Research Highlights

A weekly summary of our best ideas and developments in the companies we cover.

Morningstar Equity Research
Sept. 10-14, 2018

Contents

A New Look at U.S. Asset Managers

We've updated our moat and trend ratings for a handful of U.S.-based asset managers—Invesco, Affiliated Managers Group, Franklin Resources, Eaton Vance, and Waddell & Reed—making a few downgrades, one upgrade, and some changes in our fair value estimates. As we look at the industry today, we see a confluence of a few different issues—poor relative active investment performance, the growth and acceptance of low-cost index-based products, and the expanding power of the retail-advised channel—that have made it increasingly difficult for asset managers that are running predominantly active portfolios to generate organic growth, leaving them more dependent on market gains to drive managed asset levels higher. While we continue to believe that there will be room for active management, we expect the advantage will go to asset managers with greater scale, established brands, solid long-term performance, and reasonable fees.

Although most of the asset managers we cover have the size and scale to be competitive, we've taken a much deeper look at the switching costs and intangibles we view as sources of economic moats for the industry. With Invesco, we maintained our narrow moat rating but took the trend rating (which is being influenced more by industry events) to negative and lowered our fair value estimate to $35 per share. We lowered our moat and trend ratings for Franklin Resources and Eaton Vance to narrow and negative and took our fair value estimates to $37 for Franklin and $55 for Eaton Vance. With Waddell & Reed, we went no-moat with a negative trend and reduced our fair value estimate to $20. We actually lifted AMG's moat rating to narrow, albeit with a negative trend, and lowered our fair value estimate to $200.

In almost all cases, the reduction in fair value estimates reflects our assumption of a larger equity market decline (20%) than we were projecting previously (10%) midway through our five-year forecast. Starting with our industry-level piece, U.S. Asset Managers Still Facing a Difficult Future, and asset manager Observer, Best Business Partners for the Next Decade: Fees and Performance Loom Ever Larger Over Asset Managers, published in the first half of 2017, we've been working toward a system that would allow us to put more quantitative rankings on many of the different organizational attributes (such as product mix, distribution channel concentration, and geographic reach) and intangible assets (such as strong and respected brands and manager reputations that are derived from successful and sustainable records of investment performance) that we believe can provide asset managers with a degree of differentiation from their peers.

In our view, the asset-management business is conducive to the creation of economic moats, with switching costs and intangible assets being the most durable sources of competitive advantage for firms operating in the industry. Although the switching costs might not be explicitly large, inertia and the uncertainty of achieving better results by moving from one asset manager to another tend to keep many investors invested with the same funds for extended periods. As a result, money that flows into asset-management firms tends to stay there—borne out in the U.S. by an average annual redemption (retention) rate for long-term mutual funds of around 30% (70%) during the past 5-, 10-, 15-, 20-, 25-, and 30-year time frames.

While the barriers to entry are not significant for the industry, the barriers to success are extremely high, as it takes time and skill to not only put together a long enough record of investment performance to start gathering assets but to build the scale necessary to be competitive. This has meant that the larger, more established asset managers in the industry have tended to have an advantage over smaller players, especially when it comes to gaining cost-effective access to distribution platforms. Competition for investor inflows can be stiff and has traditionally centered on investment performance, especially in the retail channel. Although institutional investors and retail gatekeepers are exerting pressure on pricing, competition based on price has been rare, aside from what we've seen in the U.S. market for exchange-traded funds. While compensation remains the single-largest expense for most asset managers, supplier power has been manageable as many firms have reduced their reliance on star managers and have tied manager and analyst pay to portfolio and overall firm performance.

Asset stickiness (the degree to which assets remain with a manager over time) tends to be a differentiator between wide- and narrow-moat firms, as those asset managers that have demonstrated an ability to gather and retain investor assets during different market cycles have tended to produce more-stable levels of profitability, with returns exceeding their cost of capital for longer periods. While the more broadly diversified asset managers are structurally set up to hold on to assets regardless of market conditions, it has been firms with solid product sets across asset classes (built on repeatable investment processes), charging reasonable fees, and with singular corporate cultures dedicated to a common purpose that have done a better job of gathering and retaining assets. Firms offering niche products with significantly higher switching costs—such as retirement accounts, funds with lockup periods, and tax-managed strategies—have tended to hold on to assets longer.

When assessing the strengths and weaknesses of the U.S.-based asset managers we cover, we believe it is important to look deeper into the ability of an asset manager to differentiate itself from the competition with lower-cost offerings and repeatable investment strategies, as well as a willingness (and an ability) to prudently adapt to a changing competitive landscape. Being able to not only identify but rank many of the more qualitative aspects that differentiate the asset managers that we cover should, in our view, allow us to better assess the economic moats and moat trends for these companies—especially in light of the secular trends (like the growth of passive investments and a retail channel disruption) that we expect to continue to affect the industry longer term.

