Research Highlights

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

Morningstar Equity Research

Nov. 12-16, 2018

Contents

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Management Behind the Moat

Morningstar and PitchBook hosted the 10th annual Management Behind the Moat Conference in Chicago last week, offering our institutional clients an opportunity to engage with the management of 49 public companies we think have structural competitive advantages, or economic moats, as well as two private companies worth watching. Here are some excerpts from company presentations.

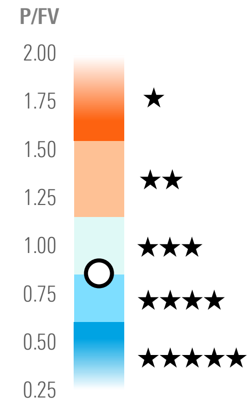
Management Behind the Moat 2018

Presenting companies

Stock Name	Sector	Moat	Market Cap (USD,Bil)	Currency	Price	Fair Value	Morningstar Rating
Anixter International	Industrials	Narrow	2.28	USD	68.05	107.00	★★★★★
AptarGroup	Consumer Cyclical	Narrow	6.55	USD	104.29	86.00	★★
Asbury Automotive Group	Consumer Cyclical	Narrow	1.33	USD	67.96	58.00	★★
Autoliv	Consumer Cyclical	Narrow	7.12	USD	81.75	80.00	★★★
BASF	Basic Materials	Narrow	72.53	USD	19.47	23.00	★★★★
BlackRock	Financial Services	Wide	67.75	USD	413.95	540.00	★★★★
Check Point Software	Technology	Narrow	17.75	USD	112.64	116.00	★★★
Coloplast	Healthcare	Narrow	20.30	DKK	633.40	610.00	★★★
General Mills	Consumer Defensive	Wide	26.50	USD	45.31	58.00	★★★★★
Gentex	Consumer Cyclical	Narrow	5.72	USD	21.83	21.00	★★★
Givaudan	Basic Materials	Wide	22.07	CHF	2406.00	2000.00	★★
Grupo Aeroportuario del Pacifico	Industrials	Wide	4.51	USD	76.81	105.00	★★★★
Iron Mountain	Industrials	Narrow	9.38	USD	32.77	36.50	★★★★
Las Vegas Sands	Consumer Cyclical	Narrow	40.82	USD	52.09	70.00	★★★★
Magellan Midstream Partners	Energy	Wide	14.28	USD	62.56	72.00	★★★★
Millicom International Cellular	Communication Svcs.	Narrow	5.92	USD	58.75	86.00	★★★★
MSC Industrial Direct	Industrials	Narrow	4.86	USD	87.13	100.00	★★★★
Novozymes	Healthcare	Wide	14.73	DKK	331.30	285.00	★★
NTT DoCoMo	Communication Svcs.	Narrow	80.75	USD	22.26	22.00	★★★
Penske Automotive Group	Consumer Cyclical	Narrow	3.74	USD	44.12	40.00	★★★
Republic Services	Industrials	Wide	24.26	USD	74.74	59.00	★★
Singapore Exchange	Financial Services	Narrow	5.59	SGD	7.19	8.40	★★★★
STMicroelectronics	Technology	None	13.53	USD	14.81	22.00	★★★★
Veoneer	Consumer Cyclical	Narrow	2.97	USD	34.08	24.00	★★
Wesco International	Industrials	Narrow	2.50	USD	53.46	87.00	★★★★★
Wyndham Hotels & Resorts	Consumer Cyclical	Narrow	4.74	USD	47.78	72.00	★★★★★

Source: Morningstar.
All data as of Nov. 9, 2018.

Company (Ticker)		Rating
Basf SE (BASFY)		★★★★
Price	Fair value	P/FV
USD 19.47	USD 23	0.85
Economic Moat	Moat Trend	Uncertainty
Narrow	Stable	High
Market Cap (Bil)	Stewardship	Analyst
USD 72.53	Standard	Hales



Source: Morningstar. Data as of November 9, 2018

Speaker: Alex Sokolowski, Director, Investor Relations
Morningstar Analyst: Rob Hales, CFA | rob.hales@morningstar.com

One Key Question We Asked

While we observe the switching costs and intangible assets moat sources in BASF's business model, a cost advantage from the company's massive Verbund chemical complexes is the primary moat source. We wanted further details on how the Verbund process creates a durable competitive advantage.

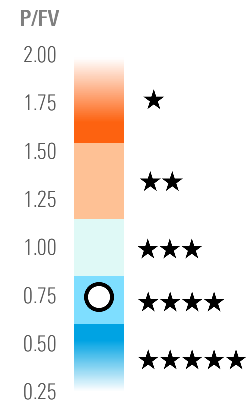
What We Heard

The Verbund process allows BASF to produce everything from upstream to downstream chemicals at one location. Upstream basic chemicals are fed directly into downstream conversion plants through a piping system. Further, waste products from some plants are used to produce products at other plants, and the heat emitted by some processes is used to generate electricity for other processes. This reduces overall production costs by eliminating transportation expenses and reducing electricity costs. As a result, BASF is able to save $1 billion per year in operating expenses using its Verbund process.

