O'Reilly Automotive Inc ORLY [Nasdaq] | ★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
82.36 USD	61.00 USD	42.70 USD	82.40 USD	Medium	None	C	BBB	Specialty Retail

O'Reilly is poised to benefit from near-term tailwinds, but demand trends are set to normalize.

by Liang Feng
Associate Analyst
Analysts covering this company do not own its stock.

Pricing data through February 06, 2012.
Rating updated as of February 06, 2012.

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

Thesis Nov. 18, 2011

By acquiring CSK Auto in 2008, O'Reilly established a presence in the Western markets, substantially expanding the firm's scale advantages. Now the combined O'Reilly operates over 3,700 stores in 38 states (without a meaningful Northeast presence), and is one of the leading auto part retailers and wholesalers in the United States. While we are optimistic about the firm's long-term prospects, we also believe O'Reilly has operated with very favorable industry conditions in recent years. Despite the firm's excellent results during this period, we do not think O'Reilly has an economic moat yet. There are few signs that favorable industry conditions will end anytime soon, but a reversal in industry tailwinds (brought on by rising new vehicle sales, for example) could reduce the record high profitability levels auto part retailers have enjoyed recently.

In the near term, management will primarily be focused on implementing best practices at CSK stores. Commercial sales only comprised 10% of CSK's revenue before its acquisition. In comparison, commercial sales drove about half of O'Reilly's legacy store top line. As a result, the average CSK sales and profitability per store still substantially lag their O'Reilly counterparts. In order to address this discrepancy, O'Reilly has invested in additional distribution infrastructure in the west and is aggressively reaching out to professional installers in these markets. Since commercial wholesalers often compete on distribution service efficiency, O'Reilly's 23 distribution centers and 184 hub stores give the firm an edge in the do-it-for-me (DIFM) market, and we expect the firm to continue gaining DIFM market share.

O'Reilly has also made progress gaining do-it-yourself (DIY) market share. Although we estimate that the DIFM market is growing faster than its DIY counterpart, we are encouraged by the company's progress in the DIY market. We think the dual market approach helps differentiate O'Reilly from smaller competitors, as the firm can leverage its existing distribution infrastructure and other fixed costs to increase economic returns. In addition, competition in the DIY market, in our view, is more rational since retail customers are relatively price-inelastic and fairly sticky to their particular auto part retailer of choice. O'Reilly's DIY sales per store still lag industry leaders, but we think increased productivity from the dual-market approach should also enable O'Reilly to open new profitable Western outlets in markets where a single approach may not have been viable.

Competitive dynamics, in our view, are progressively improving for the largest auto part retailers. Due in part to a limited distribution infrastructure, it has become increasingly difficult for small retailers to compete with larger competitors. As O'Reilly and other auto part retailers take market share from smaller industry participants, the added scale should create further leverage over suppliers, which retailers can use to lower product acquisition costs and obtain better financing terms from vendors for inventory. Over time, auto part retail, in our view, is transforming into an oligopoly that is more favorable for the largest industry participants and, as a result, we have assigned O'Reilly a positive moat trend.

While we believe the firm is poised to benefit from numerous positive trends, we do not think O'Reilly has an economic moat yet. It is difficult, in our view, to establish a moat in the commercial market, and O'Reilly's core strength continues to be its expertise as a commercial operator. Since DIFM customers are price-elastic, commercial wholesalers typically compete on the basis of price and distribution efficiency (which requires high capital investment). O'Reilly's distribution infrastructure, in our view, is topnotch and is superior to the majority of its competitors, but many of its larger peers have built up their own distribution networks in recent years. Over time, we think this arms race will reduce O'Reilly's relative advantage.

It is uncertain how sustainable present-day returns are. Auto part retailers have buffed up their distribution

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
O'Reilly Automotive Inc	USD	10,569	5,708	824	490
AutoZone Inc	USD	13,806	8,206	1,530	868
Genuine Parts Company	USD	10,040	12,252	892	549
Advance Auto Parts Inc	USD	5,567	6,113	637	376

Morningstar data as of February 06, 2012.

networks in recent years, creating substantial efficiency gains. Rather than passing off these savings to consumers, industry participants have pocketed the majority of these cost savings, which has resulted in meaningful margin gains over the past few years. Retailers could afford to do this because the demand for auto parts has been robust in recent years, as anxious consumers put off new vehicle purchases and prolong the lives of existing vehicles. While we think auto part retailers are better positioned than they were in the past, we also think competition will eventually force retailers to return some of their gains back to consumers. This may result in lower returns, especially for new stores that were built assuming positive industry tailwinds would remain strong.