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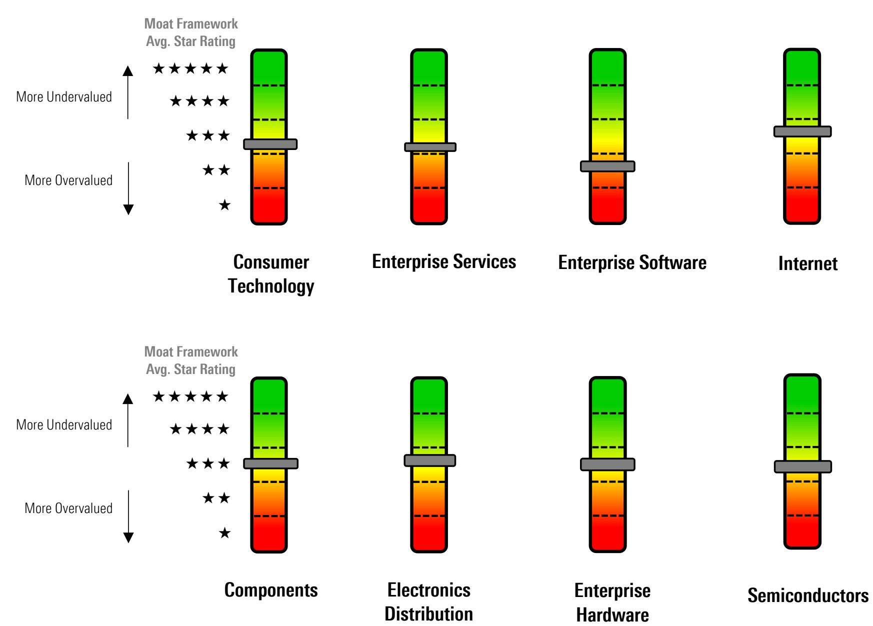
Moat Framework: Technology

The Morningstar economic moat framework collection is a critical tool we employ to fine-tune our economic moat analysis across different industries. In this report, we reiterate the key considerations for moat frameworks applicable to our technology coverage, and we highlight one compelling investment idea from each framework.

Despite recent volatility, particularly among some of our large-cap names, technology sector valuations remain elevated. Enterprise software names trade in 2-star territory on average. Although companies under this umbrella boast the largest premiums to our fair value estimates, we believe wide-moat ServiceNow offers upside that has not been fully priced in. Internet content and information companies are trading in a range that we consider fairly valued. Regardless, we highlight Tencent as an anomaly trading in 5-star territory.

Valuation multiples look reasonable across the hardware supply chain, with companies falling under the components, electronics distribution, enterprise hardware, and semiconductor moat framework umbrellas trading in 3-star territory on average. However, we still see value, particularly in the semiconductor space, as market overreactions to headline risk have caused a few of our Best Ideas to be oversold. Intel and Microchip Technology exemplify this dynamic, and we highlight both names as they trade in deep 4-star territory.

Exhibit 1 Moat Framework: Technology



Source: Morningstar. Data as of Sept. 11, 2018.

Exhibit 2 Software, Services, and Consumer Technology Framework Valuation Dashboard

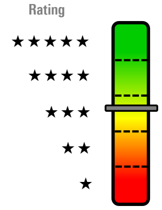
Consumer Technology

Moat Framework Avg. Star Rating

# Companies	Avg. Star Rating	Avg. P/FVE
14	★★★	1.10

Consumer technology companies offer hardware, software, services, and content to a vast audience of users. Consumer electronics and electronic gaming companies attempt to embed switching costs in order to deal with rapidly changing technologies, fickle consumer tastes, and shrinking product lifecycles

Company Star Rating

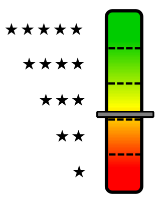


Highlighted Company	Star Rating	P/FVE
Electronic Arts Inc.	★★★	0.99

EA is one of the world's largest third-party video game publishers and has transitioned from a console-based video game publisher to the one of the largest publishers on consoles, PC, and mobile. The firm owns number of large franchises, including Madden, FIFA, Battlefield, Mass Effect, Dragon's Age, and Need for Speed. EA recently signed a 10-year contract with Disney that granted EA the exclusive rights to develop Star Wars games for core gamers across all platforms

Enterprise Services

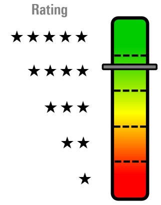
Moat Framework Avg. Star Rating



# Companies	Avg. Star Rating	Avg. P/FVE
20	★★	1.07

The enterprise services category includes IT service providers and advertising agencies, each of which helps reduce a corporation's costs. IT service providers offer everything from high-end consulting to low-end business process outsourcing. Global advertising agency holding companies have hundreds of agencies under one corporate umbrella and can offer corporations services ranging from media buying to public relations.

Company Star Rating

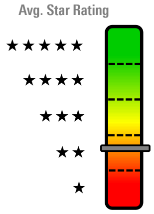


Highlighted Company	Star Rating	P/FVE
WPP PLC	★★★★	0.76

Headquartered in the U.K., WPP is the world's largest ad holding company, based on annual revenues. WPP's services, which include traditional and digital advertising, public relations, and consulting, are provided worldwide, with over 70% of its revenue coming from more developed regions such as the North America, U.K., and Western Europe.

