Coca-Cola Ko [XNYS] | ★★★

Coke Posts Solid 1Q Results, Takes First Step in Shedding Bottling Assets; Raising Fair Value to $41

by Thomas Mullaney, CFA
Senior Stock Analyst
Analyst covering this company do not own its stock.

Analyst Note Apr. 16, 2013
Coca-Cola KO continues to show that its wide economic moat is intact. During the first quarter, global volume grew 4% and comparable earnings per share rose 5%. Overall, Coca-Cola’s volume growth continued to be led by the still beverage category (up 6%) and in developing countries where per capita consumption is less than 150 servings per year (up 7%).

Coke also announced plans to slightly modify its bottling footprint in the United States. We believe this will be a first step in a multyear process of moving much of its U.S. distribution assets to its bottling partners. Given the firm’s continued strong performance, we are raising our fair value estimate to $41 per share from $38 to account for the time value of money as well as a more efficient U.S. beverage system, which should increase Coke’s profitability over the coming decades.

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Thesis Apr. 16, 2013
Coca-Cola’s wide economic moat is bolstered by its bevvy of powerhouse brands and its extensive distribution network, which enables the company to deliver its products to consumers in more than 200 countries. While declining consumption of carbonated beverages in North America will serve as a near-term headwind for Coke, we believe international markets will provide plenty of growth opportunities in the long term. Absent any strategic missteps, we view Coca-Cola as a safe haven in an uncertain economic environment, given that it has one of the widest moats in our consumer coverage universe.

Even though its existing distribution network spans the globe, Coke continues to invest for international growth. The company and its bottling partners intend to invest billions during the next few years in countries such as China, Russia, and Brazil, where per capita consumption is increasing in light of the burgeoning middle class. For example, annual per capita consumption of Coca-Cola products in China is currently just 38 servings, versus 8 servings in 1998 and more than 400 servings in the United States. We think these investments will build out the firm’s manufacturing and distribution footprint to such an extent that it would be too costly for a new entrant to duplicate, solidifying the sustainability of Coke’s competitive advantages.

During the past decade, tastes have changed in mature markets as consumers have shifted from purchasing carbonated soda to still beverages such as juices, ready-to-drink teas and coffees, and enhanced water. To mitigate this falling volume and maintain share, Coca-Cola has been forced to broaden its portfolio deeper into various still beverage categories, which has enabled the beverage giant to leverage its vast distribution system and marketing might to continue growing its worldwide volumes.

The pressure on bottlers’ margins and the demands of syrup makers for distribution and production flexibility have been sources of conflict for many years. Consequently, Coke followed PepsiCo’s PEP lead by acquiring the North American
Coca-Cola Co
KO [XNYS] | ★★★

Last Price  42.24 USD  Fair Value  41.00 USD  Consider Buy  32.80 USD  Consider Sell  51.25 USD  Uncertainty  Low  Economic Moat™  Wide  Stewardship  Exemplary  Morningstar Credit Rating  AA-  Industry  Beverages - Soft Drinks

Close Competitors

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<th>Company</th>
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<th>Oper Income</th>
<th>Net Income</th>
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Following the company’s recent earnings release and U.S. bottling realignment announcement, we are increasing our fair value estimate to $41 per share from $38. Although increased headwinds in Europe and China continue to temper our 2013 estimates, our underlying assumptions for the company’s long-term trajectory are unchanged. Our fair value estimate implies fiscal 2013 price/earnings of 19 times, enterprise value/EBITDA of 14 times, a free cash flow yield of almost 5%, and a dividend yield of 2.7%. We believe that Coca-Cola’s wide economic moat and opportunities for continued growth merit above-average valuation multiples.

Volume and pricing are key drivers of our valuation model. We forecast Coca-Cola’s top line to grow roughly 5.5% per year during the next decade, driven by roughly 3%-4% volume growth and 1%-2% pricing growth. We believe operating margins should range between 25% and 27.5%, in line with the average adjusted operating margin during the past five years. From our perspective, earnings per share growth should outpace top-line growth as the firm uses the substantial free cash flow it generates to reduce debt and repurchase shares.

Our estimates for Coke’s revenue and earnings per share growth are within the range of the company’s long-term targets of 5%-6% compound annual growth for the top line and 7%-9% compound annual growth for long-term EPS growth. For 2013, we expect Coca-Cola to generate about $49 billion in revenue and earn $2.15 per share.