Valuation, Growth and Profitability

We have increased our fair value estimate to $61 per share from $49, as we incorporate more positive margin assumptions and transfer coverage to a new analyst. Our new fair value estimate implies calendar 2012 price/earnings of 13 times, EV/EBITDA of 8.6 times, and a free cash flow yield of approximately 8%.

In 2012, we project revenue growth of about 7%, driven by mid-single-digit comparable sales, commercial momentum at CSK stores, and the addition of approximately 180 net new stores. As management streamlines CSK operations and signs up new commercial customers, we expect selling, general, and administrative expense leverage will help margins increase to about 15%.

The CSK turnaround, in our view, will be a major catalyst that should drive low- to mid-single-digit comps, as O'Reilly gains commercial market share on the West Coast over the next few years. We expect management to open over 1,400 stores over the next 10 years as the company attempts to take market share from smaller competitors, resulting in an average 5% top line growth rate. Streamlined operations at CSK stores, combined with the firm's increased bargaining power over vendors, should also help increase store profitability. However, we believe gross profit margins have been elevated above normalized levels in recent years, so we project gross margins will compress by over 100 basis points to about 47.5%, as O'Reilly gains traction in the commercial market and returns some of its lower costs to consumers. Still, we forecast O'Reilly will be able to lower SG&A expense to about 32.5%, in line with the firm's expense ratio before the CSK acquisition. We expect this expense leverage to counteract gross margin pressures, resulting in a normalized operating margin of about 15%.

As management turns its focus away from integrating CSK stores, we also anticipate significant progress negotiating financing agreements with vendors. O'Reilly has already made aggressive gains in the most recent quarter, and we project the accounts payable/inventory ratio will rise to 90% from 45% in 2010 by the end of our 10-year explicit forecast period, freeing up over $800 million in working capital.

Risk

O'Reilly is vulnerable to integration risks, since our valuation is largely dependent on whether the firm can successfully turn around CSK stores. The West Coast is an infamously difficult market for new retail entrants, and O'Reilly will have to adjust its business model in order to grow profitably. The firm's top-line performance has historically been tied to total vehicle miles driven. In the

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past, this metric consistently grew in the low single digits annually, but has stayed flat and even declined in recent years. However, the risk remains that demand for auto parts will decline if total vehicle miles driven decreases, especially given a sustained increase in oil prices. An economic recovery may also cause an influx of new car sales, which could increase scrappage rates for older vehicles, thereby reducing demand for maintenance and failure auto parts. O'Reilly is also exposed to risks associated with technological changes in the automobile market. Company profitability may also decline if the firm does not adapt to changing vehicle trends, such as a shift toward hybrid and other nontraditional vehicles.

Bulls Say

- Improved operational efficiency at CSK stores should drive strong same store sales and margin expansion.
- O'Reilly's extensive experience in the commercial business positions the firm particularly well to benefit from strong commercial growth trends.
- O'Reilly can more cheaply and effectively service commercial customers with its extensive distribution infrastructure.
- The firm has made inroads into the DIY market, and retail outlets rate highly on service and parts availability.
- If economic weakness persists (beyond our base-case forecast), the average age of vehicles could continue increasing, driving additional upside to DIY and DIFM sales.

Bears Say

- Pent-up demand for newer vehicles could result in elevated new car sales over the next few years, which would raise vehicle scrappage rates and decrease demand for aftermarket auto parts.
- O'Reilly's distribution network advantage will narrow over time, as rival retailers build out their own networks.
- Revenue and profit gains have recently been driven by hard part sales, which are infrequent purchases that may quickly go away once the surge in demand declines.
- Record high profit levels among auto part retailers in recent years may diminish as industry participants return cost savings back to the consumer.
- In order to gain market share, Advance Auto Parts has introduced expensive delivery services (such as home delivery), which could pressure industry margins if more services like this become the norm.

Financial Overview

Financial Health: O'Reilly is in good financial health. The company has a 0.23 debt/capital ratio (0.49 times including operating leases) and now holds about 800 million in debt that is scheduled to mature in 2021. O'Reilly operates in a stable market that relies on demand for necessity items (such as maintenance and failure auto parts), so free cash flow is relatively stable in good and bad times. We believe the firm can fund acquisitions and organic growth with internal cash flows, so it is unlikely that management will be forced to tap into credits on unfavorable terms.

