Global Equity Best Ideas

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Company	Morningstar Rating	Fair Value Estimate	Discount / (Premium) to FV	Economic Moat	Uncertainty Rating
RECENT ADDITIONS					
Wharf Real Estate Investment Co Ltd (01997)	★★★★★	46	45%	Narrow	Medium
Rogers Communications Inc (RCI.B)	★★★★★	78	29%	Narrow	Low
Grab Holdings Inc (GRAB)	★★★★	4.4	29%	None	Very High
AUB Group Ltd (AUB)	★★★★	34	13%	Narrow	Medium
Enbridge Inc (ENB)	★★★★	56	13%	Narrow	Medium
RECENT REMOVALS					
PDD Holdings Inc (PDD)	★★★★	213	45%	Narrow	Very High
Imperial Brands PLC (IMB)	★★★★★	2900	39%	Wide	Medium
Bayerische Motoren Werke AG (BMW)	★★★★	163	34%	Narrow	High
Anheuser-Busch InBev SA/NV (BUD)	★★★★★	90	32%	Wide	Medium
Dow Inc (DOW)	★★★★	68	15%	Narrow	Medium
CNOOC Ltd (00883)	★★★	19	5%	None	High

Data as of March 29, 2024 | UR = Under Review

Best Ideas

	Sector	Company	Morningstar Rating	Economic Moat	Uncertainty Rating	Fair Value Estimate	Discount / (Premium) to FV	Market Cap (mil)	Currency
	Americas								
	Basic Materials	Albemarle Corp (ALB)	★★★★★	Narrow	High	275	52%	15,483	USD
	Basic Materials	International Flavors & Fragrances Inc (IFF)	★★★★	Wide	High	130	34%	21,955	USD
	Basic Materials	Newmont Corp (NEM)	★★★★★	None	Medium	50	28%	41,316	USD
+	Comm. Services	Rogers Communications Inc (RCI.B)	★★★★★	Narrow	Low	78	29%	29,619	CAD
	Comm. Services	Comcast Corp (CMCSA)	★★★★	Wide	Medium	60	28%	172,180	USD
	Consumer Cyclical	VF Corp (VFC)	★★★★★	Narrow	Very High	53	71%	5,964	USD
	Consumer Cyclical	Hanesbrands Inc (HBI)	★★★★★	Narrow	Very High	17.3	66%	2,039	USD
	Consumer Cyclical	Sabre Corp (SABR)	★★★★★	Narrow	Very High	5	52%	916	USD
	Consumer Cyclical	Nordstrom Inc (JWN)	★★★★	None	Very High	40	49%	3,309	USD
	Consumer Cyclical	Hasbro Inc (HAS)	★★★★★	Narrow	Medium	84	33%	7,842	USD
	Consumer Cyclical	Sealed Air Corp (SEE)	★★★★	Narrow	High	54	31%	5,375	USD
	Consumer Cyclical	Bath & Body Works Inc (BBWI)	★★★★	Narrow	High	73	31%	11,249	USD
	Consumer Cyclical	Polaris Inc (PII)	★★★★★	Wide	Medium	145	31%	5,655	USD
	Consumer Defensive	Tyson Foods Inc (TSN)	★★★★★	None	Medium	83	29%	20,967	USD
	Consumer Defensive	The Estee Lauder Companies Inc (EL)	★★★★	Wide	Medium	210	27%	55,259	USD
	Energy	TC Energy Corp (TRP)	★★★★	Narrow	Medium	63	14%	56,481	CAD
	Energy	Exxon Mobil Corp (XOM)	★★★★	Narrow	High	133	13%	461,222	USD
+	Energy	Enbridge Inc (ENB)	★★★★	Narrow	Medium	56	13%	104,047	CAD

Sector	Company	Morningstar Rating	Economic Moat	Uncertainty Rating	Fair Value Estimate	Discount / (Premium) to FV	Market Cap (mil)	Currency
Financial Services	SoFi Technologies Inc (SOFI)	★★★★	None	Very High	13	44%	7,650	USD
Financial Services	PayPal Holdings Inc (PYPL)	★★★★	Narrow	High	104	36%	71,796	USD
Financial Services	U.S. Bancorp (USB)	★★★★	Wide	Medium	53	16%	69,657	USD
Healthcare	Moderna Inc (MRNA)	★★★★★	None	Very High	227	53%	40,800	USD
Healthcare	Illumina Inc (ILMN)	★★★★★	Narrow	High	228	40%	21,820	USD
Healthcare	Humana Inc (HUM)	★★★★	Narrow	Medium	500	31%	41,797	USD
Healthcare	ResMed Inc (RMD)	★★★★	Narrow	Medium	258	23%	29,128	USD
Industrials	TransUnion (TRU)	★★★★	Wide	High	100	20%	15,499	USD
Industrials	Chart Industries Inc (GTLS)	★★★★	Narrow	Very High	200	18%	6,964	USD
Industrials	Stericycle Inc (SRCL)	★★★★	Narrow	Medium	60	12%	4,887	USD
Industrials	WESCO International Inc (WCC)	★★★★	Narrow	Medium	191	10%	8,727	USD
Industrials	Johnson Controls International PLC (JCI)	★★★★	Narrow	Medium	72	9%	44,515	USD
Real Estate	Kilroy Realty Corp (KRC)	★★★★	None	High	59	38%	4,274	USD
Real Estate	Park Hotels & Resorts Inc (PK)	★★★★	None	High	26	33%	3,682	USD
Real Estate	Realty Income Corp (O)	★★★★★	None	Low	76	29%	46,587	USD
Technology	Cognizant Technology Solutions Corp (CTSH)	★★★★	Narrow	Medium	94	22%	36,457	USD
Utilities	NiSource Inc (NI)	★★★★	Narrow	Low	33	16%	12,379	USD
Utilities	Entergy Corp (ETR)	★★★★	Narrow	Low	123	14%	22,536	USD
Asia								
Comm. Services	NetEase Inc (NTES)	★★★★	Narrow	High	158	35%	67,105	USD
Consumer Cyclical	Yum China Holdings Inc (YUMC)	★★★★★	Wide	Medium	80	50%	15,596	USD

	Sector	Company	Morningstar Rating	Economic Moat	Uncertainty Rating	Fair Value Estimate	Discount / (Premium) to FV	Market Cap (mil)	Currency
	Consumer Cyclical	BYD Co Ltd (01211)	★★★★	None	High	300	33%	630,324	HKD
	Consumer Cyclical	Sands China Ltd (01928)	★★★★	Narrow	High	27.3	19%	178,459	HKD
	Consumer Defensive	Luzhou Laojiao Co Ltd (000568)	★★★★	Wide	High	259	29%	272,406	CNY
	Consumer Defensive	Inner Mongolia Yili Industrial Group Co Ltd (600887)	★★★★	Wide	Medium	36	23%	177,041	CNY
	Consumer Defensive	Asahi Group Holdings Ltd (2502)	★★★★	Narrow	Medium	6600	16%	2,809,030	JPY
	Industrials	Harmonic Drive Systems Inc (6324)	★★★★	Wide	High	5700	30%	380,855	JPY
	Real Estate	China Overseas Land & Investment Ltd (00688)	★★★★★	None	High	26	57%	123,239	HKD
+	Real Estate	Wharf Real Estate Investment Co Ltd (01997)	★★★★★	Narrow	Medium	46	45%	77,272	HKD
+	Technology	Grab Holdings Inc (GRAB)	★★★★	None	Very High	4.4	29%	12,428	USD
	Technology	Taiyo Yuden Co Ltd (6976)	★★★★	Narrow	High	4800	26%	445,043	JPY
	Technology	MediaTek Inc (2454)	★★★★	Narrow	High	1400	15%	1,886,318	TWD
	Australia & New Zealand								
	Comm. Services	TPG Telecom Ltd (TPG)	★★★★★	Narrow	Medium	6.6	32%	8,386	AUD
	Consumer Cyclical	Domino's Pizza Enterprises Ltd (DMP)	★★★★	Narrow	High	61	29%	3,945	AUD
	Consumer Cyclical	Bapcor Ltd (BAP)	★★★★	Narrow	Medium	8	21%	2,142	AUD
	Consumer Defensive	The a2 Milk Co Ltd (ATM)	★★★★	Narrow	High	8	15%	4,914	NZD
	Energy	Santos Ltd (STO)	★★★★	None	High	12.3	37%	25,170	AUD
+	Financial Services	AUB Group Ltd (AUB)	★★★★	Narrow	Medium	34	13%	3,224	AUD
	Financial Services	ASX Ltd (ASX)	★★★★	Wide	Low	75	11%	12,878	AUD
	Industrials	Aurizon Holdings Ltd (AZJ)	★★★★	Narrow	High	4.7	15%	7,363	AUD
	Industrials	Ventia Services Group Ltd (VNT)	★★★★	None	Medium	4.25	9%	3,294	AUD

Sector	Company	Morningstar Rating	Economic Moat	Uncertainty Rating	Fair Value Estimate	Discount / (Premium) to FV	Market Cap (mil)	Currency
Real Estate	Lendlease Group (LLC)	★★★★★	None	High	13.3	52%	4,435	AUD
Technology	PEXA Group Ltd (PXA)	★★★★	Wide	Medium	17.25	21%	2,406	AUD
Europe								
Consumer Cyclical	Just Eat Takeaway.com NV (TKWY)	★★★★★	Narrow	Very High	48.5	72%	2,829	EUR
Consumer Cyclical	The Swatch Group AG (UHR)	★★★★★	Narrow	Medium	368	43%	10,742	CHF
Financial Services	Admiral Group PLC (ADM)	★★★★	Narrow	Medium	3070	8%	8,409	GBX
Financial Services	London Stock Exchange Group PLC (LSEG)	★★★	Wide	Medium	9800	3%	50,829	GBX
Healthcare	Roche Holding AG (ROG)	★★★★★	Wide	Low	379	39%	184,545	CHF
Industrials	Intertek Group PLC (ITRK)	★★★★	Narrow	Low	5700	13%	8,045	GBX
Technology	FINEOS Corp Holdings PLC (FCL)	★★★★	Wide	Very High	3.1	45%	572	AUD
Technology	Infineon Technologies AG (IFX)	★★★★	Narrow	High	50	37%	41,088	EUR
Technology	STMicroelectronics NV (STM)	★★★★	Narrow	High	66	34%	39,451	USD
Utilities	RWE AG (RWE)	★★★★★	None	Medium	48	34%	23,401	EUR
Utilities	Engie SA (ENGI)	★★★★	None	Medium	18	14%	37,550	EUR

