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Research Highlights

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

Morningstar Equity Research
July 16-20, 2018

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Interactive web-based models are available for our Best Ideas at Trefis.

Airbnb's IPO: Network Effect Offers Investors a Unique Stay

Ahead of its anticipated IPO in 2019-20, we see Airbnb's current market capitalization ranging between $53 billion ($180 per share) and $65 billion ($221 per share), based on a peer-based and DCF-derived exit multiple approach, 70%-110% higher than the $31 billion the company fetched at its most recent funding round in July 2017 and above the valuation of any hotel operator.

Our valuation implies an enterprise value to 2019 EBITDA multiple range of 28-32 times (with an assumption of $3 billion in net cash), a premium to the 18 times awarded on average to other companies with online marketplaces. We believe a premium is warranted based on several attractive features Airbnb offers investors, including a powerful and rare network advantage that should drive continued share gains in a rapidly growing alternative accommodations market; an opportunity to expand its network and addressable market with vertical extension into hotel, experiences, corporate, and transportation; and strong profitability prospects driven by the company's high consumer awareness that allow it to leverage top-line growth.

We believe Airbnb's IPO should be on the radar screens for investors seeking exposure to a company positioned to gain share in the nearly $700 billion global online travel market that we estimate will grow 9.4% annually on average over the next five years.

- We expect Airbnb's core alternative accommodations market to experience 16.6% online industry growth annually on average the next five years, above the 9.4% lift we expect for total online travel.
- Airbnb's platform of 250 million monthly visitors and 5 million listings drives a network effect advantage, positioning it for attractive long-term growth.
- Airbnb's network advantage allows it to reach 45% online booking share of the alternative accommodation market in 2022 versus the 30% portion we estimate it held in 2017.
- We expect Airbnb to expand into hotel, experience, and transportation verticals the next few years, and for these markets to make up 19% of its total bookings in 2022 from 3% this year.
- Increased competition and alternative accommodation regulation present headwinds to Airbnb's long-term growth, mitigating its healthy competitive position.

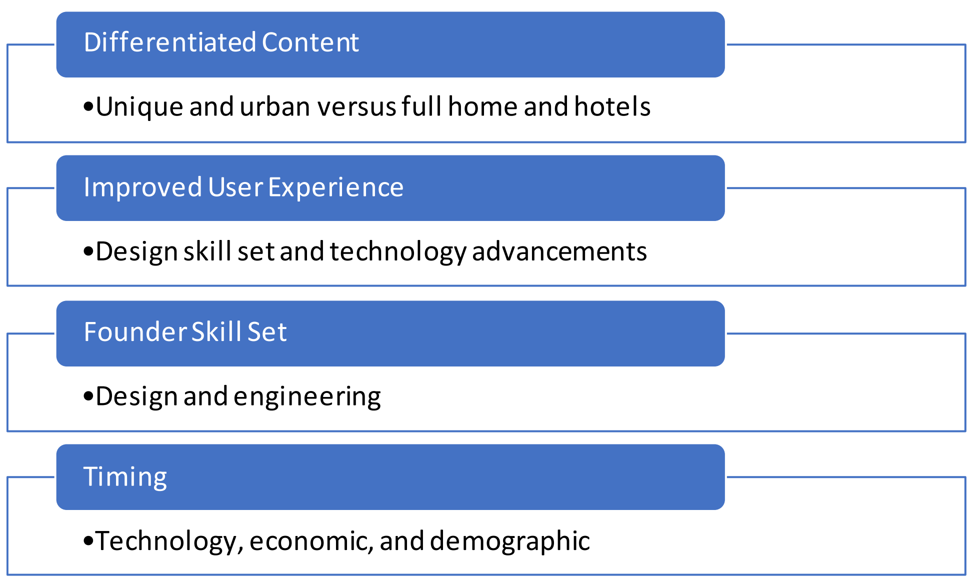
Airbnb’s Extraordinary Success Booked by the Right People With the Right Idea at the Right Time

Conceptualized in August 2007 as an alternative option to hotel lodging, we calculate that Airbnb is now the largest player in the $150 billion alternative accommodation booking market, with a high-teens share, up from just a roughly 4% share in 2014. We estimate that roughly half of the market's bookings occur online, of which Airbnb has around 35% online share today versus around 10% in 2014.