Risk

Coke’s sales and profitability could be negatively affected beyond our forecasts by greater-than-expected increases in commodity prices, particularly for raw materials such as sugar, cocoa, and oranges. Ownership of the company’s North American distribution platform will increase Coke’s exposure to other commodities such as aluminum and plastic resins, and the deal is not without integration risk. With about 60% of revenue being generated outside the U.S., the firm is subject to currency and geopolitical risks in overseas markets. Sales of Coke’s carbonated drinks could be hurt by operations of Coca-Cola Enterprises CCE. This acquisition is intended to eliminate these conflicts and to make the firm more responsive to changing customer demands. Although Pepsi was the first to control its North American bottlers, Coke’s copycat move less than a year later shows there is little that one of these beverage juggernauts can do that cannot be duplicated by the other. In April, Coca-Cola agreed to grant additional territories to five U.S. bottlers. The new agreements will be a “finished goods” model, where Coca-Cola will retain the production facilities and the bottlers will obtain exclusive territory rights, distribution assets (trucks), and cold drink equipment. Finalized agreements are expected to be reached in 2013, and closings should occur in 2014. The territories included in these deals are primarily in midsize markets, including parts of Tennessee, Kentucky, Colorado, Alabama, and Wyoming. We anticipate future bottling agreements in the U.S. will follow a similar game plan, with Coca-Cola (for now) owning the bulk of national beverage production and centrally managing its relationships with its largest 30 customers. This centralized production system, combined with regional distribution partnerships should help reduce systemwide costs, maintain consistency among the firm’s largest customer relationships, and enable Coke to more quickly roll out new beverages and new packages coast to coast.

We believe Coke’s extensive distribution network and strong brands in almost every nonalcoholic beverage category should allow the firm to successfully generate excess returns on invested capital for years to come. Thanks to its strong competitive advantages, we think Coke should trade at a premium to other consumer staples firms.

Valuation, Growth and Profitability
negative publicity regarding health issues concerning drinks with high sugar content, and Coke’s sugary drink volume could be constrained should governments look to increase taxes on soda.

**Bulls Say**
- Coca-Cola’s distribution network spans more than 200 countries. This infrastructure would be extremely difficult and costly for new entrants to duplicate.
- Coke has ample runway for growth in emerging markets where per capita consumption is relatively low.
- The company’s acquisition of its North American bottling and distribution activities should give the firm closer relationships with its retailers and prevent PepsiCo from gaining an edge in a fiercely competitive market.
- Coca-Cola products represent roughly 3% of the estimated 55 billion beverages that are served every day around the world, thereby creating a global familiarity with its brands.
- The Coca-Cola Freestyle fountain machine has the opportunity to profitably increase company revenue from the highly sticky quick-service and fast-casual restaurant channels.

**Bears Say**
- Coke’s revenue base is relatively undiversified compared with PepsiCo’s; Pepsi’s snack business has proved quite resilient during economic downturns.
- Despite the popularity of Coke’s flagship brand, cola consumption has been declining in the U.S.
- Soft drink bottling operations are capital-intensive and lower-margin than Coke’s core concentrate and syrup business. Consequently, Coke’s profitability could be hurt by its acquisition of CCE’s North American assets.
- Governments may look to increase taxes on sugary drinks, thereby stunting Coke’s volume growth trajectory.

**Financial Overview**

*Financial Health:* Coca-Cola is financially healthy. Although the acquisition of CCE’s North American bottling business measurably increased the firm’s debt, interest expense, and pension expense, we believe the company’s strong cash flows will enable it to meet all of its financial obligations, invest for future growth, and increase its dividend. During our 10-year explicit forecast period, we model EBITDA to cover interest expense more than 40 times on average and the firm to generate returns on invested capital in excess of 20%. We currently assign Coke an issuer rating of AA-, implying very low default risk.

**Company Overview**

*Profile:* Coca-Cola is the world’s largest nonalcoholic beverage company. The firm, which sells a variety of sparkling and still beverages, generates 70% of its revenue and about 80% of its operating profit from outside the United States. Coke’s core brands include Coca-Cola, Sprite, Dasani, Powerade, and Minute Maid. Following the asset swap with Coca-Cola Enterprises, Coke now owns about 80% of its distribution in North America.