Data as of March 29, 2024 | + = Recent Addition

Best Ideas Rationale

Company	Rationale
Admiral Group PLC (ADM)	Admiral has a sound balance sheet, solid returns on equity, a good management team, and is owner-founded. It has pricing power and a unique business model. Furthermore, it is capital-light and has a growing competitive advantage.
Albemarle Corp (ALB)	Albemarle shares have sold off since the beginning of 2023 as lithium spot prices declined over 80% and the company issued convertible preferred equity. End-market demand from electric vehicle sales and utility-scale batteries is healthy. However, battery makers reduced inventory in 2023, weighing on lithium purchases. Additionally, the rapid growth of new, higher-cost supply in China led the lithium market to return to balance. Lithium prices are currently below the marginal cost of production, and supply is already shutting down in response. We expect prices will rise in 2024 as demand grows and the market returns to undersupply conditions. As a result, we view the selloff in Albemarle shares as an opportunity for investors to pick up shares of this high-quality lithium producer.Albemarle's narrow moat comes from its cost-advantaged lithium production, stemming from its unique geologically advantageous resources. Lithium is the company's largest business, generating nearly 90% of profits. The largest driver of lithium demand is electric vehicle batteries, which generated around 50% of demand in 2023. As EVs grow to 40% of global auto sales by 2030, from 12% in 2023, we forecast they will eventually account for nearly 70% of total lithium demand by 2030, making lithium one of the largest beneficiaries of rising EV adoption. As one of the lowest-cost lithium producers globally, Albemarle should benefit from greater EV adoption driving higher lithium prices and growing profits.Given this and growing lithium demand from utility-scale batteries used in energy storage systems, we forecast lithium demand will grow a little less than 3 times 2023 levels by 2030, to 2.5 million metric tons. Supply will struggle to keep pace with demand during this time, which will lead to lithium prices remaining above the marginal cost of production, which we estimate to be $20,000 per metric ton, for the remainder of the decade. We forecast lithium prices will remain volatile but average around $25,000 per metric ton from 2024 to 2030, generating strong profits for Albemarle.
Asahi Group Holdings Ltd (2502)	Asahi's share price declined sharply after a surge in coronavirus cases in Japan, which led to a plunge in beer demand in bars and restaurants. The fear that a recession could jeopardize the company's premium beer strategy also weighed on the share price. We think that job loss is more likely to affect lower-income earners and that demand will gradually recover along with easing lockdowns and gradual resumption of economic activities. Despite income growth playing a crucial role in beer premiumization, Asahi has opportunities to lift margins of mainstream beers by rationalizing rebates if premiumization is deterred by a slower economy. Over the long run, we anticipate that Asahi will take advantage of the excise tax cuts through 2026 to hike prices of beer, a category in which it possesses a strong brand and more than 45% share in Japan.
ASX Ltd (ASX)	We view ASX as a natural monopoly providing essential infrastructure to Australia's capital markets. Despite the deteriorating regulatory environment, we believe the business is well protected by its wide economic moat based on network effects and intangibles. We also believe the energy transition is an underappreciated tailwind. We expect it to spark demand for resources, in which Australia holds strong natural endowments, to deliver new listings and a long tail of revenue from trading and clearing activity.

Company	Rationale
+ AUB Group Ltd (AUB)	AUB Group is a highly cash-generative business that provides a network of insurance brokers direct access to insurers, with exclusive policy wording and pricing, support on claims handling, and software needed to run the business. AUB owns equity stakes in the brokers in its network, which combined are responsible for around 10% of premiums written by intermediaries in Australia. The switching costs between the customer and the broker, and the broker and AUB, provide a durable competitive advantage that we expect to underpin low-double-digit returns on equity over the long term. Brokers earn commission on insurance premiums written, and we expect they will benefit from price increases as insurers seek to improve margins and returns amid escalating claims costs. Inflation, more frequent and intense large natural hazard events, and the rising cost of reinsurance all contribute. We also see room for brokers to take market share from the direct channel as customers faced with rising prices seek out insurance brokers to find a better deal. AUB's increasing ownership interests in brokers that are part of the network is a low-risk M&A strategy that further supports earnings growth. Revenue and cost synergy targets associated with the 2022 acquisition of London-based wholesale broker Tysers appear to be on track.
Aurizon Holdings Ltd (AZJ)	The shares of narrow-moat Aurizon offer an attractive yield, underpinned by high-quality rail infrastructure and haulage operations. Considerable downside is priced into the shares, and our analysis suggests that risks for investors are skewed to the upside. Haulage volume was weak in fiscal 2023 because of wet weather, but the outlook is for volume to recover and haulage tariffs to rise with the Consumer Price Index, as the regulated rail track is allowed higher returns. We think environmental concerns are overblown, providing an opportunity for investors to buy a better-than-average-quality company at a discount. Aurizon largely hauls coking coal from globally competitive mines. A commercially viable alternative to coking coal to make new steel is still a long way off.
Bapcor Ltd (BAP)	Creeping negative sentiment amid both short-term headwinds and structural changes facing the automotive industry means the fundamental strength and resilience of Bapcor's automotive-parts business is underappreciated. A slowdown in discretionary spending weighs on retail in the near term, new management still needs to prove itself, and the proliferation of electric vehicles is a long-term obstacle for the trade business. However, we think near-term pessimism overlooks fundamental resilience in automotive spare parts, and Bapcor is likely to successfully adapt to the gradual technological transition.
Bath & Body Works Inc (BBWI)	We view the shares of narrow-moat Bath & Body Works as compelling, trading at a nearly 35% discount to our $73 fair value estimate. We believe the company has a solid competitive edge in the sizable addressable markets in which it operates. Its strong brand intangible asset is supported by its leadership position across the bath and shower and the candle and air freshener industries in recent years, which has been bolstered by Bath & Body Works' quick response to consumer trends. The narrow moat is evidenced by a 49% average return on invested capital excluding goodwill, which we expect the business to generate over the next decade, well ahead of our 8% weighted average cost of capital estimate.Although we forecast limited North America footprint growth (with more than 1,800 owned boxes already), we expect product innovation and productivity gains of new store formats will support top- and bottom-line growth at the enterprise over time. Furthermore, gains from omnichannel improvements (buy online/pick up in store, for example) should remain a mainstay, while other digital enhancements support conversion and profit upside. A focus on international growth stands to benefit both physical and digital channels, allowing for double-digit international sales gains over the next decade, helping Bath & Body Works elevate its brand intangible asset globally.We forecast that these opportunities will lead to average sales growth of 3%-4% over the long term, around the global growth projections (per Euromonitor) for the bath and shower and soap industries, resulting in incremental share gains for Bath & Body Works on top of its already dominant position.

Company	Rationale
BYD Co Ltd (01211)	BYD is confident that it will achieve its annual sales target of 3 million units despite economic uncertainty. During the first-quarter slow season, BYD sold 552,000 units, up 89% year over year and accounting for 18% of its target. It recently launched two new models (Song L SUV and Destroyer 07) to solidify its leading position in the mass new-energy vehicle segment and one new entry-level small sedan (Seagull) for a wider customer base. In addition, the company's premium brands, Denza and Yangwang, released new models to penetrate the luxury segment. The uptick in sales volume and lower battery cost could partially offset the pricing pressure amid industry competition. BYD H shares are trading at 0.8 times 2023 sales, at a discount to Chinese EV makers' average of 1.3 times. Near-term catalysts include strong monthly sales momentum and better profitability than that of peers.
Chart Industries Inc (GTLS)	Chart Industries' fourth-quarter results and 2024 guidance broadly confirmed our thesis that the stock is mispriced. Despite a sizable increase in the stock price after fourth-quarter results, we still see further upside to our $200 fair value estimate. Chart's management team continues to achieve its stated goals, as it has done consistently, and we think the market's skepticism is unwarranted.We continue to think Chart is highly attractive as a growth story (Big LNG, hydrogen, carbon capture and storage, water treatment, and even space exploration) with numerous sizable markets to attack, as well as a margin expansion effort. Gross margin expanded more than 500 basis points in 2023, and we see another 300 basis points of expansion possible. Heat transfer systems and specialty products, where many of these markets are served, are expected to see 40%-50% revenue growth in 2024 over 2023 pro forma levels.
China Overseas Land & Investment Ltd (00688)	With significant exposure to higher-tier cities in China, China Overseas Land & Investment is well positioned to benefit from the ongoing recovery in homebuyer sentiment, in our view. We believe demand for residential properties in wealthier cities will be more resilient, leading to stronger sales growth for COLI. In addition, we think high average selling prices, coupled with effective cost control, will enable COLI to continue outperforming most peers on profit margins. We think investors are underappreciating COLI's long-term growth and margin improvement potential, as the firm maintains a robust pace of landbank acquisition in key cities in China.
Cognizant Technology Solutions Corp (CTSH)	Cognizant is one of our top picks in the technology sector, as we see an attractive long-term investment opportunity in the narrow-moat firm implied in our $94 fair value estimate. We believe the market is penalizing the firm for past execution and strategic mistakes, which we believe are in the rearview mirror.We think Cognizant is well positioned to continue to push its reputation past being a back-office outsourcer to higher-value technical offerings—like digital engineering and artificial intelligence solutions—as well as digital transformation consulting. Furthermore, we believe all the major IT services firms we cover will benefit from digital transformation demand to some degree. We see no reason Cognizant would be far less of a beneficiary of digital transformation, as the market is baking in. In our view, losers in digital transformation will be much smaller IT services players, because of consolidation of accounts with larger vendors like Cognizant. In contrast, Cognizant has a wide array of offerings that play into digital transformation needs, and we continue to believe its financial-services platform is the best in the industry. As a beneficiary of consolidation, Cognizant has the potential to increase switching costs, which is the foundation of its narrow moat, along with intangible assets. We forecast a five-year revenue compound annual growth rate of 8% for Cognizant, an acceleration of 5% over the last five years. Even with currently delayed decision-making, demand for digital transformation projects in the long run is not diminishing, which is apparent in strong bookings. Cognizant's trailing 12-month book/bill is a healthy 1.3, giving us confidence in future demand for the firm's offerings. We expect a moderate 90-basis-point operating expansion over the next five years due to a gradual, more beneficial mix of higher value-added offerings.
Comcast Corp (CMCSA)	Comcast faces a double whammy as concerns about slowing broadband customer growth have dogged the core cable business and fears surrounding increased content investments have hounded NBCUniversal. We expect broadband customer growth will further slow, as the market is maturing and the phone companies will likely gain share as their fiber upgrades progress. We still expect Comcast to increase broadband revenue through the combination of modest customer additions and solid pricing power. NBCUniversal will need to invest to increase interest around Peacock, but we still like the firm's position overall thanks to its solid stable of content franchises, strong theme parks, and still highly profitable traditional television business. With a strong balance sheet, Comcast should be able to direct most of its free cash flow to shareholder returns, including a solid dividend and heavy share repurchases.