The idea of room sharing was not a new one when Airbnb got its start. In fact, staying in another's home during travel was often used in the first part of the 20th century, until the hotel industry took hold in the 1950s, as the U.S. middle class grew and the Eisenhower Interstate Highway Plan made travel more accessible. Further, companies like Craigslist and Vacation Rentals By Owner can trace their beginnings back to the 1990s when each offered ways to share rooms and homes with others.

Despite private accommodations not being a new notion, we believe Airbnb's amazing success can be traced to four things—its differentiated content, an improved user experience, the skill set of its three founders, and sheer timing.

Exhibit 1 We See Airbnb's Success Tied to Its Content, User Experience, Founder Skills, and Timing



Source: Morningstar

Dan Wasiolek | dan.wasiolek@morningstar.com

NGL Puzzle Solved

In our inaugural Observer on natural gas liquids, we present an above-consensus forecast for NGL production and exports of 6.7 million and 3 million barrels per day by 2022, respectively. U.S. NGL supply will increase about 2.2 million bpd over the next five years compared with our forecast 2.3 million bpd for oil, making it critical to continued U.S. liquids supply growth. Consensus U.S. NGL production estimates are as low as 4.5 million bpd, which implies that the U.S. cannot supply enough ethane to meet the $150 billion-plus steam cracker expansion underway, and U.S. NGL exports will actually decline from existing levels, failing to meet the 1 million bpd of ethane export contracts already signed. We expect higher international demand, particularly from China, to take advantage of lower feedstock costs and cleaner-burning fuels versus more expensive oil- and coal-derived feedstock options. However, we do expect aggregate NGL prices to decline about 20% from current levels, reflecting our long-term view on Brent as naphtha (a competing feedstock) is oil-based. Ethane remains the exception, with our long-term pricing forecast about flat with current levels given higher export demand. We think undervalued Enterprise Products Partners is the dominant wide-moat midstream entity best positioned to take advantage of higher exports. Undervalued Targa Resources, Energy Transfer Partners, and Phillips 66 Partners are also compelling opportunities.

- We expect U.S. NGL production to increase to 6.7 million bpd by 2022 from 3.7 million bpd in 2017, led by ethane production, which we expect to more than double to 3.4 million bpd from 1.4 million bpd in 2017. This forecast is significantly higher than consensus expectations—4.5 million bpd to 6.3 million bpd—which at the low end implies that NGL production would be insufficient to meet demand from planned U.S. steam crackers and that NGL exports would actually decline from current levels.
- We expect NGL demand to increase to about 3.7 million bpd from 2.7 million bpd, led by 785,000 bpd of incremental ethane demand from steam crackers starting up on the Gulf Coast, leaving room for substantial growth in NGL exports.
- We don’t see meaningful constraints from an NGL infrastructure perspective on the Gulf Coast and expect midstream companies will benefit from expansion opportunities as Permian NGL production rises rapidly.
- We forecast that U.S. NGL exports will increase to around 3 million bpd by 2022 from only 1.5 million bpd in 2017, for a CAGR of 14%.
- U.S. exports for ethane and propane should increase significantly in the coming years, given their cost-competitiveness with European naphtha and Saudi Arabian propane. We expect ethane exports to reach 1 million bpd by 2022 and propane exports to increase to about 1.5 million bpd over the same time frame from a combined 1.1 million bpd of exports in 2017.
- Ethane export demand is being driven by China, India, and the United Kingdom, while propane export demand comes from Japan, Mexico, India, and China. We have concerns about long-term demand in Japan and Mexico, but Indian and Chinese demand for propane looks very healthy over the long run.
- We expect NGL prices to decline given our bearish long-term oil outlook ($60/bbl Brent), as most NGLs have to remain competitive on pricing with oil-derived feedstocks such as naphtha and Saudi Arabian propane. For the most part, NGL prices have been highly correlated with Brent prices. For more details on our bearish call for long-term oil prices please see our June 2018 report Oil Prices Are Unsustainably High, Stretching Energy Valuations.