*Management:* Coca-Cola generally has a high standard of management stewardship. We attribute the firm’s consistent execution in the difficult operating environment of the past several years to strong leadership and a very deep bench. We are also impressed by management’s focus on the company’s 2020 vision, which emphasizes making the best decisions to expand the business over the long term, not just the next quarter.

Muhtar Kent is CEO and chairman. In general, we prefer to see these roles separated. Executive compensation is generous, but incentive-based pay does appear to be aligned
with the long-term interests of shareholders. While 6 of Coca-Cola’s 17 board members have sat on the board for more than two decades, in recent years the firm added some high-profile new members, including Howard Buffett (Warren Buffett’s son), Evan Greenberg (CEO of ACE Limited ACE), and former Chicago Mayor Richard M. Daley.
Analyst Notes

Coke FEMSA to Acquire 51% stake in Coke's Philippine Bottler; Shares Remain Overvalued Dec. 14, 2012

After several months of negotiation with Coca-Cola KO, Coca-Cola FEMSA KOF has agreed to purchase 51% of Coca-Cola Bottlers Philippines from Coke for $688.5 million (MXN 8.8 billion) in cash. This deal values assigns the Philippine bottling operations a total enterprise value of $1.35 billion, or 13.5 times EBITDA, which we think is reasonable given that Coke FEMSA has a call option to purchase the remaining 49% at any point over the next seven years as well as a put option to sell its ownership back to Coke at any time during the next six years. We think the optionality embedded in this deal partly reflects the opportunities and challenges posed by the Philippine operations.

We believe the transaction is fairly priced, and we don’t expect it to have a material impact on our $90 fair value estimate for Coca-Cola FEMSA or our $78 fair value estimate for FEMSA FMX. Not only does the current deal size represent just 3% of our enterprise value estimate (and even less than 3% of the value currently assigned by the market) for Coca-Cola FEMSA, but the Filipino bottling operations also have much lower operating margins (6%-7%) than Coke FEMSA’s other segments (mid- to high teens). Given that Coke FEMSA trades well above our $90 fair value estimate, we believe the current risk/reward profile of the shares is unattractive. Likewise, we do not believe that this will affect our fair value estimate for Coca-Cola and are maintaining our $37 fair value estimate.

Politicians Continue to Pressure Energy Drink Makers Jan. 17, 2013

On Thursday, Sens. Dick Durbin and Richard Blumenthal along with Rep. Ed Markey wrote letters to 14 beverage companies (including Monster MNST, Coca-Cola KO, PepsiCo PEP, Dr. Pepper DPS, Red Bull, and 5-Hour Energy Drink) seeking more information about the companies’ products, ingredients, marketing practices, and any studies performed on energy drinks. Each letter is largely the same, addressing each company’s CEO to respond with answers to their 13 questions by Feb. 1, 2013. While the politicians specific requests for information is a new task for the firms involved, the letter’s introduction mostly repeats previously disclosed concerns about energy drinks. We believe that each company’s legal staff will craft a polite, prompt, and thorough response. Overall, we think this volley of letters make for good headlines, but have negligible impact on the firms’ valuations. Consequently, we are maintaining our fair value estimates for Monster ($52), Coca-Cola ($37), PepsiCo ($72), and Dr Pepper ($38).

The letter’s opening paragraph comments that the FDA is launching an investigation to strengthen the regulator’s understanding of energy drinks and the potential health risks posed to young people and individuals with pre-existing cardiac conditions. Here are some of the more interesting questions that the beverage companies have been requested to answer:

Do you consider your products to be a supplement, conventional food/beverage, or neither?

How much caffeine from all sources does your product(s) contain in the entire package? And per serving?

Does your company market to children or teenagers?

Describe the advertising claims made by your product?

Have you performed any studies to determine whether your...
product is safe for consumption by children and teens? If no, why not? If so, what was determined by these studies.

Have you performed any studies to examine the potential for serious health consequences of using your products, including caffeine toxicity, stroke, anxiety, arrhythmia, and in some cases death? If so, please provide these studies. If no, why not?