Enterprise Software

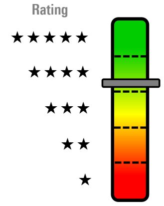
Moat Framework Avg. Star Rating



# Companies	Avg. Star Rating	Avg. P/FVE
45	★★★	1.22

Software firms create, sell, and maintain programs written for mainframes, servers, computers, and other computing devices to help run the device or help the user accomplish a task. Software can be sold as a product (license) or as a subscription-based service. Software companies tend to fall into two main categories: infrastructure and application.

Company Star Rating

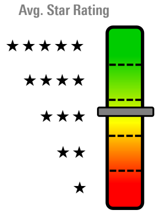


Highlighted Company	Star Rating	P/FVE
ServiceNow	★★★★	0.87

ServiceNow Inc. is a software-as-as-service firm with products to structure and automate various business functions, primarily IT services, for enterprise customers. The company began with IT service management, or ITSM, applications, expanding to IT operations management, or ITOM, and IT business management, or ITBM. ServiceNow has since entered other software verticals such as customer service, HR service delivery, and security operations. These tools are built on the firm's cloud-based Now Platform. ServiceNow reports in two segments: subscription revenue and professional services.

Internet

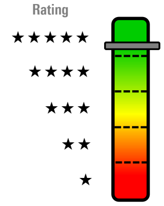
Moat Framework Avg. Star Rating



# Companies	Avg. Star Rating	Avg. P/FVE
23	★★★	0.97

Internet content and information companies operate websites and mobile apps for people to connect to other people, businesses, entertainment, and information. These companies offer free, adsubsidized, or paid services that include messaging, social networking, news and content aggregation, games, e-commerce, and Internet search.

Company Star Rating



Highlighted Company	Star Rating	P/FVE
Tencent Holdings	★★★★★	0.53

Tencent is a Chinese Internet giant with businesses and investments in a large variety of Internet services and contents. Major services include communication and social networking (Weixin/Wechat and QQ), online PC and mobile games, content (news, videos, music, comics and literature), utilities (email, app store, mobile security, and mobile browser), the cloud, and financial technology. Tenpay in Weixin/Wechat and QQ is a payment solution that enables closed-loop transactions in Tencent's ecosystems and has been adopted by many third-party partners and offline merchants.

Source: Morningstar. Data as of Sept. 11, 2018.

Exhibit 3 Hardware Manufacturers and Distributors Framework Valuation Dashboard

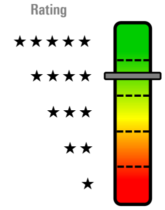
Components

Moat Framework Avg. Star Rating

# Companies	Avg. Star Rating	Avg. P/FVE
7	★★★	0.95

Electronic component suppliers manufacture and sell products used in electronic hardware. Companies may specialize within a specific vertical, like connectors, and often maintain a large portfolio of customizable products with varying degrees of proprietary technology and sell to components distributors, like Avnet or Arrow, and directly to customers.

Company Star Rating



Highlighted Company	Star Rating	P/FVE
Murata	★★★★	0.74

Murata Manufacturing produces passive components for electronic devices. Passive components are necessary for all electronic circuits, used to enable wireless communication, store electricity and handle electric flow, remove electromagnetic noise from circuits, and so on. Thus, passive components are imperative for electronic circuits. For instance, one high-end smartphone contains more than 500 passive components

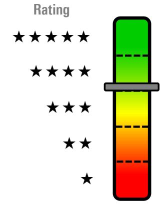
Electronics Distribution

Moat Framework Avg. Star Rating

# Companies	Avg. Star Rating	Avg. P/FVE
2	★★★	0.95

Electronics distributors generate sales from aggregating and transporting products and value-added services such as component testing, design chain consulting, and supply chain management. Global distributors sell electronic components such as semiconductors, interconnects and passives into a broad customer base composed of original equipment manufacturers, electronic manufacturing services, and original design manufacturers.

Company Star Rating

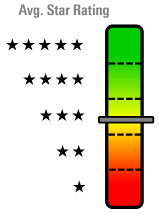


Highlighted Company	Star Rating	P/FVE
Arrow	★★★	0.83

Arrow Electronics is a leading value-added distributor of semiconductors, electronic components, software, and data center infrastructure hardware. The company operates in two segments: global components, which includes the sale of semiconductors, and global enterprise computing solutions, which includes the sale of software, storage, and servers. Arrow primarily serves small to midsize electronic equipment manufacturers and value-added resellers

Enterprise Hardware

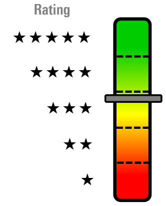
Moat Framework Avg. Star Rating



# Companies	Avg. Star Rating	Avg. P/FVE
20	★★★	1.07

Vendors of enterprise hardware systems sell equipment used to support IT and business operations, including computers, printers, phone systems, servers, data storage, and networking equipment. Vendors in this category range from relatively small firms focused on narrow product suites to large diversified suppliers selling a wide range of products and services to IT departments.