Company	Rationale
Domino's Pizza Enterprises Ltd (DMP)	Domino's Pizza is a high-quality company with a long growth runway. We forecast a 24% earnings CAGR for the next five years, underpinned by its global store rollout. Domino's sales growth has been volatile, and the share price tends to reflect near-term trading conditions rather than longer-term potential. The near-term outlook is uncertain and hinges on a moderation in elevated inflation. However, we believe the market is overly discounting Domino's intact and significant long-term growth potential. We forecast the network to grow to 6,200 stores by fiscal 2033, from some 3,800 as of June 2023, below management's long-term target of 7,100. Hitting management's target would lift our valuation by 11%.
+ Enbridge Inc (ENB)	The threat to Enbridge's Mainline tariffs and volumes from the Trans Mountain expansion is overblown, in our view. The reliability of the Mainline plus the rerouting of Trans Mountain expansion barrels to the US favors the Mainline's incumbency. The utilities purchase from Dominion Energy was a surprise, but adding more stability to Enbridge's returns can only be a benefit, in our view. Leaning into renewables growth from solar and wind displacing coal by investing in moaty utilities versus no-moat pure-play renewables projects is a good idea.
Engie SA (ENGI)	Engie's current price/earnings of 10.7 is 41% below the sector average. That reflects investors' distrust of the company based on a bad capital allocation record, too many strategic shifts over the past decade, and skepticism regarding the execution of its new business plan. We think the last is moving in the right direction, with accelerated investments in renewables, disposals of minority stakes at a high premium, and the sale of multitechnical subsidiary Equans. Engie is one of the most exposed utilities to rising power prices in Europe, thanks to its hydro dams. After canceling its 2019 dividend because of the pandemic and pressure from the French government, Engie reinstated it on 2020 earnings and should deliver 2.8% average annual dividend growth through 2025 versus the precut level, largely covered by earnings growth.
Entergy Corp (ETR)	We think Entergy offers one of the most attractive combinations of yield, growth, and value in the utilities sector. The market has been slow to accept Entergy's decadelong business transformation. For the first time in two decades, nearly all of Entergy's earnings will come from its five regulated utilities in the Southeast United States in 2023. But the market doesn't give Entergy the same valuation as other regulated utilities. Entergy's long-term growth prospects are misunderstood and undervalued. We forecast 8% annual earnings growth at least through 2026, which would be among the fastest growth of any US utility. Population growth, economic growth, and renewable energy development in the Southeast are tailwinds that few other utilities enjoy.
Exxon Mobil Corp (XOM)	In response to shareholder and market concerns about spending, Exxon has trimmed its plans. However, it still maintains a high-quality project queue that should allow for value-accretive growth. Meanwhile, earnings remain depressed because of low oil prices as well as very weak refining and chemical margins. Exxon should benefit disproportionately to peers from improvement in the latter. The dividend also appears to be safe, leaving the yield attractive.
FINEOS Corp Holdings PLC (FCL)	We believe Fineos has investment merits not generally found in profitless technology companies. We think the market underestimates revenue upside from the adoption of cloud software by insurers and the increasing stickiness of Fineos' insurer customers. Fineos is well placed to win new business, supported by longstanding customer relationships and their referrals. The company is not yet profitable but reinvests to solidify switching costs with its sticky customer base, win new business, and maintain its lead over would-be competitors. We anticipate share gains from more products per client, new client adds, and expansions into new regions and adjacent businesses. There are also opportunities for cost efficiencies from client transitions to the cloud, automation of manual functions, and hiring in emerging economies. We expect Fineos to self-fund its future growth.
+ Grab Holdings Inc (GRAB)	We like Grab Holdings due to its dominant market position in ride-hailing within Southeast Asia. Its ride-hailing has hit an inflection point where it is now cash flow positive, a significant turnaround from a year ago. In addition, its delivery business is generating increasing operating margins, and Grab has already raised its long-term margin guidance in the segment. Lastly, we believe it has multiple new long-term catalysts, including its advertising business that it has yet to fully monetize.

Company	Rationale
Hanesbrands Inc (HBI)	We view narrow-moat Hanesbrands as attractive, trading well below our $17.30 fair value estimate. While the firm has struggled in recent quarters, we think the market has been overly focused on short-term issues, such as the impact of inflation and supply chain challenges, and is underestimating Hanes' potential for free cash flow generation. Our moat rating is based on the company's intangible brand asset. Hanes owns some of the best-known brands in basic innerwear in the United States, which we think has enabled some of its products to achieve good pricing and outsell those of competitors. Hanes has diversified its brand portfolio and expanded outside the US. It has been especially successful in Australia, where Bonds and its other brands have dominant shares. Hanes disposed of noncore European innerwear brands to concentrate on better opportunities. Hanes' Champion is a popular athleisure brand among younger consumers. However, as it has underperformed of late, Hanes has announced that it is considering alternatives for the brand, including a possible sale. While it would be unfortunate if Champion were sold, such a move would allow the firm to reduce debt and focus on its innerwear operations in the US and Australia. Hanes' free cash flow to the firm was negative in 2022, but it rebounded to about $790 million in 2023. Aided by this improvement, the firm reduced debt to $3.3 billion from $3.9 billion in 2023. Hanes has eliminated its quarterly dividend and intends to use all its available free cash for debt reduction. Given this focus and our expectation for consistent cash generation, we forecast Hanes' debt will decline to $2.5 billion by the end of 2027 even if Champion is not sold. We believe the very low value of Hanes' equity reflects concerns that its cash flow will worsen, but we believe its long-term debt has peaked. Moreover, the firm recently renegotiated its debt covenants, which should eliminate the risk of a violation.
Harmonic Drive Systems Inc (6324)	We think Harmonic Drive Systems' shares are undervalued, as the market has been overreacting to concerns about orders peaking as a result of the component supply crunch; uncertainty about when Nabtesco plans to sell its remaining stake of HDS' shares; and HDS' choice to be listed on the Tokyo Standard market rather than Tokyo Prime, which has higher governance/liquidity standards.
Hasbro Inc (HAS)	Hasbro's shares have struggled to keep pace over the past 12 months, rising a mere 8% (versus a more than 30% increase in the S&P 500), rendering shares significantly undervalued relative to our $84 fair value estimate. We contend weak share performance is reflective of a business in transition that faced idiosyncratic risks, such as slower entertainment growth from the writers' strike and the overhang from the sale of the majority of the EOne production business (closed December 2023). With Hasbro now largely liberated from the low-margin EOne entertainment business, we expect significant lift from an improved revenue mix, with the high-margin Wizards of the Coast and digital segment set to represent around 35% of sales in 2024 (from 29% in 2023). Furthermore, with a higher focus on core competencies, we think Hasbro is set to benefit from more concentrated innovation and a leaner operating model—bolstered by the outlicensing of lower-productivity brands to partners, which should help free up working capital. Additionally, as a result of a stringent focus on expenses, Hasbro is set to reduce gross costs by $750 million by the end of 2025, supporting profit growth. While the company is targeting a 20% operating margin by 2027, we think the firm has the potential to reach 20% by 2025, with long-term operating margin stabilizing around 23%-24%. As such, we think the opportunity for Hasbro to outperform expectations is possible given the renewed focus on product innovation, cost management, and lean operating profile.