Valuation Assumptions and Outlook

Our BASF fair value estimate is $23 per share. Overall, we expect operating income to be largely flat over our forecast period. The chemicals segment hit peak margins in 2017 as a result of supply disruptions in isocyanates, which caused sharp price increases for these products and strong demand for petrochemicals, leading to wider cracker margins. However, significant new cracker capacity is coming on line in the U.S., and we see disruptions in the isocyanate market normalizing in the near term. Lower prices in the chemicals segment will benefit the downstream businesses in the performance products and functional materials and solutions segments, enabling increased margins. However, we expect low-single-digit volume growth in these segments due to a weakening trend in global economic growth. In agriculture, weak agricultural markets look poised to continue in the near term, but a strong pipeline of new products should drive positive results in the medium term.

Company (Ticker)		Rating
Las Vegas Sands Corp (LVS)		★★★★
Price	Fair value	P/FV
USD 52.09	USD 70	0.74
Economic Moat	Moat Trend	Uncertainty
Narrow	Stable	High
Market Cap (Bil)	Stewardship	Analyst
USD 40.82	Standard	Wasiolek



Source: Morningstar. Data as of November 9, 2018

Speaker: Daniel Briggs, SVP, Investor Relations
Morningstar Analyst: Dan Wasiolek | dan.wasiolek@morningstar.com

One Key Question We Asked

Las Vegas Sands holds one of only six Macau gaming licenses, supporting its brand intangible asset advantage. This license is up for renewal in 2022. We asked Sands what it has done to place it in a position to receive a renewal.

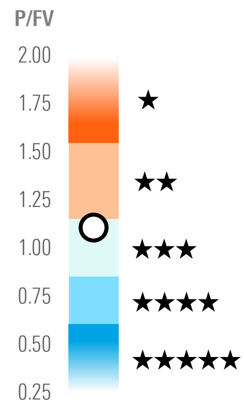
What We Heard

Las Vegas Sands is in a position to have its Macau gaming license renewed in 2021, ahead of the June 2022 expiration date, supporting its brand intangible asset advantage, the source of its narrow moat. The company has delivered on its commitment to the Macau and Chinese governments to build world-renowned integrated resorts, witnessed by the $13 billion in capital expenditure investment to date. Further, Las Vegas Sands recently announced plans to expand its investment to build out additional nongaming floor space at its Macau facilities over the next few years that will take its total expenditure in the region to $15 billion, buoying its good standing with the government, leading to a strong likelihood of a license extension.

Valuation Assumptions and Outlook

Our Las Vegas Sands fair value estimate is $70. We view Las Vegas Sands as well-positioned for long-term growth in the gaming industry because of the attractive long-term growth opportunity of Macau (56% of 2018 EBITDA) and Sands' dominant mass and nongaming position on the attractive Cotai Strip. Sands' position in the profitable Singapore gaming market (34% of EBITDA) solidifies our view of the firm's long-term growth, as does our expectation of the company being awarded a gaming license in a Japanese urban market around the end of 2020. Our forecast calls for 6%-7% average annual sales growth over the next 10 years, with operating margins expanding to 33% in 2027 from 27% in 2017.

Company (Ticker)		Rating
Penske Automotive Group Inc (PAG)		★★★
Price	Fair value	P/FV
USD 44.12	USD 40	1.10
Economic Moat	Moat Trend	Uncertainty
Narrow	Stable	High
Market Cap (Bil)	Stewardship	Analyst
USD 3.74	Standard	Whiston



Source: Morningstar. Data as of November 9, 2018

Speaker: Anthony Pordon, EVP, Investor Relations and Corporate Development
Morningstar Analyst: David Whiston | david.whiston@morningstar.com

One Key Question We Asked

Dealers are facing disruption from e-commerce, subscriptions, autonomous vehicles, and more entrants into used vehicles. We wanted to know how Penske will deal with the rise of AVs and whether they'll be a threat to private vehicle ownership. Another dealer, AutoNation, has a service agreement with Waymo for Waymo's AVs, and we have been wondering if other public dealers will follow suit. We also wanted to know if Penske has changed its mind about waiting on the sidelines for doing vehicle subscriptions.