Company Star Rating

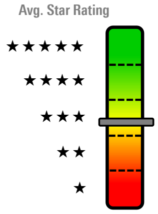


Highlighted Company	Star Rating	P/FVE
Motorola	★★★	0.94

Motorola Solutions is a global communications equipment manufacturer, creating devices such as two-way portable radios, boasting an array of communications network management, and offering support services. The company operates through two segments: products and services. The products segment is composed of radios, batteries, base stations, and consoles, primarily utilized by first responders through government contracts. The services business is composed of integration services, such as infrastructure implementation, and software offerings, such as 911 command center products.

Semiconductors

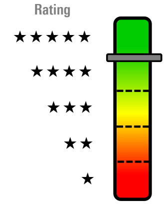
Moat Framework Avg. Star Rating



# Companies	Avg. Star Rating	Avg. P/FVE
26	★★★	1.09

This category includes the companies in the semiconductor supply chain, from suppliers of manufacturing equipment to firms that design and manufacture chip devices. The central driver of the semiconductor industry is its ability to innovate so that computing power increases while the costs of that computing power rapidly decrease--commonly referred to as Moore's law

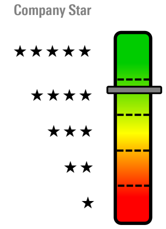
Company Star Rating



Highlighted Company	Star Rating	P/FVE
Intel	★★★★	0.69

Intel is one of the world's largest chipmakers. It designs and manufactures microprocessors and platform solutions for the global personal computer and data center markets. Intel pioneered the x86 architecture for microprocessors. It is also the prime proponent of Moore's law for advances in semiconductor manufacturing. While Intel's server processor business has benefited from the shift to the cloud, the firm has also been expanding into new adjacencies as the personal computer market has declined. These include areas such as the Internet of Things, memory, artificial intelligence, and automotive.

Company Star



Highlighted Company	Star Rating	P/FVE
Microchip	★★★★	0.74

Microchip became an independent company in 1989 when it was spun off from General Instrument. More than half of revenue comes from MCUs, which are used in a wide array of electronic devices from remote controls to garage door openers to power windows in autos. The company's strength lies in lower-end 8-bit MCUs that are suitable for a wider range of less technologically advanced devices, but the firm has expanded its presence in higher-end MCUs and analog chips as well.

Source: Morningstar. Data as of Sept. 11, 2018.

Despite Its Poor Communication, Aegon Does Have a Sound Strategy

Aegon has been a basket case for years, and this has been caused by myriad factors, among them capital, solvency, management, governance, a lack of strategy, and poor earnings visibility. Aegon has scored very poorly across all these metrics at one point or another, if not simultaneously. Suboptimal investor and management communication skills have not helped, with performance targets missed, allegedly resolved problems rearing their heads, and the analyst community not kept up to date with progress and upcoming charges. Further, any semblance of understanding an analyst might gain or feel for the business is continually dashed by ongoing peripheral divestments and acquisitions.

That said, despite the complete lack of communication from management on its vision for the business, there is a sound strategy in place. This has largely been masked by restructuring caused by many of the above issues, the purpose of which (beyond financial) has not been communicated. We think there is a five-year plan that centers on the workplace, and that shows management has a good understanding of the business' long-term purpose. However, the market is still focused on withdrawals and historical problems. In short, we think these have ended or are currently coming to a close. We think that, having largely thrown in the towel for the business, the analyst community will reawaken to Aegon, and this could happen with the release of full-year results for 2018. For now, this is a "show me" story.

As a result, we have a very cheap stock, trading at 0.5 times book, while Aegon returned a comparable 10% ROE at year-end. We estimate the business is actually earning 8%. With shares trading at a nearly 30% discount to our EUR 6.70 fair value estimate, we see sufficient margin of safety while Aegon's consolidation of restructuring and workplace-conversion plans restore investors' faith in the company.

- Aegon is considered a perennial value trap. Our take is that underlying earnings are relatively predictable, and management is almost at the end of its expansive effort to spring-clean the business.
- Divestments and acquisitions are indicative of management's intentions. The hard-to-see strategy makes sense, given Aegon's client base and assets. We think Aegon can start converting assets to earnings crossing divisions of the business, and the market is focusing ineffectively on withdrawals.
- Aegon is our cheapest name in the European insurance space, offering a 28% discount to our fair value estimate. With shares trading at 0.5 times P/B, we think Aegon offers a significant margin of safety.