Company Overview

Profile: With over 3,700 stores, O'Reilly is the second-largest auto part retailer in the United States. After acquiring over 1,300 CSK Auto stores in 2008, O'Reilly gained a major presence in the Western market. The firm now has a strong nationwide presence and only lacks exposure to the Northeastern markets. O'Reilly started as a commercially focused retailer but has since adopted a dual market approach that also targets do it yourself retail customers. The firm operates 23 distribution

centers and over 180 hubs.

Management: Gregory L. Henslee became CEO and co-president of O'Reilly in 2005, becoming the first non-O'Reilly family member to hold the CEO position. Henslee started as a parts specialist at O'Reilly 25 years ago and has taken on a variety of internal leadership roles before adopting his current position. In fact, the majority of the executive staff have decades of experience working at O'Reilly. This experience, in our view, will serve the firm well, as it continues to open new stores and integrate acquisitions. We like the fact that the CEO and chairman roles are now split. Since the O'Reilly family continues to hold over $100 million in O'Reilly equity, we think this third-party oversight will prevent egregious abuses by management. However, we are concerned about the O'Reilly family's extensive influence. The board consists of four O'Reilly family members, and the firm leases a few stores from the family. In addition, the company's bylaws employ a staggered board and poison pills, limiting minority shareholders' voice. We have not seen any egregious abuses, but investors should realize that the O'Reilly family's incentives may not entirely be aligned with shareholders'.

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Analyst Notes

Oct. 27, 2011

O'Reilly Cruises Along on Positive Momentum During 3Q

O'Reilly reported third-quarter results that were slightly ahead of our expectations, and it is on track to achieve our full-year projections. We expect the firm will continue to perform very well as a result of favorable industry conditions, its extensive experience in the rapidly growing commercial sector, and improving operations at CSK stores. However, we think the shares are moderately overvalued, as the market has already priced in many of these factors. Thanks to low new-car sales, in part due to waning consumer confidence, O'Reilly and other large auto-part retailers have made substantial profitability gains over the past few years. O'Reilly's competitive position, in our view, has grown much stronger during this time as the industry consolidates, but we think the shares could experience a pullback if the situation doesn't unfold in line with many investors' rosy expectations. Management released its fourth-quarter outlook for 3%-5% comparable sales growth and $0.80-$0.84 diluted earnings per share, which does not differ materially from our existing projections.

Year over year, revenue grew 8% to $1.54 billion, driven by a strong 4.8% comp and the addition of 171 net new stores over the past 12 months. In addition to favorable industry conditions, O'Reilly is benefiting from a turnaround at former CSK outlets, so we expect comp store growth at the O'Reilly chain to continue its relative outperformance over the next few years. Gross margins improved an impressive 50 basis points year over year to a record 59.1%. In combination with 90 basis points of selling, general, and administrative expense leverage, the operating margin increased 21% from the prior year to $241 million (or 15.7% of sales). Our initial view is that this improvement was largely due to improved operational efficiency at CSK stores, as the firm gains commercial traction in the West Coast, and a product mix shift toward high-margin hard part sales, but we will tune in to the conference call in search of more color on the major drivers. Management aggressively repurchased 8.2 million shares at a total cost of $840 million in the quarter; O'Reilly has about $141 million remaining under its original $1 billion board-authorized share-repurchase program.

Sept. 08, 2011

O'Reilly Automotive Under Review

We are placing O'Reilly Automotive under review as we assess our financial modeling assumptions and transfer coverage to a new analyst.

With new-car sales still hovering at multiyear lows, industry tailwinds are not likely to meaningfully moderate in the near term, which gives us confidence in management's full-year revenue growth target of roughly 7%. With operating margins touching record levels yet again, this is shaping up to be another solid year for the firm. We like that O'Reilly generates significant free cash flow, has plenty of runway for growth, and has done a solid job integrating the CSK business.

Disclaimers & Disclosures

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O'Reilly Automotive Inc ORLY

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
5,708	10,569	Specialty Retail	Consumer Cyclical

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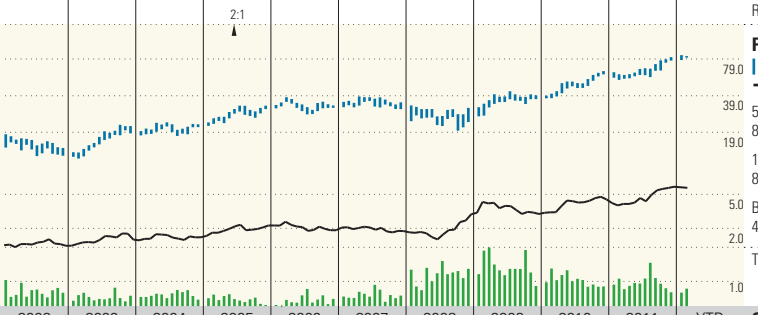
★★	82.36	61.00	Medium	None	C

per share prices in USD

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD	
18.63 / 12.05	22.45 / 11.46	23.54 / 18.03	32.53 / 21.98	38.30 / 27.49	38.84 / 30.43	32.68 / 20.00	42.92 / 26.47	63.05 / 37.47	82.17 / 53.33	85.32 / 77.77	Annual Price High / Low / Recent Splits



