wake of its most recent big acquisition, Solvay's pharmaceutical business. Since the end of 2009, the firm's leverage ratios have declined substantially. For example, debt-to-trailing twelve month EBITDA declined to 1.6x at the end of the second quarter from 2.0x at the end of 2009.

Analyst Notes (continued)

Even with other acquisitions like the Indian generics manufacturer acquisition announced in the second quarter, we expect Abbott to continue making progress on this front due to its very large expected cash flows. Combine this declining leverage with our admiration of Abbott's business prospects, and we feel comfortable boosting the firm's credit rating by a notch.

Abbott Laboratories' wide moat, large size, noncyclicality, and high levels of cash make the company highly solvent, and minimize the risk of default. Also, Abbott's diverse operating lines--including pharmaceuticals, medical devices, and nutritionals--should reduce the volatility of future cash flows. This diversity is further cushioned by Abbott's very wide customer base, which spans all major developed and emerging markets. Additionally, in contrast to its pharmaceutical peer group, Abbott faces very few major patent losses during the next five years.

Going forward, while an acquisitive strategy may continue to funnel cash away from debt repayment, we believe Abbott's strong cash flows will enable it to quickly re-establish a very solid financial position, as it has done recently after material acquisitions. At the end of June 2010, Abbott held $6.2 billion in cash and short-term investments compared to $14.2 billion in debt. The firm only needs to hold about one year's worth of free cash flow on its books to be able to completely offset its debt balance with cash, which gives its ample financial flexibility.

Jul. 21, 2010

Humira, Solvay Boost Abbott's 2Q

Abbott Laboratories reported strong second-quarter results that largely matched our expectations, and we don't expect any changes to our fair value estimate. Excluding the impact of currency, total sales increased 15% year over year, aided by strong Humira gains and the Solvay acquisition. Earnings per share increased 13.5% from the prior-year period as higher marketing and administration costs related to the Solvay operations weighed on growth.

Abbott reported strong top-line growth, partly supported by the inclusion of the recently acquired Solvay drug unit. We estimate the Solvay business added about 10% growth versus the prior-year period; the Solvay bolus should continue over the next two quarters. Also adding to the gains in the quarter, immunology drug Humira posted almost 20% operational growth versus the prior-year period. We continue to project close to 20% growth for Humira in 2010 on the basis of strong international growth and the potential for further market penetration into several immunology indications.

Outside the drug group, Abbott's segments posted steady gains, with particular strength from the vascular business. We believe drug-eluting stent Xience is driving the vascular business' strong growth; the product was recently introduced in Japan, where it has already achieved a leading market share.

As a percentage of total sales, operating costs increased more than 100 basis points versus the prior-year period. Higher marketing and administration costs related to the Solvay operations and higher research and development costs weighed on expenses. We expect the marketing and administration costs will fall over the next few years as Abbott rationalizes costs around its Solvay operations. However, since the majority of these costs are related to operations in European countries that have strong labor protection laws, we believe the cost cuts will take extra time to implement. Additionally, while the research and

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Analyst Notes (continued)

development costs were a bit higher in the quarter, we believe Abbott is addressing its weak pipeline by advancing several late-stage pipeline drugs, which should bode well for the company's long-term growth.

May 21, 2010

Abbott to Acquire Indian Generic Operations

Abbott Laboratories announced it has agreed to acquire the health-care solutions business of India-based Piramal Healthcare for $3.7 billion, which would make Abbott the largest player in the rapidly growing Indian market. While the acquisition price appears rich, we note that pharmaceutical firms are increasingly looking at generics and emerging markets in particular as key contributors to earnings growth, and the underlying growth of these areas is likely to result in higher multiples paid for companies that fit the new strategic focus of Big Pharma.

Under the terms of acquisition, Abbott will pay $2.1 billion up front and $400 million per year over the next four years beginning in 2011. The purchase price represents about 7.4 times the business' estimated 2011 sales of $500 million. This compares unfavorably with the main benchmark for acquisitions in India--the purchase of Ranbaxy by Daiichi Sankyo in 2008 for $4.2 billion, or 4.7 times sales. We're updating our model for the purchase, but a change to our fair value estimate for Abbott (if any) isn't likely to be material. Abbott estimates that the acquisition will not be dilutive to 2010 earnings, and any dilution for 2011-12 will probably be absorbed.