- We expect ethane pricing, which has proved to be less correlated with oil prices, will be flattish with current prices over the next few years due to higher demand from China, India, and Europe, since it represents an attractive, more environmentally friendly and cheaper feedstock than propane, naphtha, or coal. On a composite barrel basis, the NGL barrel will become more weighted toward ethane over time.
- Midstream moats built on efficient scale fit well with our exports thesis, as we've found that midstream firms need to own related assets (fractionation, pipelines, storage) to sanction investment in export assets because of the need to secure supply due to temporal specificities.
- We believe expansions in NGL pipeline, fractionation, and exports assets are needed to meet our exports forecast of 3 million bpd by 2022. We believe Enterprise Products Partners and Targa are two of the biggest beneficiaries, and we've raised our fair value estimates for each entity. However, Phillips 66 Partners and Energy Transfer Partners could also be compelling investment opportunities.

Top NGL Picks: Midstream

Enterprise Products Partners

Star Rating: ★★★★ | P/FV: 0.87 | Moat Rating: Wide | Trend: Stable | NGL Exposure: High

The dominant midstream firm has opportunities to pursue further investments in ethane, Permian pipelines, and Mont Belvieu expansions as NGL exports increase over the coming years beyond its existing expansion efforts. Our fair value estimate has increased to $32.50 from $31 after factoring in expected expansions at its Permian Shin Oak pipeline to 600,000 bpd from 250,000 bpd, 170,000 bpd of additional fractionation capacity at Mont Belvieu, and 250,000 bpd of additional ethane export terminal capacity.

Targa Resources

Star Rating: ★★★★ | P/FV: 0.84 | Moat Rating: None | Trend: Stable | NGL Exposure: High

The entity's biggest opportunity is with its Grand Prix pipeline (it owns 55%), and we think it can expand the pipeline to 550,000 bpd by 2022 from its original 300,000 bpd capacity. Our fair value estimate has increased to $62 from $53 after factoring in additional expansion efforts for its Grand Prix pipeline, incremental fractionation capacity (100,000 bpd) beyond its existing plans, and higher NGL production levels from its processing plants and related sales.

Phillips 66 Partners

Star Rating: ★★★ | P/FV: 0.92 | Moat Rating: Narrow | Trend: Stable | NGL Exposure: Medium

Parent Phillips 66 still owns the key assets involved (fractionation and LPG export facilities), but we expect them to be dropped down to the master limited partnership in the next few years, providing growth opportunities. Our fair value estimate for Phillips 66 Partners is unchanged at $55, reflecting our assumption that the assets will be dropped down as part of already assumed $5.4 billion in drop-down/acquisition activity in our model from 2018-22.

Energy Transfer Partners/Energy Transfer Equity

Star Rating: ★★★★ | P/FV: 0.87 | Moat Rating: None | Trend: Stable | NGL Exposure: Medium

Energy Transfer Partners plans to invest $2.4 billion-$2.5 billion in NGL and refined products infrastructure in 2018, more than half of its planned growth investment. Most of this will go into the Mariner East projects, which will add 600,000 bpd to Energy Transfer's NGL system. Although we think Energy Transfer's NGL growth investment will fall off in the coming years, we still think NGLs will be a key earnings growth driver. We think the general partner, Energy Transfer Equity, is the best bet for investors. Not only do we think there is more cash flow value in ETE as of mid-July, we also think ETE will come out ahead in what we think is an inevitable consolidation in 2019.