Company	Rationale
Humana Inc (HUM)	Humana remains on our Best Ideas list, reflecting its significant discount to our fair value estimate, strong competitive position in Medicare Advantage, and potential to boost profits substantially after a weak 2024. Specifically on that last point, Humana's 2024 outlook includes severely deflated profits due to mispriced Medicare Advantage plans that may not fully cover surging medical utilization in 2024. Going forward, we expect Humana to push that higher medical utilization onto clients and end users by increasing prices and/or reducing benefits somewhat, but the company looks likely to take it on the chin, profit-wise, in 2024. Also, the initial rate notice for Medicare Advantage reimbursement was weaker than anticipated and could constrain profit growth in 2025 somewhat, if the final rate notice does not improve moderately. The Centers for Medicare & Medicaid Services expects to finalize reimbursement rates in late March or early April, which could create some volatility in Humana's 2025 outlook. However, we would still expect shares to look undervalued at recent levels, even if the final rate notice does not change materially from the initial notice given in late January. Additionally, we recognize that the ongoing antitrust investigation into industry bellwether UnitedHealth may create further volatility in Humana shares, especially if the scope widens to all combinations of insurance and caregiver assets, including Humana's. But at this point, we see that as a fairly long-term and unlikely scenario. Overall, while uncertainty surrounds the company's typically very strong outlook, we think Humana's discounted shares currently represent the rare combination of both an attractive business and attractive valuation in managed care.
Illumina Inc (ILMN)	Illumina remains an attractive business trading well below its intrinsic value, in our opinion. After activist investor Carl Icahn entered the name in spring 2023 and new blood arrived on the board and in the C-suite, positive catalysts for the stock look more likely than further downside risk, in our opinion, despite some complications in the firm's story arc. Illumina may face more competition in its legacy genomic sequencing technology than it has in the past, but we think the factors that determine its economic moat in genomic sequencing-—intangible assets and switching costs for end users—remain intact and should help the firm generate economic profits for the long run, especially considering its new sequencing instruments. Also, Illumina owns the Grail liquid biopsy assets, which are targeting a nascent exponential technology opportunity for the earlier detection of cancer. That loss-generating business has cut into Illumina's short-term earnings power and has been a distraction as management has fought with regulators to keep Grail in the fold. Illumina plans to unwind that deal by late 2024, and if it does so, earnings should rise immediately. A tax-free spinoff to existing Illumina shareholders could be a good way to satisfy regulators while also giving Illumina shareholders long-term optionality in the Grail technology. We think Illumina shares represent a compelling opportunity for investors who can tolerate significant uncertainty around future cash flows and have a long-term investment horizon.

Company	Rationale
Infineon Technologies AG (IFX)	Narrow-moat Infineon Technologies is one of our top picks in the technology sector. Our EUR 50 fair value estimate offers an attractive margin of safety for long-term, patient investors, in our opinion. We continue to like the long-term secular tailwinds in the automotive end market, as Infineon should profit from increased chip content per car, especially in electric vehicles. We're also fond of Infineon's green industrial power business and its exposure to renewable energy. Infineon has expanded its gross and operating margins in recent years, and we foresee it maintaining these margins in the long run. STMicro, an Infineon rival, recently provided a soft outlook for 2024 revenue and profitability. We also see some warning signs in the broader EV market around excess inventory, competitive pricing among original equipment manufacturers, and possibly slower growth than what the market was expecting. Although Infineon has EV exposure as a power semis leader, we still foresee rising chip content per car in these EVs over time. We think such near-term risks are baked into market prices today, and we like the potential rewards for investors who are willing to wait out the latest cyclical downturn in broad-based semis. Longer term, we're not panicked about the expansion of trailing-edge chip manufacturing equipment and capacity in China as domestic chipmakers may seek to displace firms like Infineon over time. We think Infineon's broad product portfolio and high customer switching costs around its products will allow the firm to remain relevant in the Chinese market, and almost certainly most other markets worldwide, in the long run. We're also not overly concerned about Infineon's massive expansion plans in the silicon carbide-based semis market. Even if overcapacity were to strike at some point, we foresee Infineon emerging as an auto and industrial SiC leader that should be able to efficiently utilize these facilities.
Inner Mongolia Yili Industrial Group Co Ltd (600887)	Yili is the largest dairy producer in China, with extensive distribution and entrenched retailer relationships nationwide. The company has appropriately invested in lower-tier cities for distribution of its ultra-high-temperature dairy products, which have lower logistics costs than low-temperature products. In the medium to long term, Yili could expand its category coverage, utilizing its channel strength. The company has already shown traction in increasing market share for the infant milk formula segment, which has higher entry barriers than other packaged food categories due to regulatory requirements for product safety.
International Flavors & Fragrances Inc (IFF)	Wide-moat International Flavors & Fragrances' shares appear undervalued as the market focuses on near-term risks to the company's profits as a result of an economic slowdown weighing on volume. After a couple years of stagnant sales, the market may also be questioning the company's long-term growth outlook. The largest near-term issue is the pace of recovery after 2023 profits fell due to lower volume from customer inventory destocking. However, we expect IFF's customers, consumer packaged goods producers, will have largely completed their inventory destocking in 2023. As a result, we expect demand will normalize in 2024. This should allow IFF to run its plants at more normal capacity utilization levels, which should help profits. We forecast a small profit growth in 2024 with a larger recovery in 2025. IFF's current stock price implies that investors are skeptical of the company's ability to increase profits. The company is a market leader in flavors, fragrances, enzymes, and cultures. As consumers demand more natural flavors—and as cultures and enzyme demand rises—we expect IFF will be able to take advantage, resulting in solid long-term growth. IFF's debt is elevated as a result of the DuPont nutrition and biosciences acquisition in 2021. Management cut the dividend 50% in order to direct more free cash flow toward debt repayment. While the company has divested some businesses as a way to reduce debt, two pending divestitures, Lucas Meyer and pharma solutions, should generate enough proceeds, net of taxes and fees, combined with the dividend savings, to restore the company's balance sheet.
Intertek Group PLC (ITRK)	One of only three globally diversified firms in the testing, inspection, and certification sector, narrow-moat Intertek has been beaten up over the last year or so. Outsize exposure to China and the consumer sector negatively affected performance, leading to a material discount to peers SGS and Bureau Veritas.

Company	Rationale
Johnson Controls International PLC (JCI)	Johnson Controls has transformed over the last decade, shedding its automotive exposure and expanding its commercial buildings products portfolio with the addition of Tyco's fire and security businesses. Now, roughly 45% of Johnson Controls' revenue is tied to commercial HVAC, and another 40% is from fire and security. Residential HVAC, industrial refrigeration, and other solutions account for roughly 15% of revenue. Over the next five years, we project Johnson Controls will increase revenue at a mid-single-digit compound annual rate as the firm benefits from product innovation (supporting market share gains and pricing), increased service penetration (a higher-margin opportunity), and participation in meaningful growth themes (for example, energy efficiency, smart buildings, and indoor air quality solutions). We've been impressed by Johnson Controls' cost synergy realization after the Tyco merger and subsequent cost-reduction initiatives. The firm's profit margins have also been bolstered by its growing services and connected products offerings. We project adjusted operating margin to expand to approximately 14% over the next five years compared with 11%, on average, over the trailing five years. While HVAC-focused peers like Carrier, Lennox, and Trane Technologies have outperformed the broader US equity market recently, Johnson Controls has been a laggard, perhaps due to its significant commercial exposure (amid fears of slowing commercial construction) and uneven financial performance since free cash flow conversion has been disappointing. And Johnson Controls trades at a significant discount to HVAC peers; its forward price/earnings multiple as of late March was 13 compared with the peer group average of 21. Nevertheless, we have confidence management can close this valuation gap as the firm proves that its strategy can deliver stronger financial performance, including durable organic top-line growth and margin expansion.
Just Eat Takeaway.com NV (TKWY)	We believe Just Eat Takeaway is the best-positioned food delivery company in Europe. It is better insulated from downside risks and exhibits strong options if it expands delivery more aggressively in other fields. We embrace the company's recent decision to aggressively invest in own delivery, and we expect this to lead to accelerated profit growth at higher levels than those implied by consensus, especially for the UK market. We believe the realization of such growth in profits over the next couple of years could result in a significant rerating of the shares. Trading deep in 5-star territory, the shares appear cheap on a discounted cash flow as well as a relative valuation basis and present a material opportunity with a strong margin of safety for patient investors.

Company	Rationale
Kilroy Realty Corp (KRC)	No-moat Kilroy Realty's high-quality office portfolio now looks appetizingly cheap after the selloff of office REITs. We recognize the uncertainty surrounding the future of the office and believe the environment will remain challenging for office owners in the near to medium term. But we also believe that the selloff has been overdone and the current implied valuation of Kilroy's shares is divorced from the current private market valuations of its office portfolio. We think long-term-oriented investors could consider this stock for their portfolios, as it is currently trading well below our fair value estimate of $59 per share. We consider Kilroy's high-quality office portfolio as among the best of all publicly traded REITs. Its office portfolio has an average age of only 11 years, compared with an average of 30 years for its peers. Kilroy's office portfolio also ranks favorably on other parameters like occupancy, rent spread, and sustainability metrics. The company is very well positioned to benefit from the flight-to-quality trend that is increasingly gaining pace as employers are trying to bring their employees back to the office. Kilroy's current enterprise value is approximately $7.8 billion. The company generated about $780 million of net operating income in 2022, so the current valuation implies a cap rate of 10% for the portfolio. The company has already invested approximately $2.1 billion in tenant improvement projects, under-construction projects, and its future development pipeline. This investment is not reflected in the net operating income generated by the company in 2022. If we adjust for the $2.1 billion investment, the company is currently trading at an estimated cap rate of 13.6%. We believe that the market cap rate of Kilroy's high-quality portfolio is substantially lower than the cap rate implied by its stock price. The stable and predictable cash flows associated with a REIT make the investment thesis even more compelling. The company generated approximately $550 million of funds from operations in 2022. This translated to funds from operations per share of $4.66. Management has guided for FFO per share of $4.50 in 2023, implying a forward FFO multiple of around 7 times. The quarterly dividend of $0.54 per share implies an annualized dividend yield above 7%. We project that the company will generate around $390 million of funds available for distribution in the current year. This results in FAD per share of $3.35 and implies a current FAD multiple of only 10 times. Given that the FAD payout ratio is at a comfortable 65%, we believe that the company can continue to fund its current dividend even in a worst-case scenario. With a net debt/EBITDA ratio of approximately 6 times, Kilroy is significantly less leveraged than other REITs. The liquidity position of the company is also comfortable, with approximately $1.7 billion of liquidity to fund its operations. The fortress balance sheet gives us confidence in its ability to weather even elongated periods of economic distress. There is some risk associated with our investment thesis. The recovery in physical office occupancy levels has remained tepid. Per Kastle Systems' weekly work barometer, the average physical building occupancy of office buildings remained at approximately 50% of prepandemic levels as of the latest reported data. The other source of risk is Kilroy's geographic concentration in California and high exposure to the technology and life sciences sector.
Lendlease Group (LLC)	Lendlease securities trade near net tangible assets. We think this is overly pessimistic, given that much of the group's EBITDA comes from intangible sources of income in its development construction and investment businesses that are excluded from net tangible assets. Despite headwinds, core operating profits rebounded in fiscal 2023. We expect further substantial uplift in development earnings in 2024 and management earnings longer term. Management reaffirmed at its annual results in August 2023 that it's on track for more than AUD 8 billion of development completions in fiscal 2024. The target looks reasonable, since development work in progress increased to AUD 23 billion (up from AUD 18 billion at December 2022). Downside risks look more than priced in, and we see substantial upside if Lendlease reaches its targets in 2024 or 2025.