All in all, the congressmen seem to be focusing on labeling, ingredients, and marketing practices. We are confident that Monster, Coke, Pepsi, and Dr Pepper are currently meeting the letter of the law with regard to these requirements. However, the politicians do seem to show a keen interest in protecting young people. We continue to believe that fuller disclosure (of caffeine content and ingredients) will be the likely outcome once the FDA finishes their studies later this year. However, there is still a chance that marketing restrictions would force energy drink makers to solely target adults. Nonetheless, we view it as highly unlikely that energy drinks will have to reduce their caffeine content or age-gate their products (similar to alcohol and tobacco sales).

Coca-Cola’s 2012 Results Meet Expectations, 2013 to Likely Have Headwinds; Shares Fairly Valued Feb. 12, 2013

Despite having a few pockets of softness during 2012 and the fiscal fourth quarter, we remain convinced that long-term opportunities for Coca-Cola KO remain robust. The firm’s strong brands, combined with its unmatched global distribution system, remain the key pillars of its wide economic moat, which remains intact. Although we anticipate headwinds to weigh on Coca-Cola’s performance in Europe, China, and North America this year, we expect the company will grow adjusted earnings per share by over 6% to $2.14 per share and will be increasing our fair value estimate to $38 from $37, which takes into account the time-value of money. Our new fair value estimate implies 17.8 times our 2013 adjusted earnings estimate and an EV/EBITDA of roughly 13 times.

During 2012, Coca-Cola’s global beverage volumes grew 4% and the firm gained value and volume share. Softness was realized in Europe (where volumes fell 5% in the quarter and were down 1% for the year), China (where volumes fell 4% during the fourth quarter), and in North American sparkling beverages (where volumes fell 1% during the full year). However, despite the macroeconomic uncertainty in Europe and China, the Coca-Cola system will continue to invest for future growth: Thereby enabling the firm to more greatly profit when consumers regain confidence. Likewise, we aren’t concerned about the carbonated soft drink (CSD) declines in North America, as volume gains in still beverages more than offset soda declines.

Emerging markets continue to be a source of growth for Coca-Cola, with full-year volumes climbing in Thailand (up 22%), India (16%), Russia (8%), and China (4%). In countries in which consumers drink fewer than 150 eight-ounce servings of Coca-Cola beverages per year, volumes climbed 7% during 2012. We continue to note that packaged beverage consumption is highly correlated with per capita GDP, and as emerging markets grow in population and economic prowess, billions of people will increasingly be able to opt for a refreshing Coca-Cola beverage.

Coke Posts Solid 1Q Results, Takes First Step in Shedding Bottling Assets; Raising Fair Value to $41 Apr. 16, 2013

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The Coca-Cola Co is a manufacturer, distributor and marketer of nonalcoholic beverage concentrates and syrups.

**Growth Rates Compound Annual**

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<tr>
<th>Grade</th>
<th>1 Yr</th>
<th>3 Yr</th>
<th>5 Yr</th>
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<td>10.7</td>
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<tr>
<td>Operating Income %</td>
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<td>Earnings/Share %</td>
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<td>Dividends %</td>
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<td>Book Value/Share %</td>
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<td>Stock Total Return</td>
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<td>+/- Industry</td>
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<td>+/- Market</td>
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**Profitability Analysis**

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<tr>
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<td>Return on Assets %</td>
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<td>Inventory Turns</td>
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<td>Net Margin %</td>
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<td>Free Cash Flow/Rev %</td>
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<td>R&amp;D/Rev %</td>
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**Financial Position (USD)**

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**Valuation Analysis**

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<td>Price/Book</td>
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<td>Price/Free Cash Flow</td>
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<td>Dividend Yield %</td>
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<td>Price/Book</td>
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<td>Price/Sales</td>
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<td>PEG Ratio</td>
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**Quarterly Results (USD)**

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<th>Jun</th>
<th>Sep</th>
<th>Dec</th>
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<td>Most Recent</td>
<td>11137.0</td>
<td>13085.0</td>
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<td>Previous</td>
<td>10517.0</td>
<td>12737.0</td>
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<tr>
<td>Price/Earnings</td>
<td>13.0</td>
<td>19.0</td>
<td>18.4</td>
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<tr>
<td>Price/Sales</td>
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<td>4.6</td>
<td>4.2</td>
<td>4.7</td>
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<tr>
<td>Price/Book</td>
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<td>15.1</td>
<td>19.1</td>
<td>20.0</td>
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<td>PE Ratio</td>
<td>2.1</td>
<td>2.8</td>
<td>2.6</td>
<td>1.9</td>
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**Price/Earnings**