This purchase will make Abbott the largest player in India, with nearly 7,000 sales representatives and expected sales of close to $2.5 billion by 2020. The addition of the health-care solutions business brings in a portfolio of 350 branded generics sold exclusively in India in the respiratory, cardiovascular, and antibiotics areas. We've outlined the rationale for Big Pharma entering Indian market in our latest issue of the Healthcare Observer, and this acquisition adds more evidence to our belief that emerging markets' prominence will rise significantly over the next decade. Abbott has been aggressively expanding its footprint in these geographies, as the emerging markets theme was key in its rationale for last year's acquisition of Solvay. With close to 20% of sales currently from these markets and an established sales and manufacturing footprint, Abbott is well positioned to capitalize on the explosive growth we expect over the next few decades.

Disclaimers & Disclosures

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Abbott Laboratories ABT

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
33,989	74,447	Drug Manufacturers - Major	Health Care

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.

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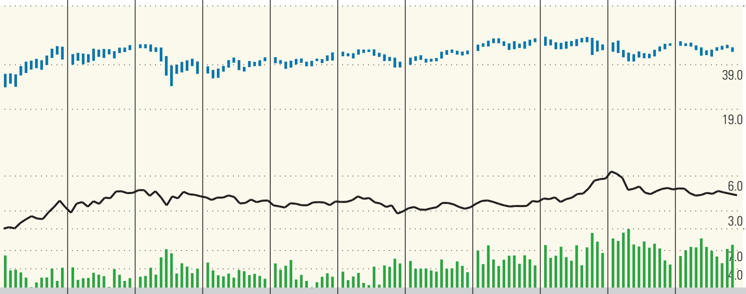
Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship Grade
★★★★★	48.16	68.00	Low	Wide	C

per share prices in USD

52.61	53.47	54.23	44.10	47.63	50.00	49.87	59.50	61.09	57.39	56.79	Annual Price High
27.36	39.28	27.87	31.57	36.74	37.50	39.18	48.75	45.75	41.27	44.59	Low
											Recent Splits



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

52 week High/Low
56.79 - 44.59

10 Year High/Low
61.09 - 27.36

Bear-Market Rank
10 (10=worst)

Trading Volume Million

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD	**Stock Performance**
35.6	16.9	-26.5	19.1	9.4	-13.2	26.5	17.9	-2.5	4.1	-7.6	Total Return %
45.7	29.9	-3.1	-7.3	0.4	-16.2	12.9	14.4	36.0	-19.3	-15.0	+/- Market
-6.2	28.9	-14.8	4.8	13.5	-15.7	12.1	13.7	14.7	-7.6	-8.9	+/- Industry
1.5	1.5	2.3	2.1	2.2	2.8	2.4	2.3	2.6	2.9	3.6	Dividend Yield %
70078	80955	58461	68142	72652	61165	74763	86767	82808	83748	74447	Market Cap USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	**Financials**
13746	16285	17685	19681	19680	22338	22476	25914	29528	30765	33989	Revenue USD Mil
54.6	52.4	51.9	51.9	54.9	52.4	56.3	55.9	57.3	57.1	57.6	Gross Margin %
3401	1894	3530	3323	3898	4362	2042	4579	5694	6236	6121	Oper Income USD Mil
24.7	11.6	20.0	16.9	19.8	19.5	9.1	17.7	19.3	20.3	18.0	Operating Margin %
2786	1550	2794	2753	3236	3372	1717	3606	4881	5746	4724	Net Income USD Mil
1.78	0.99	1.78	1.75	2.06	2.16	1.12	2.31	3.12	3.69	3.05	Earnings Per Share USD
0.74	0.82	0.92	0.97	1.03	1.09	1.16	1.27	1.41	1.56	1.68	Dividends USD
1566	1566	1573	1572	1571	1564	1537	1560	1561	1547	1549	Shares Mil
5.54	5.84	6.83	8.36	9.20	9.29	9.16	11.51	11.27	14.73	13.85	Book Value Per Share USD
3100	3567	4183	3746	4408	5174	5329	5184	7344	7275	8252	Oper Cash Flow USD Mil
-1036	-1164	-1296	-1247	-1292	-1207	-1338	-1656	-1288	-1089	-969	Cap Spending USD Mil
2064	2403	2887	2500	3116	3967	3991	3528	6056	6186	7283	Free Cash Flow USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	**Profitability**
18.7	8.0	11.8	10.8	11.7	11.7	5.3	9.5	11.9	12.1	8.8	Return on Assets %
34.8	17.6	28.3	23.2	23.6	23.5	12.1	22.7	27.7	28.5	22.1	Return on Equity %
20.3	9.5	15.8	14.0	16.4	15.1	7.6	13.9	16.5	18.7	13.9	Net Margin %
0.92	0.84	0.74	0.77	0.71	0.77	0.69	0.68	0.72	0.65	0.63	Asset Turnover
1.8	2.6	2.3	2.0	2.0	2.0	2.6	2.2	2.4	2.3	2.7	Financial Leverage