Company	Rationale
London Stock Exchange Group PLC (LSEG)	We believe London Stock Exchange Group is the best-positioned financial data and exchange group in Europe. With the acquisition of Refinitiv, LSEG has significantly improved its position in the lucrative financial data market, adding strong data distribution capabilities as well as unique data sets to its already-strong FTSE/Russell index business. We expect the group to benefit from an increasing shift from active to passive investment strategies as well as new theme-based investment styles such as environmental, social, and governance. We believe the market currently is overly concerned about integration risks around the Refinitiv acquisition, offering a great entry point for investors eager to pick up a high-quality business with a wide moat and a long structural growth pathway ahead.
Luzhou Laojiao Co Ltd (000568)	We believe the baijiu sector's premiumization is a long-term tailwind for distillers, and leading players are better positioned to benefit. At current price levels, Luzhou Laojiao is our top pick in the sector due to its strong brand heritage, supreme product quality, and extensive distribution network. We expect the company's aggressive national expansion strategy and deepening cooperation with distributors will have also bolstered its competitiveness, allowing it to achieve higher net profit growth compared with major peers, such as Wuliangye, in the next five years.
MediaTek Inc (2454)	MediaTek trades at a steep discount to our TWD 1,400 fair value estimate and offers a compelling forward yield. We think short-term worries about the company ceding smartphone chipset market share to Qualcomm provide ample entry opportunity, as MediaTek still has plenty of headroom to expand its product portfolio on midrange to high-end 5G smartphones. We expect the company can achieve its midteens revenue three-year CAGR target and probably extend the streak to five years, as it is rapidly diversifying into ARM-based PCs, enterprise computing systems, and automotive infotainment systems. Autonomous driving and augmented reality devices are key growth drivers beyond the next three years, in our view.
Moderna Inc (MRNA)	Moderna's shares were on a roller-coaster in 2021. We think investors were first overly enthusiastic about the potential of the company's technology but subsequently too bearish on its postcoronavirus growth. While we have modest expectations for sales of the firm's covid vaccine following massive pandemic-fueled demand in 2021 and 2022, we think Moderna's pipeline of mRNA-based vaccines and treatments is advancing rapidly across multiple therapeutic areas. As of the end of 2023, Moderna had 37 development candidates in clinical trials. Even as sales dip in 2023-24 ahead of new launches from the pipeline, we're increasingly confident in the long-term sales trajectory of the firm's diversified pipeline. We think Moderna's technology looks well validated in respiratory virus vaccines (with RSV vaccine to launch in 2024 and a covid/flu combo to launch in 2025), oncology (melanoma launch possible by 2025), and rare diseases (accelerated approvals also possible).
NetEase Inc (NTES)	We think NetEase is undervalued because the market has overreacted to recent regulatory risks and overlooked the firm's long-term opportunities overseas. Regulatory concerns should go away once license approvals resume, and earnings revisions should come through as new titles achieve successes overseas. At the same time, NetEase's book of business is looking stronger than ever. We expect strong performance to continue, driven by the Harry Potter: Magic Awakened card game going global; Naraka: Bladepoint porting to mobile and console; and Diablo Immortal launching in China. We think investors should take advantage of market weakness to buy this narrow-moat business with net cash and 20%-plus EPS growth trading at a 5% free cash flow yield.
Newmont Corp (NEM)	The acquisition of Newcrest in November 2023 extended Newmont's lead over Barrick Gold as the world's largest gold miner, with forecast 2024 sales of roughly 6.9 million ounces of gold. The combined company also has material copper production of roughly 150,000 metric tons as well as numerous development projects that we think are valuable and perhaps overlooked. We think Newmont's shares are undervalued given its weak sales volumes and elevated unit costs in 2023 along with disappointing 2024 guidance. However, we think sales volumes will recover and unit cash costs fall, driving some improvement in the enlarged Newmont's current position around the middle of the cost curve.

Company	Rationale
NiSource Inc (NI)	We think NiSource offers investors an opportunity to buy a high-growth utility trading at the same valuation as its slower-growing peers. NiSource's transition from fossil fuels to clean energy in the Midwest supports a decade of above-average growth. Its electric utility plans to close its last coal-fired power plant in 2028 and replace the generation with wind, solar, and energy storage. We expect NiSource to invest $12 billion over the next five years and as much as $30 billion during the next 10 years, leading to 7% earnings and dividend growth.
Nordstrom Inc (JWN)	We view Nordstrom as extremely undervalued, trading at about half our $40 fair value estimate. While the effects of inflation and other issues have slowed the company's recovery from the pandemic, we anticipate earnings will continue to rise. With this profit recovery, Nordstrom has resumed its quarterly dividend payments and now has a dividend yield of about 4%. Nordstrom's strengths include its loyal customer base, reputation for service, large e-commerce sales, and presence in both luxury and off-price apparel, footwear, accessories, and beauty. However, the department store model has been crushed by intense competition, and we recently downgraded our moat rating for Nordstrom to none from narrow. Given the market dynamics, we do not think the firm can return to the double-digit operating margins it consistently posted before 2014. However, we still anticipate a turnaround as management implements its Closer to You plan, which emphasizes e-commerce, growth in key cities, and a broader off-price offering. Among the merchandising changes, Nordstrom intends to increase its private-label sales and greatly expand the number of items offered through partnerships. As a result, we believe Nordstrom's operating margin will stabilize around 6% in the medium term as sales enhancement and efficiency plans should allow for greater leverage on costs such as marketing, wages, and store overhead. Through effective cost-cutting, efficiency gains, and an improved merchandise mix, we forecast Nordstrom will improve its gross margins on net sales to around 36% by 2025 (from about 34% in 2022), while lowering its selling, general, and administrative expense as a percentage of total revenue to about 32% from about 33% in 2023. Finally, there was a recent media report that the Nordstrom family is interested in a go-private deal. The family had tried to buy the company for $50/share a few years ago, but the deal did not forward.
Park Hotels & Resorts Inc (PK)	After the successful development of a covid vaccine in November 2020, the hotel industry along with the rest of the REIT sector rallied as investor confidence grew that business would eventually return to prepandemic levels. However, the spread of the delta and omicron variants of the coronavirus caused hotel stock prices to decline while the rest of the sector continued to rally. Many hotel companies have yet to produce positive corporate cash flows since the pandemic began; the uptick in virus cases delayed the industry's recovery and extended the period of negative cash flows. We view the current situation as creating an opportunity for investors to buy Park Hotels & Resorts at a discount to our fair value estimate. In our view, the company's balance sheet is strong enough to handle continued disruption to the hotel industry for the next several years. While many businesses have pushed back plans to fully return employees to the office, which in turn delays the return of hotel demand generated by business travel, the current disruption is unlikely to materially alter the long-term demand for Park's portfolio of high-quality hotels. Park's management also did a better job managing hotel net operating income during the pandemic than we had anticipated, so we feel comfortable with its capabilities to handle the current challenges facing the hotel industry. We think that Park should rebound from the pandemic with several years of strong growth and will return to 2019 peak levels by the end of 2024.

Company	Rationale
PayPal Holdings Inc (PYPL)	Over the past few years, the market has vacillated between hope and despair when it comes to PayPal. The stock roughly tripled in the early stages of the pandemic but has since fallen nearly 80% from its peak to a level materially below its prepandemic price. With market confidence in the stock at a low ebb, we see a potentially good long-term opportunity. Our fair value estimate for the narrow-moat company is $104. We think the market is overly focused on near-term absolute growth when we believe it should be more focused on relative performance. In our view, relative performance is a better indicator of the company's competitive position and long-term value. We recognize the headwinds the company faces in the near term. But in the long term, PayPal's fate remains tied to the high-growth e-commerce space, with Venmo providing some additional upside option value. Historically, PayPal has demonstrated it can take share in this area, and we believe the company retains a strong competitive position. That said, we recognize that this e-commerce focus could be a double-edged sword, as competition in e-commerce is relatively intense. We believe PayPal can hold its own, and we see no signs in its recent performance to suggest its overall competitive position has weakened. That said, we recognize the potential for results to veer in either direction longer term. As a result, we see the stock as more suited for risk-tolerant investors.
PEXA Group Ltd (PXA)	Pexa's Australian exchange business is showing potential for exceptional margins and profits, in line with other financial exchange businesses. Moreover, this is despite suppressed revenue from a subdued property market and elevated costs as the company develops and rolls out its exchange infrastructure across additional regions and use cases. We believe the market is overly focused on the loss-making UK business and expect it to either become profitable or be abandoned in the next years.
Polaris Inc (PII)	Polaris' shares trade at a roughly 35% discount to our $145 fair value estimate. The company's favorable brands, innovative products, and Lean manufacturing support its wide economic moat. We think Polaris will continue to capitalize on its research and development, solid quality, and operational excellence to increase demand. It has historically generated topnotch returns on invested capital, including goodwill, and should be able to deliver a 27% ROIC in 2033, well above our 10% weighted average cost of capital assumption. Although the company is facing headwinds from slowing consumer conversion and cautious dealer behavior, we think long-term demand stemming from product launches will support shipment growth and profit improvement beyond 2024. For 2024, the firm said it expects a sales decline of 5%-7% and adjusted EPS of $7.75-$8.25, down 10%-15% year over year. We forecast a 6% sales decline and $7.77 in EPS. Once dealer inventory is trimmed, wholesale shipments should more closely track with consumer demand, as dealer inventory was up just 5% versus 2019 at the end of 2023. Over the next decade, we think the company could achieve average sales growth of 3% and EPS growth of 12%.