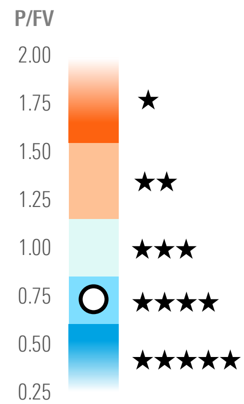
What We Heard

Penske Automotive Group doesn't think that private vehicle ownership is going away anytime soon. In an AV world, Penske believes that dealers will not only survive but succeed through the higher-margin service segment that makes up nearly half of gross profit. Automakers do not have the ability to service the increasingly technologically complex vehicles that AVs would bring into the market because they outsource service to dealers already. Dealers are well-positioned to service customers, and Pordon is confident that the company will be a leader in the industry should AV adoption proliferate. Pordon also highlighted plans to remain on the sidelines with vehicle subscription models, which are currently unprofitable for automakers.

Valuation Assumptions and Outlook

Our Penske Automotive Group fair value is $40. We expect a decline in new-vehicle vehicle sales in the U.S. through 2020 and model a midcycle operating margin, including floorplan interest, in 2022 of 2.5%. Our midcycle margin reflects our expectation of margins of between 2% in bad times and about 3% in good times. We forecast revenue to increase 3% on a five-year compound annual growth rate basis, including the boost we expect from acquisitions. We model the operating margin, including floorplan interest expense, to average 2.2% during our five-year explicit forecast period.

Company (Ticker)		Rating
Grupo Aeroportuario del Pacifico (PAC)		★★★★
Price	Fair value	P/FV
USD 76.81	USD 105	0.73
Economic Moat	Moat Trend	Uncertainty
Wide	Stable	High
Market Cap (Bil)	Stewardship	Analyst
USD 4.51	Standard	Higgins



Source: Morningstar. Data as of November 9, 2018

Speaker: Saúl Villarreal García, CFO
Morningstar Analyst: Chris Higgins | chris.higgins@morningstar.com

One Key Question We Asked

The election of Andrés Manuel López Obrador as Mexico's next president has thrown the future of Mexico City's desperately needed new airport—which isn't operated by Pacifico but does provide connecting flights to the company's airports—into doubt. The election has also increased the uncertainty around Mexico's economic policy and called into question Pacifico's concessions. We were eager to hear from Pacifico CFO Saúl Villarreal García about what he thought a cancellation of the new Mexico City airport and the election of Obrador means for the company.

What We Heard

The CFO believes that Pacifico's primary airports won't be affected by the cancellation of the Mexico City airport's construction; we concur, since Pacifico's tourist airports (Puerto Vallarta and Los Cabos) rely on direct flights. Moreover, we also agree with management that Guadalajara could serve as a second hub in Mexico. Although the CFO didn't mention it, we think Pacifico's smaller airports rely on Mexico City connections, so we expect an impact, albeit immaterial. Separately, the CFO doesn't believe Pacifico's concessions will fundamentally change. However, he did mention that Obrador's administration plans an audit.

Valuation Assumptions and Outlook

Our fair value estimate for Pacifico is $105 per share (MXN 210 for local shares). Going into the referendum held by Mexico's president-elect, we had already trimmed our traffic forecasts at Pacifico's smaller airports since they rely heavily on connecting traffic through Mexico City. In addition, we continue to assume zero air traffic growth in 2020 and margin compression to simulate a potential slowdown in the Mexican economy. As such, we're maintaining our annualized revenue growth forecast of 8.4% from 2018-22, and our midcycle margins remain unchanged at roughly 55%. Lastly, we're standing by our view that Obrador won't drastically alter Pacifico's concessions.

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New Coverage in Healthcare and Energy

We're adding two companies to our coverage list: a biotech supplier in the healthcare sector and an exploration and production company in the energy sector.

Bio-Techne TECH | ★★

Bio-Techne is a Minnesota-based biotechnology supplier to the life sciences and diagnostics industry, and we've assigned it a narrow, stable moat rating. Our fair value estimate of $122 per share implies a forward price/earnings multiple of 27, and at current prices, we think shares are modestly overvalued.

Bio-Techne supplies proteins, antibodies, assays, diagnostic tests, controls, and calibrators primarily to the academic research, biopharma, and clinical diagnostics markets. We think it possesses a narrow moat, mostly through intangibles and switching costs. In its legacy biotech segment, the company's large and high-quality portfolio of sophisticated biotech products creates loyalty among researchers that run sensitive and valuable tests. This segment shows clear evidence of pricing power, with a segment gross and operating margin near 80% and 50%, respectively. The protein platform and diagnostic product lines also benefit from switching costs thanks to installed bases of instruments that have a recurring revenue stream of consumables.

Thanks in part to recent acquisitions of high-growth businesses, we model a 10% compound annual growth rate due to stable mid-single-digit growth in the company's legacy biotechnology and diagnostic segments. We anticipate sustainable double-digit growth from recent acquisitions like ACD and Exosome Diagnostics as well as ongoing market penetration of the company's protein characterization instruments.

Returns on capital have declined over the past few years as the company has embarked on a more aggressive merger and acquisition strategy to broaden its product offerings, enter higher-growth markets, and move up-market into more proprietary instruments and associated consumables. As these new business lines gain from operating leverage, we forecast adjusted operating margin gradually recovering back to above 40% by 2023.