Oneok

Star Rating: ★★ | P/FV: 1.15 | Moat Rating: Narrow | Trend: Stable | NGL Exposure: High

Our $62 fair value estimate remains unchanged, primarily because Oneok is already aggressively investing in NGLs with a $4.2 billion program over the next few years, and we think it has limited capacity to assume incremental investments beyond its existing efforts. We do think Oneok has expansion opportunities in fractionation at Mont Belvieu, but also in export assets where it currently has none. However, the longer it waits to pursue export assets, the greater risk we think it faces in terms of putting a terminal in a less-desirable geography, or simply having peers such as Enterprise Products Partners build the capacity required, taking the opportunity from Oneok.

MPLX

Star Rating: ★★★ | P/FV: 0.88 | Moat Rating: Narrow | Trend: Stable | NGL Exposure: High

If significantly higher levels of exports from Marcus Hook, Pennsylvania, become a reality via Energy Transfer's expansion or other firms making the needed investments, MPLX has opportunities around sanctioning NGL pipelines and fractionation assets in the Marcellus/Utica region. We would anticipate increasing our $38.50 fair value estimate for MPLX if Energy Transfer significantly expands at Marcus Hook because of the incremental processing fees available from extracting the currently rejected ethane from the gas stream as well as the incremental pipeline efforts need to move the ethane to the newly expanded Marcus Hook facility. As it stands, with units trading slightly below our fair value estimate, unitholders are effectively paying nothing for the upside here.

Stephen Ellis | stephen.ellis@morningstar.com

Uber May Pick Up Investors, Along With Riders, in Its IPO

We've taken a deeper look at privately held Uber, the ride-sharing service provider that sits at the number-two spot in the world (based on rides hailed) and is attempting to gain traction in what we estimate to be a $630 billion addressable market for the company by 2022. In our view, Uber's core business, the ride-sharing platform, would warrant a narrow economic moat rating, as it has displayed some moat sources such as network effects and intangible assets, which could position the firm to become profitable and generate excess returns on invested capital in the future.

Based on our analysis and using publicly available data on Uber's financials from *The Wall Street Journal* as a starting point, we value Uber at a $110 billion market capitalization, ahead of the company's last valuation round of nearly $62 billion in May, according to PitchBook. We project that Uber's net revenue will grow at a 27% average annual pace over the next 10 years to $82.4 billion. We foresee Uber continuing to spend on expansion and research and development but think it will become profitable by 2022. The company is likely to go public during the second half of 2019, and considering its success at raising capital, we expect the initial public offering price to value Uber between $100 billion and $110 billion.

Looking ahead, Uber may leverage its moaty ride-sharing business and tap into other growth opportunities, including bike-sharing, meal takeout and delivery (Uber Eats), freight brokerage (Uber Freight), and ride-sharing via autonomous vehicles. In our view, autonomy is the most transformative technology set to affect the world of ride-sharing; we see powerful economic forces driving autonomous vehicle adoption in the ride-sharing industry, from which Uber may benefit.

On the other hand, risks remain, such as increased competition and the firm's legal issues, which gave Uber a tainted reputation under former CEO Travis Kalanick. We believe that under new CEO Dara Khosrowshahi, Uber will see better days; however, pressure brought forth by legal matters will persist.

- Uber's core business, the ride-sharing platform, has displayed some moaty characteristics such as network effects and intangible assets, which could position the firm to become profitable and generate excess returns on invested capital in the future.
- We expect Uber to grab nearly 50% of the ride-sharing market by 2022 (up from 29% in 2017) as it leverages its first-mover advantage along with its network effect and data moat sources.
- We value Uber's total addressable market, which includes the aggregate of the global taxi, ride-share, and food delivery industries along with the U.S. markets for freight brokerage and the share we believe ride-share companies can take from global public transport and U.S. bike-share, at $630 billion by 2022, representing a 26% five-year compound annual growth rate.
- We estimate a market capitalization of $110 billion for Uber as the firm is projected to increase its top line by 27% annually during the next 10 years and become profitable in 2022.