Company	Rationale
Realty Income Corp (O)	No-moat Realty Income currently trades at a material discount to our $76 fair value estimate. We think the shares have traded down since August 2022 due to rising interest rates. In our analysis of stock performance and interest-rate movements, we have found that Realty Income is the most sensitive REIT that we cover, with its stock showing the greatest negative correlation with interest rates. It has positioned itself as "The Monthly Dividend Company," so many investors are attracted to the name when interest rates are low. However, those investors may rotate out of the name and invest in risk-free Treasuries when interest rates rise. Additionally, since the company sets annual rent escalators relatively low, it relies on executing billions in acquisitions each year to fuel overall growth. Rising interest rates have reduced the spread between the company's acquisition cap rates and the weighted average cost of capital used to fund those acquisitions, thus potentially reducing growth. However, Realty Income has actually ramped up the volume of acquisitions over the past several years and still acquires at a positive spread over its cost of capital. Realty Income executed $9.5 billion in acquisitions at an average cap rate of 7.1% in 2023, well above the average interest rate of approximately 5% on the debt the company issued to fund those deals. The company's $9.3 billion acquisition of Spirit Realty, which closed in January 2024, should also be accretive to shareholder value. We anticipate that management will be able to continue to find deals that increase funds from operations, thereby supporting continued dividend growth for shareholders. We think the selloff caused by rising interest rates presents investors with an attractive entry point, particularly if the Federal Reserve announces any rate cuts in 2024.
ResMed Inc (RMD)	ResMed is delivering strong device sales with Philips still hampered by remediation work, sleep apnea diagnosis rates recovering, and ResMed's supply constraints easing. Recent share price weakness is being driven by concerns that weight-loss drugs will disrupt the sleep apnea industry. However, we think widespread adoption of these drugs will take some time, given their higher cost, limited supply, and risk of side effects. Obesity is also just one risk factor for sleep apnea, and sleep apnea patients who experience weight loss may still be considered obese and, in most cases, would likely still benefit from a sleep device. We expect ResMed to remain a meaningful player in addressing sleep apnea. See our special report, "The Start of Unconstrained Sales for ResMed," published in July 2023, for more details.
Roche Holding AG (ROG)	We don't think the market fully appreciates Roche's drug portfolio and industry-leading diagnostics that combine to create durable competitive advantages. Headwinds from falling covid diagnostic revenue and generic and biosimilar competition to older drugs are still present but shrinking in 2024, which should highlight the strength in the firm's portfolio of market-leading drugs. We think the firm's R&D spending is becoming more efficient, and tuck-in acquisitions in obesity and immunology look capable of multi-billion-dollar sales potential. As the market leader in biotech and diagnostics, this Swiss healthcare giant is in a unique position to guide global healthcare into a safer, more personalized, and more cost-effective endeavor. The collaboration between its diagnostics and drug-development groups gives Roche a unique in-house angle on personalized medicine. Also, Roche's biologics account for three fourths of its pharmaceutical sales; biosimilar competitors have seen development setbacks, while Roche's innovative pipeline could make these products less relevant by their launch.
+ Rogers Communications Inc (RCI.B)	Rogers has been part of a huge industrywide decline in Canada telecom stocks, mostly due to fear of increased regulation after CEOs were called in front of Parliament. We think it's unlikely new regulations would be overly severe, because we don't think the environment warrants it. Competition has been high; pricing has been stubborn; the companies haven't seen financial windfalls; and the companies have continued to invest to significantly improve Canadian networks. Rogers continues to generate significant free cash flow, has additional synergies to realize with its Shaw merger, and has been the strongest wireless carrier in terms of new customer additions. Rogers isn't likely to have a booming business, but pessimism has gotten far too extreme. Each of the Big Three looks very undervalued, but we're most comfortable with Rogers position.

Company	Rationale
RWE AG (RWE)	RWE's transformation from a coal-weighted company to a renewables leader reflects excellent strategy and execution that are not fully priced in, despite the clear way out of coal after its agreement with the German government. With the acquisition of ConEd's clean energy business, RWE became the fourth-largest renewables player in the US, a very attractive market since the adoption of the Inflation Reduction Act. RWE has one of the highest exposures to European power prices and clean spark spreads thanks to the high liberalized share of its renewable volumes and combined-cycle gas turbine plants. Additionally, the group typically benefits from commodity price volatility thanks to its trading business.
Sabre Corp (SABR)	We believe concerns regarding Sabre's financial health in an environment with elevated credit costs and lower demand for corporate travel as a result of the pandemic present an opportunity to own a company with network, efficient scale, and switching cost advantages at an attractive margin of safety. Sabre's global distribution system faces manageable competitive risk from the new distribution capability protocol and direct connections. These technologies face material aggregation and/or processing hurdles to compete with Sabre and peers. Platform investments in the cloud and new distribution capability and revenue opportunities in ancillary, hotel IT, and airline IT further entrench Sabre's customers, supporting its competitive advantages. We estimate that more than half of Sabre's prepandemic sales were exposed to corporate travel, which is experiencing a slower recovery than leisure travel. Although we think some corporate travel could be displaced by video conferencing over the long term, we still expect business trips to see a rebound in the next few years as macroeconomic visibility improves and more workers return to the office. It is our view that in-person interaction can be a valuable differentiator to retaining and winning customers versus video calls. Sabre has improved its debt profile. Heading into 2022, it had $3.8 billion in debt scheduled to mature in 2024-25, but it now has no major debt maturing until 2026 after successful tender offers and refinancing. We believe Sabre's cash levels, free cash flow generation, and gradual recovery in platform demand position the company with the ability to service this maturing debt.
Sands China Ltd (01928)	Macao has been seeing a solid recovery from covid-19 disruptions, and as of the third quarter, industry gross gaming revenue had returned to 69% of the prepandemic 2019 levels, despite the ease of Junket VIP income amid a regulatory change. We believe Sands China’s focus on the mass market and having the largest room count in Macao, as well as a successful record in nongaming activities, makes it the key beneficiary to capture further demand recovery in Macao, particularly the faster growth of base mass revenue starting from the third quarter.
Santos Ltd (STO)	We think Santos is not being sufficiently credited for new oil and gas developments underway, and the shares are cheap. A solid balance sheet and low costs, including a freight advantage to Asia, mean the company is well-placed to weather any cyclical low prices. But crude and liquefied natural gas prices are strong now, and gas has a growing role to fuel the world, including to complement increasing renewable energy production. We forecast group hydrocarbon growth of around 50% by 2027, chiefly from the Pikka oilfield development in Alaska and reinvigoration of Darwin LNG's output due to new feed from the Barossa gas field development. We forecast Santos to largely maintain earnings in 2027 from buoyant 2022 levels as rising volumes offset a normalization in very favorable prices.

Company	Rationale
Sealed Air Corp (SEE)	We see value in Sealed Air shares, which are trading 37% below our $54 fair value estimate. Sealed Air produces a wide variety of flexible resin packaging, protective shipping materials, and integrated packaging systems. Packaging demand hit its stride in 2021 as pent-up demand for goods and supply chain challenges created robust end-market demand. As a result, the company enjoyed record financial performance in 2021-22. However, this euphoria quickly flipped as supply chain disruptions abated, and inventory levels began to build. Many retailers were left with excess inventory and were forced to take inventory destocking actions, which has weighed heavily on the packaging industry. Management provided an optimistic outlook when giving its initial full-year 2023 guidance and maintained this through first-quarter earnings despite signs of end-market weakness persisting. Then, Sealed Air reported underwhelming second-quarter results and cut full-year adjusted EPS guidance by over 20%, unnerving the market. The shares have fallen 50% from their January 2022 high and have vastly underperformed packaging peers during this time. Despite the company's challenges in 2023, Sealed Air's differentiated business model in the packaging industry cannot be overlooked. Sealed Air sells packaging equipment and automation solutions to companies that use its packaging materials for years thereafter. This dynamic removes the price-taker approach that weighs on other packaging producers. Sealed Air's competitive positioning and favorable long-term prospects give us greater confidence that the currently discounted share price will ultimately reward long-term investors.
SoFi Technologies Inc (SOFI)	SoFi Technologies trades well below our $13 fair value estimate. Its results during most of 2023 were negatively affected by the automatic forbearance of federal student debt that was granted as part of the Cares Act. Before the pandemic, roughly 60% of the loan volume in SoFi's lending segment was from student debt refinancing. As one would expect, there is far less incentive to refinance student debt when payments are not required, and SoFi's student loan origination volume has been well below prepandemic levels for several years now. With student forbearance now over, a material headwind for SoFi's future results has been removed. SoFi has continued to produce strong results in its other segments, with progress toward its long-term strategic goals. As at other digital lenders, SoFi's personal loans have seen a substantial increase in volume, with loan origination more than doubling over the last couple of years. The company's financial-services segment also enjoyed a substantial improvement in user monetization, with revenue from the segment benefiting from higher interest rates, higher debit card transaction volume, and SoFi's new credit card. SoFi's acquisition of a bank charter is benefiting the firm significantly, with rapidly increasing deposits allowing it to drastically improve the funding structure of its lending operations and financial-services segment. Rising net interest income was the largest major driver of the company's strong results in 2023, which came despite weak student loan origination. The company's banking-as-a-service subsidiary, Galileo, has seen its account growth reaccelerate after a weak start to 2023, with the number of accounts on the platform rising over 12.4% from the end of June to the end of December. We believe the market is too focused on the short-term risk of rising credit costs and missing the value of the long-term growth drivers at SoFi.