Bulls Say

- Bio-Techne's capital allocation and strategic initiatives have focused the company on higher-growth markets where it's a niche player facing limited competition.
- Bio-Techne's biotechnology products tend to have very long lives once they become established in the market, which supports this segment's very high profitability.
- The company's very high product quality generates consistent customer loyalty and brand recognition.

Bears Say

- Bio-Techne's biotech division competes in highly fragmented markets. Competitive pressure could increase as more companies develop higher-quality and more-sophisticated biotech manufacturing capabilities.

- Bio-Techne's shift into proprietary equipment and diagnostic tests could put the company on competitive paths with larger and well-funded peers. Smaller players can quickly become displaced.
- The company's acquisition strategy has hurt returns on capital. Poor integration, asset overpayment, or market size miscalculations could permanently depress returns.

Devon Energy DVN | ★★★

We are initiating coverage of Devon Energy with a fair value estimate of $32 per share and a no-moat rating. We think shares look fairly valued. Devon holds acreage across a variety of U.S. shale plays, but its key shale assets are in the Delaware portion of the Permian Basin and in the STACK oil play in western Oklahoma. In addition to shale assets, Devon owns heavy oil operations in the Athabasca sands of Canada.

We view the company's position in the Delaware as its most promising asset. Devon holds a long-lived inventory of drilling opportunities in the attractive basin, having identified 6,500 gross risked drilling locations. In the STACK, a less mature play, Devon seems to be still working out the kinks in its development plan, namely spacing, but the company isn't that far away from entering full-field development mode. Delaware and STACK assets should drive a more than 15% compound annual growth rate for Devon's U.S. oil production to the end of the decade.

Growth prospects are less compelling in other parts of the portfolio, but the Canadian oil sands operations in particular should deliver solid cash flow that can be deployed in other areas. The company sold its midstream operations recently for $3 billion and is in the midst of a $4 billion share repurchase plan. The balance sheet is solid, and Devon pays a modest dividend. Devon has targeted further noncore asset sales by the end of the year, and we wouldn't be surprised to see anything other than the Delaware and STACK assets sold.

Despite what looks like an attractive slate of future investment options in the Delaware and STACK, Devon is unlikely to generate returns on capital that would exceed costs of capital at our midcycle oil and gas prices of $55/barrel WTI and $3/mcf Henry Hub, respectively. Like many of its oil and gas exploration and production peers, we believe Devon invested too much capital under the assumption that oil and gas prices would considerably exceed our midcycle forecasts.

Bulls Say

- Devon is focused on driving per barrel operating cost savings. For example, the company expects a meaningful reduction in unit lifting costs by the end of the decade.
- As Devon moves into "factory development" mode in the Delaware and eventually the Stack, the company should realize well cost savings per barrel of oil produced.
- The majority of Devon's U.S. oil production has access to Gulf Coast markets, reducing exposure to depressed in-basin Permian oil prices.

Bears Say

- The company's Canadian cash flows are suffering from high price differentials between WTI and Western Canadian Select due to a current lack of infrastructure to move heavy oil out of Canada.
- Despite what look like some attractive investment opportunities, returns on capital at the company level are unlikely to eclipse costs of capital without a return to heady commodity prices, owing to a large capital base.
- With essentially flat production from assets in Canada, Devon's production growth will likely lag those of peers focused exclusively on U.S. shale assets.

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Covestro Has More Room to Fall

Covestro shares had a remarkable run. Between the initial public offering in late 2015 and early 2018, the stock price quadrupled as unprecedented supply disruptions in the company's key polyurethane market led to record-breaking prices and a doubling of group EBITDA. The tide has now turned. The shares are down 40% from their peak due to falling polyurethane prices (for MDI and TDI, specifically) and concerns about global growth.

Is this a buying opportunity? We don't think so. The stock has more room to fall, with nearly 20% downside from here to our EUR 47 fair value estimate. In our view, the market is underestimating the coming price and margin correction in the polyurethane division as industry production disruptions in MDI and TDI fade; this causes our 2019 and 2020 EBITDA estimates for Covestro to be 16% and 23% below consensus, respectively. In the longer term, we think demand growth for MDI and TDI will disappoint market expectations, given our more conservative view on demand coming from construction and housing-related markets in China.

This industry/country combination is the most important for Covestro's polyurethane business, given that 60% of the company's polyurethane sales are destined for construction and housing-related end markets and 22% of group sales go to China. With lower expectations for demand growth, we expect the MDI and TDI industries to become oversupplied, which contrasts with consensus expectations for a continued tight supply/demand balance.