Ali Mogharabi | ali.mogharabi@morningstar.com

Best Ideas

Interactive web-based models are available for our Best Ideas at Trefis.

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	$10.6	High	Narrow	0.62	4.29	Inton
Compass Minerals International (CMP)	★★★★	$83	$67.65	High	Wide	0.82	2.29	Goldstein
Martin Marietta Materials (MLM)	★★★★	$265	$225.87	High	Narrow	0.85	14.22	Inton
Communication Services								
BT Group (BT.A)	★★★★	GBX 360	GBX 217.65	High	Narrow	0.60	21.60	C. Nichols
China Mobile (941)	★★★★★	HKD 102	HKD 68.5	Medium	Narrow	0.67	1402.57	Baker
Comcast (CMCSA)	★★★★	$42	$34.91	Medium	Wide	0.83	160.64	Macker
Telefonica (TEF)	★★★★★	$13	$7.4	High	Narrow	0.57	38.44	C. Nichols
Telstra (TLS)	★★★★★	AUD 4.4	AUD 2.79	Medium	Narrow	0.63	33.18	Han
Consumer Cyclical								
Advance Auto Parts (AAP)	★★★★	$157	$143.37	Medium	Narrow	0.91	10.61	Akbari
Bayerische Motoren Werke (BMW)	★★★★	EUR 117	EUR 80.75	High	Narrow	0.69	52.49	Hilgert
Expedia Group (EXPE)	★★★★	$180	$127.81	High	Narrow	0.71	19.19	Wasiolek
General Motors (GM)	★★★★	$56	$39.31	High	None	0.70	55.41	Whiston
Great Wall Motor (2333)	★★★★★	HKD 13.5	HKD 5.44	High	None	0.40	81.51	Su
Hanesbrands (HBI)	★★★★	$29	$22.2	Medium	Narrow	0.77	8.00	Hottovy
InvoCare (IVC)	★★★★	AUD 17	AUD 13.86	Medium	Wide	0.82	1.53	Ragonese
Mattel (MAT)	★★★★	$21.5	$16.04	High	Narrow	0.75	5.52	Katz
Norwegian Cruise Line Holdings (NCLH)	★★★★	$69	$49.85	High	Narrow	0.72	11.20	Katz
Walt Disney (DIS)	★★★★	$130	$112.13	Medium	Wide	0.86	166.71	Macker
WPP (WPP)	★★★★	GBX 1500	GBX 1141	Medium	Narrow	0.76	14.40	Mogharabi
Consumer Defensive								
G8 Education (GEM)	★★★★	AUD 4	AUD 2.46	High	None	0.62	1.12	James
General Mills (GIS)	★★★★★	$59	$43.35	Low	Wide	0.73	25.72	Vora
Imperial Brands (IMB)	★★★★★	GBX 3900	GBX 2905.5	Low	Wide	0.75	27.71	Gorham
Kao (4452)	★★★★	JPY 8800	JPY 8247	Low	Wide	0.94	4019.76	Wei
Mondelez International (MDLZ)	★★★★	$51	$42.24	Medium	Wide	0.83	62.31	Lash
PepsiCo (PEP)	★★★★	$123	$115.77	Low	Wide	0.94	163.74	Vora
Procter & Gamble (PG)	★★★★★	$98	$78.73	Low	Wide	0.80	197.97	Lash
Reckitt Benckiser Group (RB.)	★★★★	GBX 7300	GBX 6444	Low	Wide	0.88	45.52	Gorham
Energy								
Cenovus Energy (CVE)	★★★★	$21	$13.51	Very High	None	0.64	16.60	Gemino
Enbridge (ENB)	★★★★	$64	$46.74	Medium	Wide	0.73	79.68	Gemino
Enterprise Products Partners (EPD)	★★★★	$32.5	$29.06	Low	Wide	0.89	63.14	Ellis
Royal Dutch Shell (RDS.B)	★★★★	$78	$72.43	Low	None	0.93	290.68	Good
Total (TOT)	★★★★	$74	$61.53	Medium	None	0.83	161.04	Good
Financial Services								
Agricultural Bank of China (601288)	★★★★	CNY 4.2	CNY 3.54	High	Narrow	0.84	1225.37	Tan
American International Group (AIG)	★★★★	$76	$53.85	Medium	None	0.71	48.34	Horn
Capital One Financial (COF)	★★★★	$127	$98.17	Medium	Narrow	0.77	46.39	Plunkett
Credit Suisse Group (CSGN)	★★★★	CHF 22	CHF 15.21	High	Narrow	0.69	38.64	Scholtz
Invesco (IVZ)	★★★★★	$40	$25.69	Medium	Narrow	0.64	10.55	Warren
Mitsubishi UFJ Financial Group (8306)	★★★★	JPY 880	JPY 662.6	Medium	None	0.75	8693.01	Wu
QBE Insurance Group (QBE)	★★★★	AUD 12	AUD 9.89	High	None	0.82	13.43	Ellis
Westpac Banking (WBC)	★★★★	AUD 35	AUD 29.9	Medium	Wide	0.85	101.25	Ellis