Company	Rationale
Stericycle Inc (SRCL)	Since its founding in 1989, Stericycle has acquired over 500 companies. This acquisitive strategy led to a lengthy period of impressive growth, and the firm built unmatched scale. However, acquisitions began to stray from Stericycle's core competencies and poor integration efforts caused inefficiencies to build. After decades of strong growth and profitability, Stericycle's financial performance began to deteriorate in 2017. However, with a refreshed management team, led by CEO Cindy Miller, Stericycle's turnaround strategy has progressed well. The company has now divested almost 20 noncore, low-margin businesses; management achieved its goal of reducing the debt leverage ratio to below 3; it is reinvesting in its competitively advantaged medical waste collection and disposal business, with improvements to its autoclave and incinerator infrastructure (including a new incinerator in Nevada), and perhaps more fleet-related investment in the future; it successfully implemented its new enterprise resource planning system; and management has implemented much-needed oversight and standardization across the company, which has improved revenue quality and operational efficiencies. Stericycle's operational focus has shifted back to its core competencies, and we see multiple opportunities for improved profitability and free cash flow generation. Over the next five years, we forecast Stericycle will realize 4% organic revenue growth, adjusted EBITDA margin will expand to 23.5% (from around 16% in 2022-23), and free cash flow will exceed $400 million by 2027. By then, we think Stericycle will have the financial flexibility to pursue prudent acquisitions and perhaps repurchase shares.
STMicroelectronics NV (STM)	Narrow-moat STMicroelectronics is one of our top picks in the technology sector, as our fair value estimates of $66 for US shares and EUR 63 for European shares offer an attractive margin of safety for long-term, patient investors, in our opinion. We continue to like the long-term secular tailwinds in the automotive end market, as ST should profit from increased chip content per car, especially in electric vehicles. The company has also achieved nice gross margin expansion in recent years, and we foresee the company maintaining these margins in the long run. We acknowledge near-term risks around ST as it recently provided a soft outlook for 2024 revenue and profitability, while we see some warning signs in the broader EV market around excess inventory, competitive pricing among OEMs, and possibly slower growth than what the market was expecting. Still, we're encouraged by ST's recent forecast for mid-single-digit automotive revenue growth in 2024, especially if the EV market were to perform a little worse than feared. Overall, we think such near-term risks are baked into market prices today, and we like the potential rewards for investors who are willing to wait out the latest cyclical downturn in broad-based semis. Longer-term, we're not panicked about the expansion of trailing edge chip manufacturing equipment and capacity in China, as domestic chipmakers may seek to displace firms like ST over time. We think ST's broad product portfolio and high customer switching costs around its products will allow the firm to remain relevant in the Chinese market, and almost certainly most other markets worldwide, in the long run. We're also not overly concerned about expansion in the silicon carbide-based semis market, and still anticipate that ST will remain a market leader with strong revenue growth in these products through the rest of this decade.
Taiyo Yuden Co Ltd (6976)	We maintain our view that supply/demand for multilayer ceramic capacitors will remain healthy and tighten as the year draws to a close, driven by the recovery of smartphone production and content growth in autos. While we see all passive components suppliers in our coverage as undervalued, we believe narrow-moat Taiyo Yuden's shares offer the best opportunity to accumulate. While we acknowledge risks from the Russia-Ukraine conflict and the chip shortage, we expect robust demand for high-end multilayer ceramic capacitors to continue in the longer term. Smaller size and larger capacity will be necessary for MLCCs used on smartphones, and larger-capacity, higher-reliability, and higher-breakdown voltage will be required for auto MLCCs. We believe that Taiyo Yuden will be one of the beneficiaries of this trend.

Company	Rationale
TC Energy Corp (TRP)	TC Energy is dealing with multiple investor concerns: too-high debt, lingering worries over future impacts from the Coastal GasLink overruns, and skepticism over the planned 2024 liquids spinoff. In contrast, we think the completed CAD 5 billion-plus in asset sales plus another CAD 3 billion in additional sales and CAD 1 billion in optimization opportunities provide plenty of capital to reduce debt. The liquids spinoff should be capitalized at 5 times debt/EBITDA, suggesting more leverage to be moved off TC Energy's balance sheet. Coastal GasLink is 100% complete and ready to supply gas to LNG Canada. We believe the liquids spinoff will highlight the quality and growth opportunities available in the gas and power portfolios, including carbon capture and hydrogen.
The a2 Milk Co Ltd (ATM)	There is much to like about a2 Milk, notably in China, the key battleground. A2's share of Chinese-language-labeled infant formula continues to grow, supported by a2 Platinum's solid brand health underpinning its narrow moat. Granted, there are hurdles. Births in China are declining and the tailwind of consumers preferring foreign brands no longer blows. Offsetting the falling number of births in China, we anticipate premiumization to continue and a2 Milk to capture market share. We forecast 8% annual revenue gains to fiscal 2028 as channel inventory levels normalize and market share increases alongside improved sales of higher-margin English-label product and operating leverage from higher revenue.
The Estee Lauder Companies Inc (EL)	Shares of wide-moat Estee Lauder have sold off 42% over the past 12 months, largely driven by a weaker-than-expected postpandemic recovery in travel retail in China. We think the shares, trading at a 34% discount to our $210 fair value estimate, represent compelling value and recommend them to investors looking for exposure to the secularly attractive beauty care. We view Estee Lauder's competitive position as intact and think the challenges it currently faces in China are temporary and addressable as the firm leverages its strong brands, tight channel relations, and various research and manufacturing initiatives in Asia to reinforce its positioning. While Estee reported a 10% sales contraction in fiscal 2023 (ended June) due to inventory issues in travel retail in China, we see little change in the premiumization trends in the country or in Estee's long-term standing in terms of brand perception and channel relations. For fiscal 2024, we now forecast revenue to be flat to reflect prolonged challenges in China, though from fiscal 2025 onward, we model sales growth to rebound to high-single digits as we expect Estee to outpace the mid-single-digit growth in the overall beauty market thanks to its focus on structurally attractive premium skincare. We expect operating margins to expand to the high teens by fiscal 2033, driven by a better channel mix (away from heavy promotions in department stores), manufacturing efficiency gains, and cost-cutting measures.
The Swatch Group AG (UHR)	Swatch benefits from a narrow moat through brand intangible assets and manufacturing scale. Its valuation is very appealing as tailwinds are not priced in, including high exposure to Chinese consumption, post-lockdown recovery, bottoming out of lower-priced watches, smartwatches reaching maturity, and operating leverage.
TPG Telecom Ltd (TPG)	Shares in narrow-moat TPG Telecom screen as the most attractive under our Australia and New Zealand telecom coverage. We see catalysts for earnings recovery on several fronts and forecast an adjusted EBITDA CAGR of 5% over the next five years. Benefits from a more rational mobile market are clearly coming through, augmented by continuing growth from fixed wireless and the corporate division. Cost-outs from the current transformation program are progressing slower than we had previously anticipated, curtailing near-term earnings growth amid the current 5G rollout-related capital expenditure hump. Overhang of major shareholders whose holdings are now out of escrow after the Vodafone merger is also causing some investor consternation. However, these concerns are more than reflected in the share price, especially given the longer-term tailwinds for the telecom industry as it makes the transition to 5G and as transformation benefits are gradually realized.
TransUnion (TRU)	TransUnion's shares have been volatile amid modestly choppy trends in the firm's business and the investor indecision about the company. We believe the firm's revenue will be resilient in a recession, and we regard the firm's current valuation, which is in line with the S&P 500 Index, to be attractive given the firm's wide moat and business model. Improving US mortgage trends with higher pricing from FICO should boost the bottom line. In addition, the firm has seen softer revenue in normally noncyclical lines of business, such as insurance and tenant screening, because of idiosyncrasies in those markets that we expect to normalize over time. On the cost side, restructuring activities and lower interest rates (the firm has variable debt on its balance sheet) should also help profitability in 2024.