- Consensus expects Covestro's EBITDA to fall in 2019. We agree with the direction but disagree with the magnitude of the decline. Our 2019 EBITDA estimate is 16% below consensus mainly because of lower margins.
- The market expects the MDI and TDI industries to remain tight in the long term, assuming announced capacity additions will fail to keep up with continued robust demand. We disagree due to more-conservative expectations on the demand side. Indeed, we forecast the MDI and TDI markets to become oversupplied.
- We expect EBITDA to decline 10% per year, on average, over our five-year forecast period compared with 34% average annual growth in the last four years.

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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)	★★★★	$19.5	$11.88	High	Narrow	0.61	4.49	Inton
Compass Minerals International (CMP)	★★★★	$81	$51.59	High	Wide	0.64	1.75	Goldstein
Martin Marietta Materials (MLM)	★★★★	$250	$188.72	High	Narrow	0.75	11.84	Inton
Communication Services								
BT Group (BT.A)	★★★★	GBX 360	GBX 254.9	High	Narrow	0.71	25.60	C. Nichols
China Mobile (941)	★★★★	HKD 97	HKD 76.85	Medium	Narrow	0.79	1573.54	Baker
Comcast (CMCSA)	★★★★	$42	$38.49	Medium	Wide	0.92	174.20	Macker
Telefonica (TEF)	★★★★★	$13	$7.49	High	Narrow	0.58	38.93	C. Nichols
Telstra (TLS)	★★★★	AUD 4.4	AUD 3.04	Medium	Narrow	0.69	36.16	Han
Vodafone Group (VOD)	★★★★	$250	$155.4	High	Narrow	0.62	42.10	C. Nichols
Consumer Cyclical								
Alibaba Group Holding (BABA)	★★★★	$240	$156.22	High	Wide	0.65	386.92	Hottovy
Bayerische Motoren Werke (BMW)	★★★★	EUR 117	EUR 74.2	High	Narrow	0.63	48.32	Hilgert
Expedia Group (EXPE)	★★★★	$180	$119.75	High	Narrow	0.67	18.16	Wasiolek
General Motors (GM)	★★★★	$45	$35.55	High	None	0.79	49.72	Whiston
Hanesbrands (HBI)	★★★★★	$27	$15.67	Medium	Narrow	0.58	5.65	Swartz
InvoCare (IVC)	★★★★	AUD 16	AUD 12.07	Medium	Wide	0.75	1.33	Ragonese
Mattel (MAT)	★★★★	$21	$13.65	High	Narrow	0.65	4.58	Katz
Norwegian Cruise Line Holdings (NCLH)	★★★★	$69	$50.44	High	Narrow	0.73	11.02	Katz
Walt Disney (DIS)	★★★★	$130	$117.11	Medium	Wide	0.90	174.19	Macker
WPP (WPP)	★★★★★	GBX 1450	GBX 865.4	Medium	Narrow	0.60	10.87	Mogharabi
Consumer Defensive								
A2 Milk (ATM)	★★★★	AUD 14.6	AUD 10.17	High	Narrow	0.70	7.47	Fleck
Anheuser-Busch InBev (BUD)	★★★★★	$118	$77.23	Low	Wide	0.65	146.89	Gorham
G8 Education (GEM)	★★★★	AUD 3.5	AUD 2.84	High	None	0.81	1.29	James
General Mills (GIS)	★★★★★	$58	$45.23	Low	Wide	0.78	26.97	Vora
Imperial Brands (IMB)	★★★★★	GBX 3700	GBX 2603.5	Low	Wide	0.70	24.86	Gorham
Kao (4452)	★★★★	JPY 8800	JPY 8015	Low	Wide	0.91	3856.18	Wei
Mondelez International (MDLZ)	★★★★	$52	$43.94	Medium	Wide	0.85	63.62	Lash
PepsiCo (PEP)	★★★★	$122	$116.8	Low	Wide	0.96	164.87	Vora
Procter & Gamble (PG)	★★★★	$97	$93.83	Low	Wide	0.97	232.92	Lash
Energy								
Cenovus Energy (CVE)	★★★★	$21	$10.94	Very High	None	0.52	13.25	Gemino
Enbridge (ENB)	★★★★★	$62	$42.55	Medium	Wide	0.69	77.91	Gemino
Enterprise Products Partners (EPD)	★★★★★	$35.5	$26.65	Low	Wide	0.75	58.17	Ellis
Royal Dutch Shell (RDS.B)	★★★★	$83	$63.78	Medium	Narrow	0.77	256.27	Good
Total (TOT)	★★★★	$77	$57.13	Medium	None	0.74	148.84	Good
Woodside Petroleum (WPL)	★★★★	AUD 46.5	AUD 33.02	High	None	0.71	30.91	Taylor
Financial Services								
Agricultural Bank of China (601288)	★★★	CNY 4.2	CNY 3.6	High	Narrow	0.86	1248.24	Tan
Altaba (AABA)	★★★★	$98	$64.39	High	None	0.66	37.53	Mogharabi
American International Group (AIG)	★★★★★	$76	$42.69	Medium	None	0.56	37.10	Horn
BlackRock (BLK)	★★★★	$540	$406.88	Medium	Wide	0.75	63.79	Warren