Source: Morningstar. As of July 20, 2018

Best Ideas

Interactive web-based models are available for our Best Ideas at Trefis.

Company and Industry	Morningstar Rating	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price / Fair Value	Market Cap (B)	Analyst
Healthcare								
Allergan (AGN)	★★★★★	$263	$173.39	Medium	Wide	0.66	58.79	Waterhouse
McKesson (MCK)	★★★★★	$210	$133.81	Medium	Wide	0.64	27.00	Lekraj
Medtronic (MDT)	★★★★	$105	$88.42	Medium	Wide	0.84	119.52	Wang
Ramsay Health Care (RHC)	★★★★★	AUD 82	AUD 56.94	Medium	Narrow	0.69	11.51	Kallos
Roche Holding (ROG)	★★★★★	CHF 337	CHF 234	Low	Wide	0.69	200.54	Andersen
Shire (SHP)	★★★★	GBX 4890	GBX 4444.5	Medium	Narrow	0.91	40.64	Andersen
Industrials								
Allegion (ALLE)	★★★★	$91	$78.68	Medium	Wide	0.86	7.47	Bernard
Anixter International (AXE)	★★★★★	$107	$66	Medium	Narrow	0.62	2.21	Bernard
Beijing Enterprises Holdings (392)	★★★★★	HKD 58	HKD 38.65	Medium	Narrow	0.67	48.78	Song
Brambles (BXB)	★★★★	AUD 11.2	AUD 9.63	Medium	Wide	0.86	15.32	Fleck
CK Hutchison Holdings (1)	★★★★★	HKD 125	HKD 83.75	Medium	None	0.67	323.08	Tan
G4S (GFS)	★★★★	GBX 337	GBX 270	Medium	None	0.80	4.19	Field
GEA Group (G1A)	★★★★★	EUR 47	EUR 31.48	Medium	Wide	0.67	5.68	Molina
Grupo Aeroportuario del Pacifico (GAP B)	★★★	MXN 217	MXN 187.58	High	Wide	0.86	105.23	Higgins
Guangshen Railway (525)	★★★★	HKD 6.8	HKD 4.09	High	None	0.60	33.79	Song
Johnson Controls International (JCI)	★★★★	$53	$35.85	High	Narrow	0.68	33.20	Bernard
KION GROUP (KGX)	★★★★	EUR 90	EUR 63.44	Medium	Narrow	0.70	7.49	Molina
Royal Philips (PHIA)	★★★★	EUR 42	EUR 37.04	Medium	Narrow	0.88	35.21	Vonk
Sodexo (SW)	★★★★	EUR 110	EUR 91.56	Medium	Narrow	0.83	13.58	Field
Stericycle (SRCL)	★★★★	$86	$67.77	High	Narrow	0.79	5.80	Young
Real Estate								
AVEO Group (AOG)	★★★★	AUD 2.8	AUD 2.3	Medium	None	0.82	1.34	Sherlock
Sun Hung Kai Properties (16)	★★★★	HKD 153	HKD 117	Medium	Narrow	NA	338.95	Zhong
Welltower (WELL)	★★★★	$74	$62.77	High	None	0.85	23.35	Brown
Technology								
Intel (INTC)	★★★★	$62	$51.98	Medium	Wide	0.84	242.23	Davuluri
KLA-Tencor (KLAC)	★★★	$125	$108.49	High	Wide	0.87	16.88	Davuluri
Microchip Technology (MCHP)	★★★★	$112	$94.8	Medium	Wide	0.85	22.32	Colello
MYOB Group (MYO)	★★★★	AUD 3.82	AUD 3.06	Medium	Narrow	0.80	1.83	James
Qualcomm (QCOM)	★★★★	$75	$59.31	High	Narrow	0.79	87.95	Davuluri
Synaptics (SYNA)	★★★★	$64	$50.11	Very High	None	0.78	1.73	Davuluri
TDK (6762)	★★★	JPY 12500	JPY 11680	High	None	0.93	1474.54	Ito
Tencent Holdings (700)	★★★★	HKD 641	HKD 376.6	High	Wide	0.59	3578.90	Tam
Utilities								
Dominion Energy (D)	★★★★	$84	$72	Low	Wide	0.86	47.00	Fishman
FirstEnergy (FE)	★★★★	$40	$35.64	Low	Narrow	0.89	17.00	Fishman
Gas Natural SDG (NTGY)	★★★	EUR 23.5	EUR 23.38	Medium	Narrow	0.99	23.38	Fulop
SCANA (SCG)	★★★★★	$56	$40.2	Medium	Narrow	0.72	5.73	Miller