Company	Rationale
Tyson Foods Inc (TSN)	From the beginning of 2002 to late October 2023, Tyson Foods' shares fell nearly 50%, underperforming the Morningstar US Market Index's decline of 5% and protein-centric peer Pilgrim's Pride (down 7%) and Hormel (down 33%). Although the recovery has begun with Tyson up nearly 30% since then, shares still trade significantly below our fair value estimate and offer an attractive risk-adjusted upside as well as a healthy dividend yield of more than 3%. At first glance, the decline in Tyson's share price is understandable, given eroding financial performance. Trailing 12-month adjusted EBITDA has plunged by 55% as of the end of the first fiscal quarter. And as a no-moat food producer that generates most of its revenue from raw meats, Tyson is exposed to volatility in both input costs and prices for its goods. This has proved particularly challenging of late, given rampant cost inflation that has been compounded by supply and demand issues for beef and pork. But we think the current price implies that these challenging conditions will linger. Meat markets are cyclical, and a return to a more normal operating environment is all that is needed to justify our valuation. Further, we do not see any structural changes to meat markets to warrant a permanent change to profitability. Thus, we forecast moderate 2% top-line growth over the next five years and operating margin recovering to our 2027 estimate of 7.5%, in line with historical levels and an improvement from the fiscal 2023 result of roughly negative 1%.
U.S. Bancorp (USB)	We believe the banking sector is relatively undervalued. The biggest risk to our top picks would be surprises on deposit and funding costs or the realization of a recession. While we think banks are already trading at recessionary valuations, the realization of recession isn't likely to help valuations in the short term. US Bancorp has sold off like some of the regionals, but we see the risk of deposit outflows as minimal, given that it is the largest regional. The bank does have slightly higher-than-average unrealized losses on securities, but we view this more as an earnings problem (lower-yielding assets stuck on the balance sheet) and not a capital problem. While US Bancorp's earnings could be pressured as rates rise, its size and wide moat rating, combined with the relatively better deposit positioning, make us think the selloff is overdone for the name. That said, depending on how rates move from here, it could put more pressure on the stock and extend the timeline for how long it takes this call to play out.
Ventia Services Group Ltd (VNT)	The market is seemingly unimpressed by Ventia, perhaps reflecting a large but declining vendor shareholding overhanging since the IPO. We project EPS growing at a near 4.0% CAGR to 2026 and a fully franked yield nearing 7.0%, also by 2026. We like the relatively defensive revenue streams with maintenance cash flows comparatively resilient to external shocks. Business capital requirements are low, expected at less than 1% of revenue. Over the next four years, macro tailwinds including population growth, outsourcing volume rates, and environmental regulations underpin Ventia's expectation for the market to grow at a robust 6.6% CAGR for Australia and New Zealand.

Company	Rationale
VF Corp (VFC)	VF’s shares trade at a large discount to our $53 fair value estimate as its results have deteriorated over the past few quarters. We believe investors are focused on recent problems and are overlooking the company's history of successful portfolio management and brand development, as well as its potential for sales growth and margin improvement in the medium term. In October 2023, new CEO Bracken Darrell unveiled a strategic plan with goals including innovation and new management for Vans, a new platform for VF in the Americas, cost cuts, and debt reduction. The firm is also likely to sell at least one major brand to raise capital for debt reduction. We believe VF's valuation will improve as this plan is installed, but it will take time. Led by Vans and The North Face, VF is a narrow-moat company based on its brand intangible asset. VF is one of the largest apparel firms in the US, but its share price has plummeted due to a series of disappointments, including a slowdown in Vans sales, a stronger US dollar, inflation, elevated inventory, and an unfavorable ruling in a tax case. While we acknowledge its challenges, we think VF’s diminished valuation presents an opportunity to invest at a discount in a firm that is poised for improved profitability. We forecast the firm can raise its operating margins above 14% within three years. Reflecting its recent challenges, VF cut its quarterly dividend twice in 2023. While disappointing for income investors, we believe the company's focus on improving liquidity and reducing debt is the correct one. VF has recently been targeted by activist investors who are pushing for cost cuts and the sale of noncore brands. Some of their aims are covered by the new strategic plan, so we believe they are supportive of Darrell's efforts.
WESCO International Inc (WCC)	Wesco International completed its merger with close competitor Anixter International in June 2020. In fiscal 2021, the combined entity generated $18 billion in sales, dwarfing W.W. Grainger as the largest US-based industrial distributor, and management estimates that the firm will have 13% share in the North America electrical distribution market, ahead of Sonepar North America, Graybar, and Rexel. Wesco has achieved $315 million in cost synergies, thanks to the elimination of redundant corporate and infrastructure costs and the optimization of its supply chain. The company has also achieved $2.3 billion in revenue synergies from cross-selling and enhanced pricing power. We think Wesco can improve capital efficiency going forward as digitalization efforts promote a shorter cash-conversion cycle. Thanks to the Anixter combination, Wesco now has a more comprehensive and complementary portfolio to offer to customers. While some investors may be concerned about the significant amount of leverage Wesco took on to acquire Anixter, we're comforted by both firms' records of generating significant free cash flow throughout the business cycle. Wesco's net leverage ratio sits at 2.8 times, within its targeted range of 2 times-3.5 times when the Anixter deal was announced. At the end of 2023, management lowered its target range to 1.5 times-2.5 times. We remain confident in Wesco's ability to generate enough free cash flow to further reduce leverage.
+ Wharf Real Estate Investment Co Ltd (01997)	We like Wharf REIC for its prime retail assets Harbour City and Times Square. These assets are the largest retail assets in the respective area and we expect the firm to benefit from the recovery in Hong Kong's tourism. Wharf REIC is also a beneficiary of the luxury retail consolidation trend, where luxury brands reduce their footprint elsewhere in the city, but expand their space in key shopping locations, such as Harbour City.
Yum China Holdings Inc (YUMC)	We view Yum China as a long-term beneficiary of China’s demographic shifts. We believe there is significant room for fast-food penetration to go up, driven mainly by long-term secular trends such as longer working hours for urban consumers, rapidly rising disposable income, and ever-smaller family sizes. We think investors are underestimating the company's long-term growth prospects and the potential for margin enhancement as Yum China continues to shift toward more franchising over the long term.

+ = Recently Added

Recent Removals Rationale

Company	Rationale
Anheuser-Busch InBev SA/NV (BUD)	We're removing Anheuser-Busch InBev from the Best Ideas list as we transition coverage.
Bayerische Motoren Werke AG (BMW)	We are removing BMW from the Best Ideas list. We see heightened uncertainty around its 2024 performance because management expects this year to be the peak for capital spending as well as research spending. Continued geopolitical uncertainty and high energy costs due to the Ukraine-Russia war, the US presidential election’s impact on that nation’s economy, and possible automotive supply chain delays following the Baltimore bridge collapse, when combined with the higher spending, raise the risk profile for our investment thesis. Peak capital investment for new vehicle and battery plants in China, Germany, Hungary, Mexico, and the US will eventually likely see a payoff, but we see that payoff happening beyond 2024. Research and development costs will also peak in 2024 to focus on electrification, including the products of the Neue Klasse, and in-car digital innovations around connectivity, software, and autonomous driving. We think the auto industry has a ways to go to match the tech industry in software, and this learning curve will require long-term investment. We think BMW is on the right track, but heightened 2024 spending and uncertainty beyond management’s control now make us think that investors might need to be more patient with the stock.
CNOOC Ltd (00883)	We are removing CNOOC from the Best Ideas list after recent share price gains.
Dow Inc (DOW)	We are removing Dow from our Best Ideas list. The shares have appreciated since being added to the list, and we see stronger upside in other names in the sector.
Imperial Brands PLC (IMB)	We're removing Imperial Brands from the Best Ideas list as we transition coverage.
PDD Holdings Inc (PDD)	Heightened risk from US regulations which includes the potential ban of Temu in the US, investigation over forced labor, and removal of the de minimis rule.

Research Methodology for Valuing Companies

Components of Our Methodology
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Capital Allocation

We believe that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth. Four key components drive the Morningstar rating: our assessment of the firm's economic moat, our estimate of the stock's fair value, our uncertainty around that fair value estimate and the current market price. This process ultimately culminates in our single-point star rating. Underlying this rating is a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's equity analysts.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our actual calculation of our fair value estimates. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns on invested capital over at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. The assumptions that we make about a firm's economic moat play a vital role in determining the length of "economic outperformance" that we assume in the terminal sections of our valuation model. To assess the sustainability of excess profits, analysts perform ongoing assessments of what we call the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model— where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from one year (for companies with no economic moat) to 10-15 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard perpetuity formula. In deciding on the rate at which to discount future cash flows, we use a building block approach,

Morningstar Research Methodology for Valuing Companies

Source: Morningstar, Inc.

Research Methodology for Valuing Companies

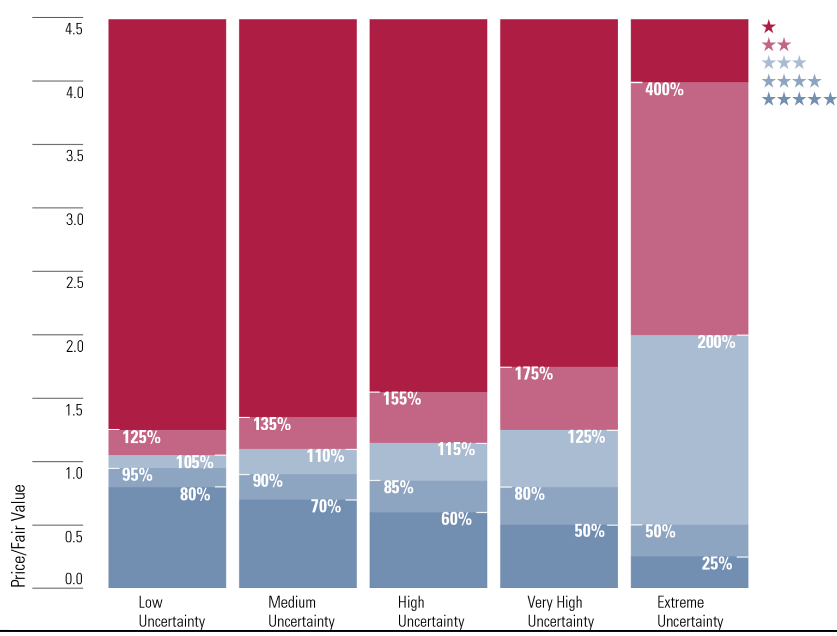
which takes into account expectations for market real return, inflation, country risk premia, corporate credit spread, and any additional systematic risk.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts model three scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of likely potential fair values and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Our corporate Capital Allocation Rating represents our assessment of management's capital allocation of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge capital allocation from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Equity Research Star Rating Methodology



Global Equity Research Disclosure

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