Source: Morningstar. As of Nov. 16, 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, Continued								
Capital One Financial (COF)	★★★★	$127	$89.16	Medium	Narrow	0.70	42.23	Plunkett
Credit Suisse Group (CSGN)	★★★★★	CHF 22	CHF 12.38	High	Narrow	0.56	31.60	Scholtz
Link Administration Holdings (LNK)	★★★★	AUD 8.5	AUD 7.52	Medium	Narrow	0.88	3.98	James
Macquarie Group (MQG)	★★★	AUD 135	AUD 119	Medium	Narrow	0.88	40.85	Ellis
Pendal Group (PDL)	★★★★	AUD 11	AUD 8.2	Medium	Narrow	0.75	2.61	Likos
Westpac Banking (WBC)	★★★★	AUD 33	AUD 25.27	Medium	Wide	0.77	86.65	Ellis
Healthcare								
Allergan (AGN)	★★★★★	$245	$159.37	Medium	Wide	0.65	53.75	Waterhouse
McKesson (MCK)	★★★★★	$210	$127.47	Medium	Wide	0.61	24.90	Lekraj
Medtronic (MDT)	★★★★	$110	$92.77	Medium	Wide	0.84	125.53	Wang
Roche Holding (ROG)	★★★★★	CHF 333	CHF 250.3	Low	Wide	0.75	213.75	Andersen
Industrials								
Anixter International (AXE)	★★★★★	$107	$69.16	Medium	Narrow	0.65	2.32	Bernard
Beijing Enterprises Holdings (392)	★★★★	HKD 58	HKD 44	Medium	Narrow	0.76	55.53	Song
CK Hutchison Holdings (1)	★★★★★	HKD 118	HKD 81.5	Medium	None	0.69	314.28	Tan
G4S (GFS)	★★★★★	GBX 337	GBX 183.45	Medium	None	0.54	2.86	Field
GEA Group (G1A)	★★★★★	EUR 45	EUR 26.01	Medium	Wide	0.58	4.73	Molina
General Dynamics (GD)	★★★★	$216	$182.34	Medium	Wide	0.84	54.00	Higgins
Grupo Aeroportuario del Pacifico (GAP B)	★★★★	MXN 210	MXN 144.01	High	Wide	0.69	82.43	Higgins
Guangshen Railway (525)	★★★★★	HKD 6.3	HKD 3.04	High	None	0.48	25.05	Song
Johnson Controls International (JCI)	★★★★	$46	$33.52	High	Narrow	0.73	31.00	Bernard
Kion Group (KGX)	★★★★★	EUR 90	EUR 51.26	Medium	Narrow	0.57	6.12	Molina
Sodexo (SW)	★★★★	EUR 110	EUR 93.06	Medium	Narrow	NA	13.55	Field
Stericycle (SRCL)	★★★★★	$83	$46.06	High	Narrow	0.55	4.17	Young
Real Estate								
Aveo Group (AOG)	★★★★	AUD 2.3	AUD 1.62	Medium	None	0.70	0.94	Sherlock
Sun Hung Kai Properties (16)	★★★★★	HKD 153	HKD 106.6	Medium	Narrow	0.70	308.82	Zhong
Welltower (WELL)	★★★	$72	$69.49	Medium	None	0.97	26.10	Brown
Technology								
Applied Materials (AMAT)	★★★★	$49	$35.02	High	Wide	0.71	34.42	Davuluri
Intel (INTC)	★★★★	$65	$48.11	Medium	Wide	0.74	214.92	Davuluri
KLA-Tencor (KLAC)	★★★★	$128	$94.44	High	Wide	0.74	14.13	Davuluri
Lam Research (LRCX)	★★★★	$185	$146.4	High	Narrow	0.79	22.15	Davuluri
Microchip Technology (MCHP)	★★★★★	$112	$75.35	Medium	Wide	0.67	17.03	Colello
Murata Manufacturing (6981)	★★★★	JPY 24000	JPY 16075	High	Narrow	0.67	3589.12	Ito
Tencent Holdings (700)	★★★★★	HKD 499	HKD 290.4	High	Wide	0.58	2764.68	Tam
Utilities								
Dominion Energy (D)	★★★★	$84	$73.45	Low	Wide	0.87	48.12	Fishman
Enel (ENEL)	★★★★	EUR 5.7	EUR 4.45	Medium	None	0.78	45.69	Fulop
FirstEnergy (FE)	★★★★	$41	$38.82	Low	Narrow	0.95	19.85	Fishman
Orsted (ORSTED)	★★★	DKK 450	DKK 454.2	Low	Narrow	1.01	190.78	Fulop
Scana (SCG)	★★★★	$56	$42.28	Medium	Narrow	0.76	6.03	Miller

Source: Morningstar. As of Nov. 16, 2018

Highlighted Stocks

Orsted ORSTED:DK

Morningstar Rating	Sector	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★	Utilities	Stable	DKK	450	451	Low	Narrow	1.00	190.78

Source: Morningstar. As of Nov. 16, 2018

We have raised our stewardship rating from Standard to Exemplary because of Orsted's best-in-class capital allocation and its excellent track record of delivering incremental value from projects.