Source: Morningstar. As of July 20, 2018

Highlighted Stocks

InvoCare IVC:AU

Morningstar Rating	Industry	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★★	Consumer	Stable	AUD	17	13.86	Medium	Wide	0.82	1.53

Source: Morningstar. As of July 20, 2018

The domestic funeral market is sufficiently fragmented for both companies to continue gaining share for the foreseeable future without stepping on each other's toes.

Analyst Note, July 20, 2018
We are raising our fair value estimate for InvoCare AUD 17 per share after taking a more bullish view on the company's future market share and to reflect the increasingly valuable prepaid funeral business. The share price has been punished during the past six months, and we believe the market's myopic concerns are misplaced, offering an opportunity to invest in this attractively priced wide-moat company.

While the market is concerned about the threat of newly listed Propel Funeral Partners, the smaller rival is unlikely to pose a major threat. The domestic funeral market is sufficiently fragmented for both companies to continue gaining share for the foreseeable future without stepping on each other's toes. We estimate both firms will account for 60% of the domestic market by fiscal 2022, up from the current 44%. Yet we forecast that InvoCare will maintain its dominant position, given its leading scale, market segmentation, and brand strength. Since Propel was listed, InvoCare has accelerated its pace of acquisitions, acquiring seven regional funeral operators during the past few months. This adds approximately AUD 15 million to group revenue, around 1% in additional share of the Australia and New Zealand markets.

The current share price implies no additional return on the AUD 200 million refurbishment program "Protect and Grow 2020." While this capital expenditure will dilute returns on invested capital in the near term, upon completion of the program, we expect ROIC to return to the low teens, comfortably exceeding the firm's 7% weighted average cost of capital.

Hidden value lies within the prepaid funeral business, which we value at AUD 1 per share in our base-case scenario. This assumes the asset allocation is unchanged at 20% equities, 16% property, and 64% cash and fixed income, which is conservative, given the highly stable nature of the funeral industry and predictable cash requirements. We also forecast the average contract life remains at 11 years on average, and that prepaid funeral sales account for around 10% of group sales, broadly in line with the historical average.