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Best Ideas

Company and Industry	Morningstar Rating	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price / Fair Value	Market Cap (B)	Analyst
Basic Materials								
Cameco (CCJ)	★★★★★	$17	$9.67	High	Narrow	0.57	3.83	Inton
Compass Minerals International (CMP)	★★★★	$83	$62.9	High	Wide	0.76	2.13	Goldstein
Martin Marietta Materials (MLM)	★★★★	$265	$193.13	High	Narrow	0.73	12.17	Inton
Communication Services								
BT Group (BT.A)	★★★★	GBX 360	GBX 223.8	High	Narrow	0.62	22.21	C. Nichols
China Mobile (941)	★★★★	HKD 100	HKD 76.9	Medium	Narrow	0.77	1574.56	Baker
Comcast (CMCSA)	★★★★	$42	$37.04	Medium	Wide	0.88	169.71	Macker
Telefonica (TEF)	★★★★★	$13	$6.68	High	Narrow	0.51	34.69	C. Nichols
Telstra (TLS)	★★★★	AUD 4.4	AUD 3.19	Medium	Narrow	0.73	37.94	Han
Consumer Cyclical								
Alibaba Group Holding (BABA)	★★★★	$240	$165.53	High	Wide	0.69	425.73	Hottovy
Bayerische Motoren Werke (BMW)	★★★★	EUR 117	EUR 82.47	High	Narrow	0.70	53.59	Hilgert
Expedia Group (EXPE)	★★★★	$185	$130.41	High	Narrow	0.70	19.49	Wasiolek
General Motors (GM)	★★★★	$45	$34.25	High	None	0.76	48.32	Whiston
Hanesbrands (HBI)	★★★★★	$27	$17.57	Medium	Narrow	0.65	6.33	Hottovy
InvoCare (IVC)	★★★★	AUD 17	AUD 12.5	Medium	Wide	0.74	1.38	Ragonese
Mattel (MAT)	★★★★	$21.5	$16.11	High	Narrow	0.75	5.54	Katz
Norwegian Cruise Line Holdings (NCLH)	★★★★	$69	$53.99	High	Narrow	0.78	11.96	Katz
Walt Disney (DIS)	★★★★	$130	$110.67	Medium	Wide	0.85	164.59	Macker
WPP (WPP)	★★★★	GBX 1500	GBX 1125	Medium	Narrow	0.75	14.19	Mogharabi
Consumer Defensive								
G8 Education (GEM)	★★★★★	AUD 3.5	AUD 1.97	High	None	0.56	0.90	James
General Mills (GIS)	★★★★★	$59	$47.59	Low	Wide	0.81	28.36	Vora
Imperial Brands (IMB)	★★★★★	GBX 3700	GBX 2624	Low	Wide	0.71	25.03	Gorham
Kao (4452)	★★★	JPY 8800	JPY 8885	Low	Wide	1.01	4330.73	Wei
Mondelez International (MDLZ)	★★★★	$52	$43.87	Medium	Wide	0.84	64.34	Lash
PepsiCo (PEP)	★★★★	$123	$114.99	Low	Wide	0.93	162.63	Vora
Procter & Gamble (PG)	★★★★	$97	$83.45	Low	Wide	0.86	207.72	Lash
Reckitt Benckiser Group (RB.)	★★★★	GBX 7300	GBX 6506	Low	Wide	0.89	45.99	Gorham
Energy								
Cenovus Energy (CVE)	★★★★	$21	$11.66	Very High	None	0.56	14.33	Gemino
Enbridge (ENB)	★★★★	$64	$44.43	Medium	Wide	0.69	76.22	Gemino
Enterprise Products Partners (EPD)	★★★★	$35.5	$29.07	Low	Wide	0.82	63.25	Ellis
Royal Dutch Shell (RDS.B)	★★★★	$83	$66.86	Medium	Narrow	0.81	268.90	Good
Total (TOT)	★★★★	$77	$62.85	Medium	None	0.82	163.14	Good
Woodside Petroleum (WPL)	★★★★	AUD 46.5	AUD 36.91	High	None	0.79	34.55	Taylor
Financial Services								
Agricultural Bank of China (601288)	★★★★	CNY 4.2	CNY 3.63	High	Narrow	0.86	1257.20	Tan
American International Group (AIG)	★★★★	$76	$52.67	Medium	None	0.69	46.79	Horn
Capital One Financial (COF)	★★★★	$127	$97	Medium	Narrow	0.76	46.41	Plunkett
Credit Suisse Group (CSGN)	★★★★	CHF 22	CHF 14.47	High	Narrow	0.66	36.90	Scholtz