Select Report, Nov. 12, 2018
The market seems a bit skeptical of Orsted's ability to continue creating significant value from future offshore wind projects because of concerns of declining subsidies and a lack of visibility on new projects' economics, especially in Taiwan and on the U.S. East Coast. We anticipate that the company will increasingly emphasize these projects, possibly as soon as its Nov. 28 capital market day, and that detailed information and the attractive economics of these projects will help alleviate the market's concerns. Based on our market analysis, we've built a net present value for every new project and estimate that Orsted will achieve a weighted average internal rate of return of 12% on these projects, creating significant value.

In June, Orsted initiated the divestment process of its Danish distribution and retail businesses. In line with recent comparable transactions, we believe the selling price will imply a significant premium to the implicit value of this business. Accordingly, we incorporate this premium into our fair value estimate.

Last but not least, management hints that this premium will be returned to shareholders.

- Future projects' value and premium of the sale of Danish and distribution activities have led us to increase our fair value estimate to DKK 450 from DKK 430 per share.
- We have raised our stewardship rating from Standard to Exemplary because of Orsted's best-in-class capital allocation and its excellent track record of delivering incremental value from projects, as shown by the recent farm-down of Hornsea 1.
- In addition to its Exemplary stewardship rating and appealing risk/reward, Orsted has a narrow moat and boasts one of the highest returns on capital under our coverage, which has led us to add Orsted to our Best Ideas list.

Tancrede Fulop, CFA | tancrede.fulop@morningstar.com

Maersk MAERSK B:DK

Morningstar Rating	Sector	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★★	Industrials	Stable	DKK	12,000	8,770	High	None	0.73	174.45

Source: Morningstar. As of Nov. 16, 2018

The company has in the past two years become a focused transport business, has shored up its balance sheet significantly, and should be in a good position to return significant amounts of cash to shareholders over the next few years.

Analyst Note, Nov. 14, 2018

Shipping giant Maersk delivered a solid third-quarter update, with like-for-like revenue up 12% year over year and EBITDA up 16%, as a combination of a more supportive macroeconomic environment, weak comparatives, and an element of self-help drove performance. These results were broadly in line with our full-year expectations and as such we do not expect to make any material changes to our forecasts. We reiterate our no-moat rating and DKK 12,000 fair value estimate. We see an attractive upside opportunity from the current share price.

Ocean, Maersk's primary business, which generates over 70% of group revenue, saw volume growth of 5% over the period, almost twice the market level. EBITDA margins of 12.6% were a solid achievement given the huge ramp-up in bunker fuel costs in 2018. Maersk's swift action on this—introducing a fuel surcharge from the end of the second quarter—helped recover some of this increased cost. However, the situation remains tenuous, with fuel costs still rising. We believe the supply/demand picture for ocean freight for the next few years to be supportive of the business, with Maersk reporting no new vessel orders placed in the quarter and no deliveries expected before 2020. The other material businesses in the group, logistics and services, and terminals and towage, registered much-improved results year over year, with margins in the latter improving further to 20.5% as the added bulk of Hamburg Sud to the ocean freight business has led to greater throughput in the terminals business.

Longer term, we believe the Maersk story to be an attractive one. The company has in the past two years become a focused transport business, has shored up its balance sheet significantly, and should be in a good position to return significant amounts of cash to shareholders over the next few years.

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Infineon Technologies IFNNY

Morningstar Rating	Industry	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★★	Technology	Stable	USD	25	19.58	High	Narrow	0.78	22.79

Source: Morningstar. As of Nov. 16, 2018

Infineon's power semis are crucial components in electric vehicles, and the firm's results may provide investors with the best evidence yet that the automotive story for chipmakers is far more about rising content per vehicle rather than car unit sales growth.

Analyst Note, Nov. 12, 2018

Infineon reported strong fiscal fourth-quarter results and provided investors with an impressive forecast for fiscal 2019 in light of recent sluggishness in near-term chip demand. Infineon appears to be well-positioned within pockets of healthy demand and believes it is on pace to outperform many of its U.S.-based peers in the months ahead. We are raising our fair value estimate for narrow-moat Infineon to $25 per ADR from $23, mainly due to the time value of money as we roll our valuation model, but also in light of the firm's relatively bright near-term outlook that was ahead of our prior expectations. Shares fell about 8% after the earnings report, perhaps as part of a broader tech sell-off, but we think the dip is providing long-term investors with a near-term buying opportunity for an industry leader in power semis with strong secular growth tailwinds in the automotive and industrial sectors, in particular.