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

52 week High/Low
85.32 - 53.33

10 Year High/Low
85.32 - 11.46

Bear-Market Rank
4 (10=worst)

Trading Volume Million

Stock Performance	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD
Total Return %	-30.7	52.5	16.8	42.1	0.2	1.1	-5.2	24.0	58.5	32.3	3.0
+/- Market	-7.3	26.1	7.8	39.1	-13.4	-2.4	33.3	0.6	45.7	32.3	-3.9
+/- Industry	-20.7	-20.7	-10.4	48.1	4.5	-6.9	38.0	-48.7	30.9	36.4	-5.5
Dividend Yield %	—	—	—	—	—	—	—	—	—	—	0.0
Market Cap USD Mil	1348	2093	2487	3588	3643	3732	4135	5240	8521	10260	10569

Financials	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM
Revenue USD Mil	1092	1312	1512	1721	2045	2283	2522	3577	4847	5398	5708
Gross Margin %	42.8	42.2	42.2	43.2	43.6	44.1	44.4	45.5	48.0	48.6	48.7
Oper Income USD Mil	114	138	165	190	253	282	305	336	538	713	824
Operating Margin %	10.4	10.5	10.9	11.1	12.3	12.4	12.1	9.4	11.1	13.2	14.4
Net Income USD Mil	66	82	100	140	164	178	194	186	308	419	490
Earnings Per Share USD	—	0.77	0.92	1.26	1.45	1.55	1.67	1.48	2.23	2.95	3.49
Dividends USD	—	—	—	—	—	—	—	—	—	—	—
Shares Mil	—	107	109	111	113	115	116	125	138	142	141
Book Value Per Share USD	6.10	7.22	8.58	10.22	12.00	13.84	16.97	19.54	22.76	22.06	22.06
Oper Cash Flow USD Mil	50	105	173	227	213	186	299	299	285	704	951
Cap Spending USD Mil	-69	-102	-137	-173	-205	-229	-283	-342	-415	-365	-332
Free Cash Flow USD Mil	-18	2	36	53	8	-43	17	-43	-130	338	619

Profitability	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM
Return on Assets %	—	8.8	9.1	10.7	10.4	9.7	9.1	5.8	6.8	8.5	9.4
Return on Equity %	—	13.6	13.9	16.1	15.7	14.2	13.1	9.6	12.4	14.2	16.6
Net Margin %	6.1	6.2	6.6	8.1	8.0	7.8	7.7	5.2	6.3	7.8	8.6
Asset Turnover	—	1.41	1.38	1.31	1.30	1.24	1.18	1.11	1.08	1.10	1.10
Financial Leverage	—	1.6	1.5	1.5	1.5	1.5	1.4	1.8	1.8	1.6	1.9

Financial Health	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	09-11
Working Capital USD Mil	430	484	442	480	425	567	573	822	995	1072	1030
Long-Term Debt USD Mil	166	190	121	100	25	110	75	725	684	357	797
Total Equity USD Mil	556	651	784	948	1146	1364	1592	2282	2686	3210	2831
Debt/Equity	—	0.29	0.15	0.11	0.02	0.08	0.05	0.32	0.25	0.11	0.28

Valuation	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM
Price/Earnings	16.5	21.0	21.4	22.1	20.7	19.4	20.8	17.1	20.5	22.9	23.6
P/E vs. Market	—	—	—	—	—	—	—	—	—	1.3	1.6
Price/Sales	1.0	1.4	1.5	1.8	1.6	1.5	1.1	1.1	1.6	2.0	2.0
Price/Book	2.1	2.7	2.6	3.1	2.7	2.3	1.8	2.0	2.6	3.6	3.7
Price/Cash Flow	13.0	12.2	11.1	16.9	19.8	12.6	12.9	18.4	12.2	11.8	12.2