- Recent: 28.7 (Mar 2013)
- 52 week High: 20.8 (Mar 2013)
- 52 week Low: 19.8 (Mar 2013)
- 52 week: 22.3 (Mar 2013)
- 12 month: 23.9 (Mar 2013)
- 12 month: 18.2 (Mar 2013)
- 12 month: 19.5 (Mar 2013)
- 12 month: 13.0 (Mar 2013)
- 12 month: 19.0 (Mar 2013)
- 12 month: 18.4 (Mar 2013)
- 12 month: 21.7 (Mar 2013)

**Price/Earnings**

- Most Recent: 11137.0 (Mar 2013)
- Previous: 10517.0 (Mar 2013)
- High: 11315.4 (Mar 2013)
- Low: 10371.7 (Mar 2013)
- 52 week High: 12424.2 (Mar 2013)
- 52 week Low: 11228.0 (Mar 2013)
- 12 month: 11137.0 (Mar 2013)
- 12 month: 10517.0 (Mar 2013)
- 12 month: 11315.4 (Mar 2013)
- 12 month: 10371.7 (Mar 2013)

**Price/Earnings**

- Most Recent: 11137.0 (Mar 2013)
- Previous: 10517.0 (Mar 2013)
- High: 11315.4 (Mar 2013)
- Low: 10371.7 (Mar 2013)
- 52 week High: 12424.2 (Mar 2013)
- 52 week Low: 11228.0 (Mar 2013)
- 12 month: 11137.0 (Mar 2013)
- 12 month: 10517.0 (Mar 2013)
- 12 month: 11315.4 (Mar 2013)
- 12 month: 10371.7 (Mar 2013)

**Price/Earnings**

- Most Recent: 11137.0 (Mar 2013)
- Previous: 10517.0 (Mar 2013)
- High: 11315.4 (Mar 2013)
- Low: 10371.7 (Mar 2013)
- 52 week High: 12424.2 (Mar 2013)
- 52 week Low: 11228.0 (Mar 2013)
- 12 month: 11137.0 (Mar 2013)
- 12 month: 10517.0 (Mar 2013)
- 12 month: 11315.4 (Mar 2013)
- 12 month: 10371.7 (Mar 2013)
Morningstar’s Approach to Rating Stocks

Our Key Investing Concepts

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst’s estimate of how much a company’s business is worth per share. Our analysts arrive at this “fair value estimate” by forecasting how much excess cash—or “free cash flow”—the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock’s market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don’t change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock’s fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn’t changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they’re cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you’ll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst’s current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm’s ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such

Morningstar Research Methodology for Valuing Companies

**Morningstar Research**

**Methodology for Valuing Companies**

- **Competitive Analysis**
  - Analyst conducts company and industry research:
    - Management interviews
    - Conference calls
    - Trade-show visits
    - Competitor, supplier, distributor, and customer interviews
- **Economic Moat™ Rating**
  - The depth of the firm’s competitive advantage is rated:
    - None
    - Narrow
    - Wide
- **Company Valuation**
  - Analyst considers company financial statements and competitive position to forecast future cash flows.
- **Fair Value Estimate**
  - Assumptions are input into a discounted cash-flow model.
- **Uncertainty Assessment**
  - DCF model leads to the firm’s Fair Value Estimate, which anchors the rating framework.
  - An uncertainty assessment establishes the margin of safety required for the stock rating.
  - The current stock price relative to fair value, adjusted for uncertainty, determines the rating.
Morningstar’s Approach to Rating Stocks  (continued)

Morningstar’s Approach to Rating Stocks (continued)

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow
This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate
We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we’ll use a lower discount rate, also known as “cost of capital,” than for a firm in a cyclical business with fierce competition, since there’s less risk clouding the firm’s future.

Fair Value
This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company’s intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have—for example, we deduct from a company’s fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a “target price” in two ways. First, it’s an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it’s a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty
To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety
This is the discount to fair value we would require before recommending a stock. We think it’s always prudent to buy stocks for less than they’re worth. The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling
The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we’d consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades
Our corporate Stewardship Rating represents our assessment of management’s stewardship 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 stewardship 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.