Revenue in the September quarter was EUR 2.5 billion, up 5% sequentially, up 12% year over year, and above the high end of the firm's previous guidance of 1%-5% sequential growth. Despite weakness in car sales in China and Europe, Infineon's automotive chip business held up well, up 4% sequentially and 18% year over year. The firm noted strength in China electric vehicle car sales, running counter to soft sales of gas-powered cars in the region. Power management sales were up 12% sequentially and 14% year over year with broad-based demand. Higher sales levels enabled adjusted operating margins to rise 120 basis points sequentially to 19.5%. Infineon expects revenue in the December quarter to fall 2%-6% sequentially, although sales would still be up 11% year over year at the midpoint, in contrast to modest growth expected by U.S. rivals in the months ahead. For fiscal 2019 (ending September), Infineon expects revenue to rise 9%-13% sequentially.

Infineon's near-term sales appear to be pinpointed at areas of automotive and industrial chip demand that have been immune (at least thus far) to sluggish business conditions. As an example, China car sales were down 10% in September, but EV sales were up 55% in the same month, management said. Infineon's power semis are crucial components in EVs, and the firm's results may provide investors with the best evidence yet that the automotive story for chipmakers is far more about rising content per vehicle rather than car unit sales growth. Similarly, China's focus on electric train networks and renewables has still supported demand for Infineon's power semis despite a likely downturn in overall GDP growth in the region.

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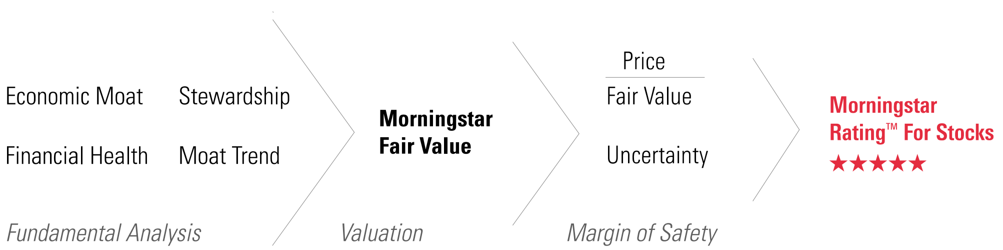
Research Methodology for Valuing Companies

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.

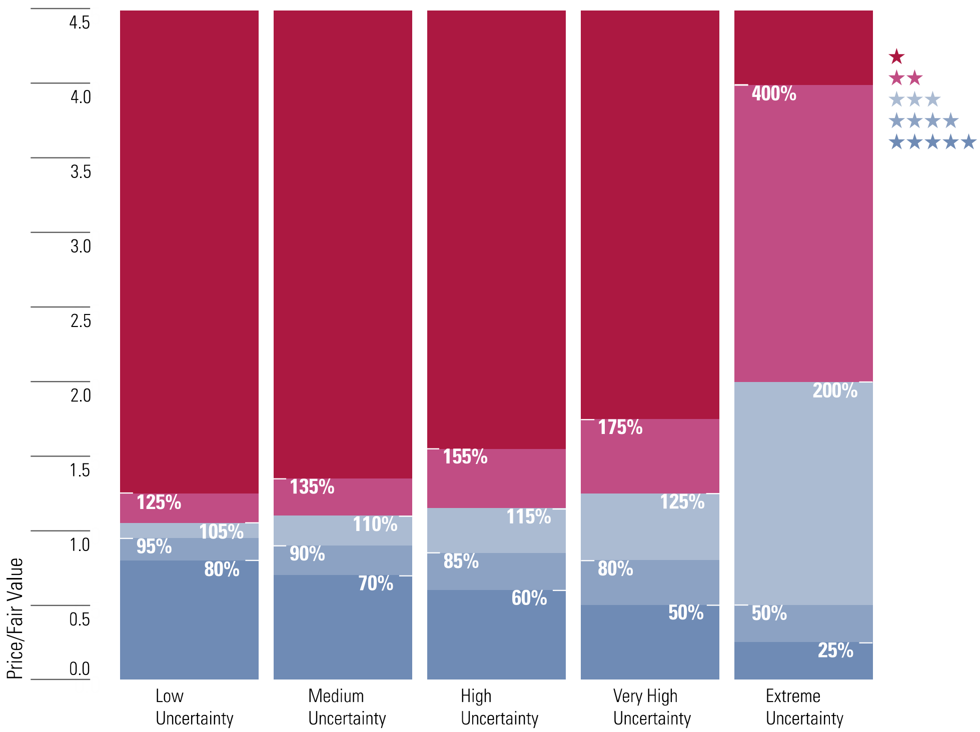
Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case and a 25% probability that the company will perform worse than 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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