Growth Rates Compound Annual

Grade: B	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	11.4	28.9	21.4	19.8
Operating Income %	32.6	32.7	23.1	23.0
Earnings/Share %	32.3	20.9	15.3	19.4
Dividends %	—	—	—	—
Book Value/Share %	16.5	18.0	17.4	17.6
Stock Total Return %	43.0	38.9	19.1	17.3
+/- Industry	41.4	9.3	13.0	7.5
+/- Market	40.5	23.2	20.6	15.8

Profitability Analysis

Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	16.6	12.7	15.9	22.4
Return on Assets %	9.4	8.0	6.6	9.4
Fixed Asset Turns	2.9	2.9	9.2	7.6
Inventory Turns	1.5	1.6	4.5	15.9
Revenue/Employee USD K	121.1	103.5*	—	1047.1
Gross Margin %	48.7	46.1	31.4	38.2
Operating Margin %	14.4	11.6	4.6	16.6
Net Margin %	8.6	7.0	3.8	11.1
Free Cash Flow/Rev %	10.8	—	4.7	0.1
R&D/Rev %	—	—	—	9.8

Financial Position

Grade: A	12-10 USD Mil	09-11 USD Mil
Cash	30	277
Inventories	2023	2009
Receivables	184	202
Current Assets	2301	2537
Fixed Assets	1930	2058
Intangibles	744	744
Total Assets	5048	5397
Payables	952	1203
Short-Term Debt	1	1
Current Liabilities	1229	1506
Long-Term Debt	357	797
Total Liabilities	1838	2566
Total Equity	3210	2831

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	23.6	20.1	22.3	14.8
Forward P/E	18.8	—	—	13.5
Price/Cash Flow	12.2	13.6	11.7	8.0
Price/Free Cash Flow	18.7	—	18.3	17.2
Dividend Yield %	—	—	0.3	1.9
Price/Book	3.7	2.5	3.8	2.2
Price/Sales	2.0	1.4	0.9	1.3
PEG Ratio	1.1	—	—	1.4

Quarterly Results

Revenue USD Mil	Dec 10	Mar 11	Jun 11	Sep 11
Most Recent Period	1310.3	1382.7	1479.3	1535.5
Prior Year Period	1173.7	1280.1	1381.2	1425.9

Rev Growth %	Dec 10	Mar 11	Jun 11	Sep 11
Most Recent Period	11.6	8.0	7.1	7.7
Prior Year Period	5.3	10.0	10.4	13.3

Earnings Per Share USD	Dec 10	Mar 11	Jun 11	Sep 11
Most Recent Period	0.73	0.72	0.96	1.10
Prior Year Period	0.52	0.70	0.71	0.82

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
O'Reilly Automotive	10569	5708	23.6	16.6
AutoZone Inc	13806	8206	17.1	—
Genuine Parts Compan	10040	12252	18.6	19.4

Major Fund Holders

	% of shares
	—
	—
	—

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

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

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.

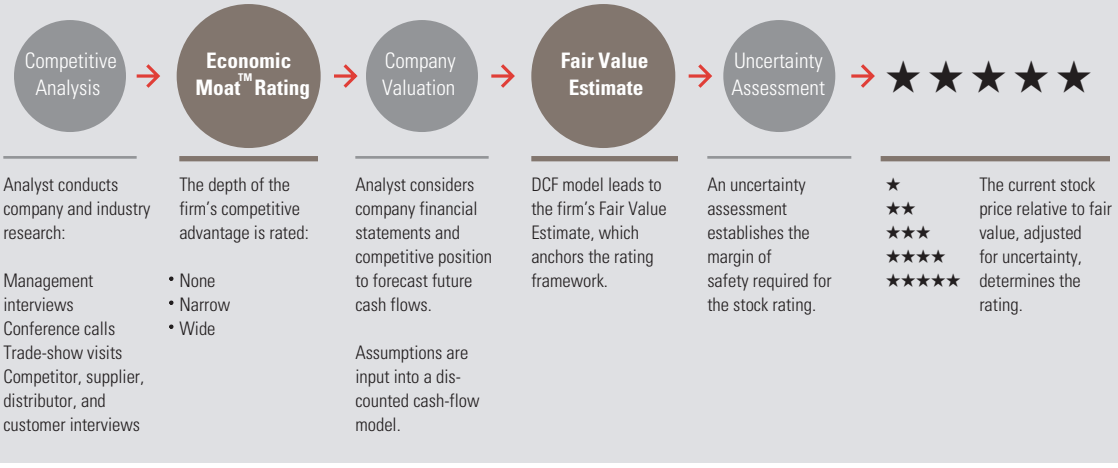
Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely 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



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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."