Source: Morningstar. As of Sept. 14, 2018

Best Ideas

Company and Industry	Morningstar Rating	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price / Fair Value	Market Cap (B)	Analyst
Financial Services (cont.)								
Invesco (IVZ)	★★★★★	$35	$23.36	Medium	Narrow	0.67	9.60	Warren
Mitsubishi UFJ Financial Group (8306)	★★★★	JPY 880	JPY 680.6	Medium	None	0.77	8901.35	Wu
Pendal Group (PDL)	★★★★	AUD 11	AUD 9.18	Medium	Narrow	0.83	2.58	Likos
Westpac Banking (WBC)	★★★★	AUD 35	AUD 27.76	Medium	Wide	0.79	94.00	Ellis
Healthcare								
Allergan (AGN)	★★★★★	$263	$190.08	Medium	Wide	0.72	64.52	Waterhouse
McKesson (MCK)	★★★★★	$210	$129.61	Medium	Wide	0.62	25.89	Lekraj
Medtronic (MDT)	★★★★	$105	$96.95	Medium	Wide	0.92	130.93	Wang
Ramsay Health Care (RHC)	★★★★	AUD 76	AUD 54.98	Medium	Narrow	0.72	11.11	Kallos
Roche Holding (ROG)	★★★★★	CHF 337	CHF 238.4	Low	Wide	0.71	203.95	Andersen
Industrials								
Anixter International (AXE)	★★★★★	$107	$70.95	Medium	Narrow	0.66	2.37	Bernard
Beijing Enterprises Holdings (392)	★★★★★	HKD 58	HKD 39.15	Medium	Narrow	0.68	49.41	Song
CK Hutchison Holdings (1)	★★★★	HKD 118	HKD 91.15	Medium	None	0.77	351.50	Tan
G4S (GFS)	★★★★	GBX 337	GBX 233.2	Medium	None	0.69	3.62	Field
GEA Group (G1A)	★★★★★	EUR 47	EUR 30.81	Medium	Wide	0.66	5.56	Molina
General Dynamics (GD)	★★★	$220	$198.57	Medium	Wide	0.90	58.83	Higgins
Grupo Aeroportuario del Pacifico (GAP B)	★★★	MXN 217	MXN 202	High	Wide	0.93	113.32	Higgins
Guangshen Railway (525)	★★★★★	HKD 6.5	HKD 3.28	High	None	0.50	27.33	Song
Johnson Controls International (JCI)	★★★★	$53	$37.94	High	Narrow	0.72	35.09	Bernard
Kion Group (KGX)	★★★★★	EUR 90	EUR 53.56	Medium	Narrow	0.60	6.31	Molina
Royal Philips (PHIA)	★★★	EUR 42	EUR 39.3	Medium	Narrow	0.94	36.61	Vonk
Sodexo (SW)	★★★★	EUR 110	EUR 89.94	Medium	Narrow	0.82	13.10	Field
Stericycle (SRCL)	★★★★	$86	$60.92	High	Narrow	0.71	5.23	Young
Real Estate								
Aveo Group (AOG)	★★★★	AUD 2.8	AUD 2.22	Medium	None	0.79	1.29	Sherlock
Sun Hung Kai Properties (16)	★★★★	HKD 153	HKD 117.2	Medium	Narrow	0.77	339.53	Zhong
Welltower (WELL)	★★★	$74	$67.15	High	None	NA	24.98	Brown
Technology								
Intel (INTC)	★★★★	$65	$45.57	Medium	Wide	0.70	210.12	Davuluri
Microchip Technology (MCHP)	★★★★	$112	$83.77	Medium	Wide	0.75	19.73	Colello
MYOB Group (MYO)	★★★★	AUD 3.82	AUD 2.95	Medium	Narrow	0.77	1.77	James
Synaptics (SYNA)	★★★★	$64	$45.49	Very High	None	0.71	1.61	Davuluri
TDK (6762)	★★★	JPY 12500	JPY 11670	High	None	0.93	1473.28	Ito
Tencent Holdings (700)	★★★★★	HKD 590	HKD 330	High	Wide	0.56	3142.32	Tam
Utilities								
Dominion Energy (D)	★★★★	$84	$72.18	Low	Wide	0.86	47.19	Fishman
Enel (ENEL)	★★★★	EUR 5.7	EUR 4.52	Medium	None	0.79	46.01	Fulop
FirstEnergy (FE)	★★★★	$41	$37.79	Low	Narrow	0.92	18.37	Fishman
Scana (SCG)	★★★★★	$56	$35.48	Medium	Narrow	0.63	5.06	Miller

Source: Morningstar. As of Sept. 14, 2018

Highlighted Stocks

SQM SQM

Morningstar Rating	Industry	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★★	Basic Materials	Stable	USD	55	45.90	High	Narrow	0.83	11.98

Source: Morningstar. As of Sept. 14, 2018

Although the transaction must still be granted court approval, we now assign a 100% chance that the deal will close.

Analyst Note, Sept. 10, 2018

On Sept. 7, Reuters reported that Chilean antitrust regulators have approved the sale of Nutrien's 24% equity stake in SQM to Tianqi Lithium. Nutrien's minority stake in SQM is the last remaining required divestiture as a regulatory condition of the merger between PotashCorp and Agrium that created Nutrien. Although the transaction must still be granted court approval, we now assign a 100% chance that the deal will close, up from 75%, and we expect the transaction to be completed by the end of the year.

In addition to the SQM stake, Nutrien also had to divest minority equity stakes in Israel Chemicals and Arab Potash. Although we increased our assumed probability that the SQM divestiture will close, we continue to estimate that Nutrien will receive roughly $5 billion after taxes and fees from the three equity stake sales. With our outlook unchanged, we maintain our fair value estimates of $65 and CAD 85 per share for narrow-moat Nutrien. Our $55 fair value estimate for narrow-moat SQM is also unchanged. Once the transaction closes, Tianqi Lithium will be able to name three of SQM's eight board members.