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	09-10	**Financial Health**
3079	492	2120	2651	3909	3971	-669	4939	5451	10264	3864	Working Capital USD Mil
1076	4335	4274	3452	4788	4572	7010	9488	8713	11266	12911	Long-Term Debt USD Mil
8571	9059	10665	13072	14326	14415	14054	17779	17480	22856	21404	Total Equity USD Mil
0.13	0.48	0.40	0.26	0.33	0.32	0.50	0.53	0.50	0.49	0.60	Debt/Equity

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	**Valuation**
27.3	56.2	22.5	26.6	23.1	18.3	43.5	24.3	17.6	14.6	15.8	Price/Earnings
—	—	—	—	—	—	—	—	—	0.8	1.0	P/E vs. Market
5.5	5.4	3.6	3.7	3.7	2.8	3.3	3.4	2.8	2.7	2.2	Price/Sales
8.7	9.6	5.9	5.6	5.1	4.2	5.3	4.9	4.7	3.7	3.5	Price/Book
24.4	24.4	15.0	19.6	16.6	11.9	14.1	16.9	11.3	11.5	9.0	Price/Cash Flow

Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	4.2	11.0	9.3	8.8
Operating Income %	9.5	45.1	9.8	7.1
Earnings/Share %	21.8	48.8	12.8	8.9
Dividends %	11.0	10.4	8.8	9.0
Book Value/Share %	30.8	17.2	9.9	11.7
Stock Total Return %	-5.8	-1.0	5.9	2.5
+/- Industry	-11.4	1.0	3.2	2.1
+/- Market	-15.3	5.2	6.4	4.4

Profitability Analysis

Grade: B	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	22.1	22.9	11.2	22.4
Return on Assets %	8.8	10.1	5.4	8.6
Fixed Asset Turns	4.4	3.8	3.8	7.1
Inventory Turns	4.3	4.1	2.6	13.9
Revenue/Employee USD K	465.6	410.2*	—	873.3
Gross Margin %	57.6	55.8	72.0	39.7
Operating Margin %	18.0	17.2	21.2	14.3
Net Margin %	13.9	14.4	9.6	9.6
Free Cash Flow/Rev %	21.4	17.9	20.4	0.1
R&D/Rev %	10.3	0.1	—	10.0

Financial Position

Grade: A	12-09 USD Mil	09-10 USD Mil
Cash	8809	3818
Inventories	3265	3309
Receivables	6542	6249
Current Assets	23314	19447
Fixed Assets	7619	7940
Intangibles	19492	28454
Total Assets	52417	57374
Payables	2343	2407
Short-Term Debt	5190	5806
Current Liabilities	13049	15584
Long-Term Debt	11266	12911
Total Liabilities	29561	35970
Total Equity	22856	21404

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	15.8	23.7	13.3	15.4
Forward P/E	10.3	—	—	14.1
Price/Cash Flow	9.0	13.2	9.9	7.8
Price/Free Cash Flow	10.3	17.3	11.7	15.7
Dividend Yield %	3.6	—	3.7	1.8
Price/Book	3.5	4.6	2.5	2.1
Price/Sales	2.2	3.0	2.4	1.3
PEG Ratio	1.0	—	—	1.6

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

Quarterly Results

Revenue USD Mil	Dec 09	Mar 10	Jun 10	Sep 10
Most Recent Period	8790.1	7698.4	8826.0	8674.5
Prior Year Period	7950.3	6718.4	7494.9	7761.3

Rev Growth %	Dec 09	Mar 10	Jun 10	Sep 10
Most Recent Period	10.6	14.6	17.8	11.8
Prior Year Period	10.1	-0.7	2.5	3.5

Earnings Per Share USD	Dec 09	Mar 10	Jun 10	Sep 10
Most Recent Period	0.99	0.64	0.83	0.57
Prior Year Period	0.98	0.92	0.83	0.95

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Abbott Laboratories	74447	33989	15.8	22.1
Johnson & Johnson	176145	62494	13.2	25.3
Pfizer Inc.	134167	66785	21.9	8.0

Major Fund Holders

	% of shares
American Funds Washington Mutual A	1.21
Vanguard Total Stock Mkt Idx Inv	1.06
Vanguard 500 Index Investor	0.92

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

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."