As a condition of approval, Tianqi Lithium agreed to not name any of its executives or employees to SQM's board. Chilean regulators required this measure as a means to limit Tianqi's access to commercially sensitive information held by SQM. As we wrote in our May 17 note when the Nutrien-Tianqi transaction was announced, we think Tianqi's ability to influence SQM's actions will be limited. Although SQM may sell lithium to Tianqi's battery business, we would expect transaction prices to be similar to those offered by Albemarle or FMC.

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Anta Sports Products 02020:HK

Morningstar Rating	Industry	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★★★	Consumer	Stable	HKD	55	35.60	Medium	Narrow	0.65	95.58

Source: Morningstar. As of Sept. 14, 2018

The purchase does not change our narrow economic moat rating on Anta, as we believe the company's return on invested capital will remain above the weighted average cost of capital in the next 15 years.

Analyst Note, Sept. 13, 2018
We have updated our valuation model to account for Anta's nonbinding proposal to acquire Amer Sports. Our latest model assumes the acquisition is completed at the start of 2019. Anta's intent to purchase Amer is strategically sound, and given potential synergies between the two businesses, we think its buyout offer is valuation-neutral. We reiterate our fair value estimate of HKD 55 on Anta Sports and encourage investors to focus on the long-term positives coming out of the acquisition.

We are modeling Anta to pay CNY 18.7 billion in cash to obtain 50% of Amer. The company is expected to pick up roughly CNY 12 billion in debt that will carry an interest rate of between 3% and 4%. If the acquisition is successful, we assume a permanent change in Anta's capital structure from 100% to 90% equity, lowering the weighted average cost of capital to 9.5% from 10.0%. Amber Sports will add roughly CNY 24 billion to Anta's top line in 2019 (45% of the combined firm's total) and about CNY 1.4 billion in operating income (17% of consolidated total).

The acquisition of Amer will give Anta a meaningful presence in the global premium sports equipment market. We expect 13 of Amer's brands, which have mainly been mainly U.S. and Europe-centric, to see significant growth from the Asia-Pacific region, especially Greater China. In comparison with Anta's acquisition of Fila back in 2009, brands under Amer are slightly more recognizable for Chinese consumers, as shown by their sales CAGR of 29% over the past five years. With Anta's distribution strengths, we see sales of Amer growing at 9.1% annually over the next five years, in line with Fila China's performance after Anta's takeover. Underlying our revenue growth assumption for Amer is an even stronger sales expansion in Greater China. We see 48% of Amer's top line coming from China by 2028, up from less than 5% in 2017.

Amer brands will further benefit from Anta's scale in raw material sourcing and manufacturing, which should help lift gross margin from 45% to 50%. On the flip side, however, we expect the operating margin for the combined firm will drop to 16% (from 24% in 2017) immediately following the acquisition, before returning to 18% at the end of our 10-year forecast. The purchase does not change our narrow economic moat rating on Anta, as we believe the company's return on invested capital will remain above the weighted average cost of capital in the next 15 years.

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Adient ADNT

Morningstar Rating	Industry	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★★	Consumer	Negative	USD	72	43.06	Very High	Narrow	0.60	3.94

Source: Morningstar. As of Sept. 14, 2018

We continue to think the stock is very undervalued and its problems are fixable.

Analyst Note, Sept. 13, 2018
We are glad to see Adient's CEO search come to an end soon after former chairman and CEO Bruce McDonald left the company on June 11. We are not changing our fair value estimate on news that Doug DelGrosso, 56, will become president and CEO on Oct. 1 and join Adient's board, increasing the number of directors to eight. Interim CEO and director Fritz Henderson will remain on the board and become chairman, while interim chairman John Barth remains on the board. DelGrosso did not come cheap as his salary will be $1.15 million, with a cash bonus of up to 200% of his salary based on yet to be determined metrics by the compensation committee. He will also receive a onetime cash bonus of $1.3 million and long-term equity awards with a target value of $7 million to compensate him for forfeited compensation from his current role as CEO of aluminum and iron cast supplier Chassix, plus another equity award as part of normal annual compensation with a target value of $7.3 million. The value of these stock awards will depend on where Adient's stock trades at a later time.

DelGrosso appears to meet Adient's needs of an executive with extensive operational and manufacturing experience, so we like the hire but specifics on his strategic vision are not known yet. Prior to Chassix he was president and CEO of automotive sealing company Henniges Automotive and spent five years at TRW running its global braking and suspension business. Most relevant to Adient's seating supplier role is DelGrosso spent 20 years at rival seating and electronics supplier Lear, including time as president and COO. He left Lear in 2007 and joined TRW late that year. We like the move as DelGrosso sounds like the operational leader Adient needs right now due to many execution problems in its structures and mechanisms business, and in the core seating segment. We continue to think the stock is very undervalued and its problems are fixable as outlined in our Aug. 17 Stock Strategist report on Morningstar.com.

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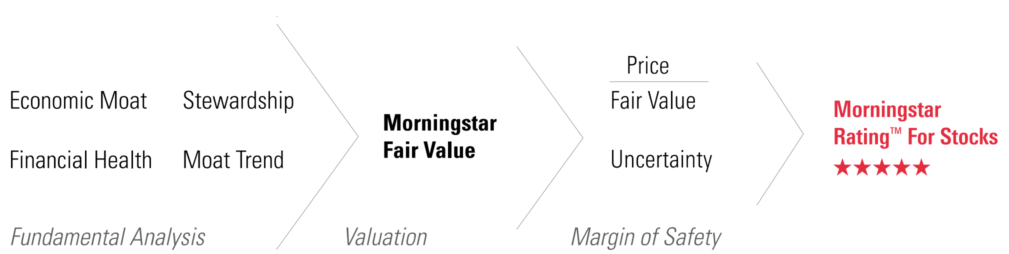
Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss short-term market price movements), but we believe these negatives are mitigated by deep analysis and our long-term approach.

Morningstar's equity research group ("we," "our") believes 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.

Morningstar Research Methodology



Source: Morningstar.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate, and (4) the current market price. This process ultimately culminates in our single-point star rating.

Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for 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. We believe low-quality, no-moat companies will see their normalized returns gravitate toward their cost of capital more quickly than companies with moats.

To assess the sustainability of excess profits, analysts perform ongoing assessments of 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 where we see signs of deterioration.

Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last 5 to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in working capital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested (RONIC)—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market value weights.

Uncertainty Around That Fair Value Estimate

Morningstar's uncertainty rating captures a range of likely potential intrinsic values for a company 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.

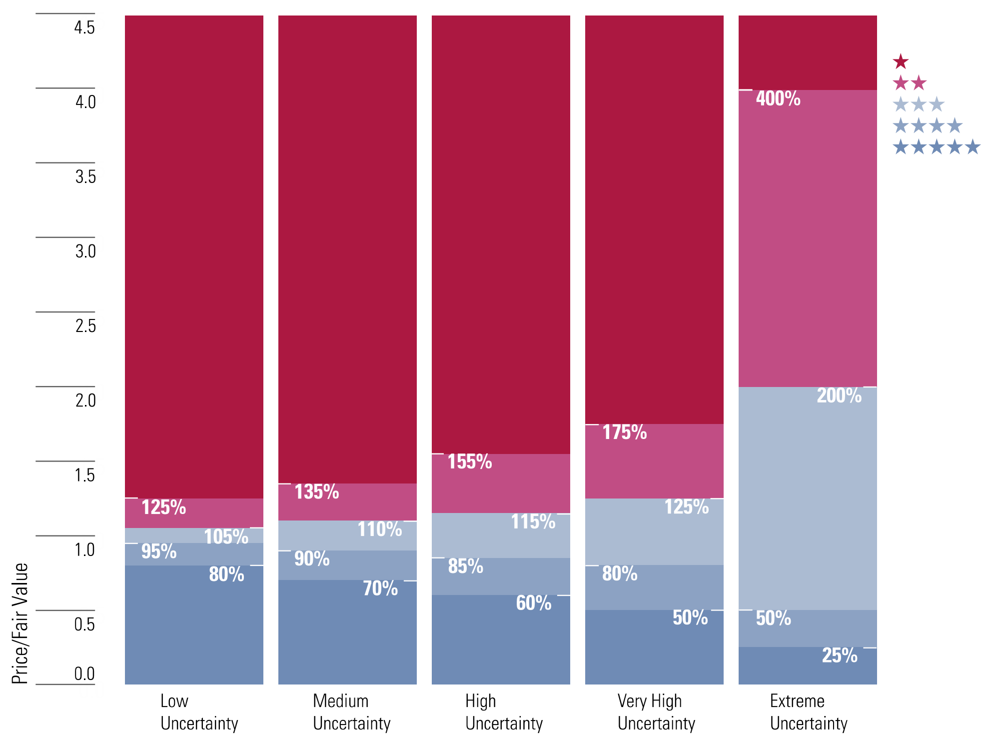
Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate.

Our recommended margin of safety widens as our uncertainty regarding the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

- Low: Margin of safety for 5-star rating is a 20% discount and for 1-star rating is a 25% premium.
- Medium: Margin of safety for 5-star rating is a 30% discount and for 1-star rating is a 35% premium.
- High: Margin of safety for 5-star rating is a 40% discount and for 1-star rating is a 55% premium.
- Very high: Margin of safety for 5-star rating is a 50% discount and for 1-star rating is a 75% premium.
- Extreme: Margin of safety for 5-star rating is a 75% discount and for 1-star rating is a 300% premium.

Morningstar Equity Research Star Rating Methodology



Market Price

The market prices used in this analysis and noted in the report come from the exchange on which the stock is listed, which we believe is a reliable source.

For more details about our methodology, please go to http://global.morningstar.com/equitydisclosures.

Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically recalculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true, the market price will converge on our fair value estimate over time, generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience, and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk-adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to capital loss.

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