Daniel Ragonese | daniel.ragonese@morningstar.com

Meggitt MGGT:GB

Morningstar Rating	Industry	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★	Industrials	Stable	GBX	630	565	Medium	Narrow	0.90	4.36

Source: Morningstar. As of July 20, 2018

In our view, the consensus revenue CAGR estimate of 2.5% underestimates Meggitt's strong production and increased dollar value per aircraft, improved outlook for defense, and high utilization of large jets.

Analyst Note, July 18, 2018

After updating our sales and profit estimates for Meggitt, along with an in-depth analysis of the firm’s exposure to our large-jet delivery forecasts, and accounting for the time value of money, we are increasing our fair value estimate to GBX 630 per share. Our analysis of Morningstar's proprietary delivery forecasts for manufacturers Airbus, Boeing, Bombardier, and Embraer leads us to forecast an average annual growth rate of jet deliveries with Meggitt content installed of 10.7% over 2018-21, and supports our above-consensus forecast for group revenue CAGR of 4.4%. In our view, the consensus revenue CAGR estimate of 2.5% underestimates Meggitt's strong production and increased dollar value per aircraft, improved outlook for defense, and high utilization of large jets.

Meggitt’s increased equipment sales content on new and growing aircraft platforms like the Airbus A320neo series (20% higher OE shipset dollars versus the old A320ceo series), A350 (250% increase compared with A330), and Boeing 737MAX (up 55% versus B737) will drive increased aftermarket sales for decades. More than 50% of Meggitt's revenue is derived from higher-margin aftermarket services, which we view as evidence of sticky customer relationships, supporting our narrow moat rating. We foresee reinforcement of switching costs, as a 6% CAGR for civil aerospace aftermarket revenue over 2018-22 exceeds the group average. Meggitt's installed fleet is getting younger as a result of success in securing positions on new platforms over the past couple of years. A young fleet is a headwind for Meggitt's short-term aftermarket revenue, but an important driver for long-term aftermarket demand, as a large volume of aircraft are due to move into the aftermarket sweet spot over the next five years. The sweet spot regarding civil aerospace aftermarket services activity and profitability is within the 10- to 20-year range.

Immediate expensing of program participation costs (or a heavily discounted product sale) due to adoption of IFRS 15 will depress Meggitt's EBIT margin by 130 basis points. Additionally, increased costs as a result of a high level of deliveries of platforms over the medium term, with firms breaking shipsets free of charge, will be dilutive to margins as well. Despite these headwinds, group EBIT margin will strengthen by 90 basis points due to efficiency gains, increasing attribution of higher-margin aftermarket, a lower level of research and development spending, new product introduction costs as a percentage of sales, and successfully addressing production issues with the polymers and composites business.

Jeffrey Vonk, CEFA | jeffrey.vonk@morningstar.com

Millicom International Cellular MIICF

Morningstar Rating	Industry	Moat Trend	Currency	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price/Fair Value	Market Cap (Bil)
★★★★	Communication	Stable	USD	86	63.06	High	Narrow	0.73	6.26

Source: Morningstar. As of July 20, 2018

We are particularly pleased with the improvement in mobile, which is the firm's largest segment and declined 3.8% one year ago. We have anticipated this recovery for some time and have been frustrated that it has taken so long.

Analyst Note, July 20, 2018
Millicom reported mixed second-quarter results, with solid revenue growth but light EBITDA margins. We believe these results demonstrate that our thesis is playing out and we are maintaining our fair value estimate of $86 per ADR and narrow moat rating. We continue to believe the shares are undervalued.

The firm reported revenue growth of 4.8% year over year, well ahead of our 2.3% full-year projection. Revenue grew in all three of its main divisions, with mobile business-to-consumer up 2.1%, home growing 12.6%, and business-to-business increasing 7.1%. We are particularly pleased with the improvement in mobile, which is the firm's largest segment and declined 3.8% one year ago. We have anticipated this recovery for some time and have been frustrated that it has taken so long. We are also impressed by the further increase in the home (or pay-TV) segment. This has been the most consistent performer, with revenue growth of 7% to 8%, but it popped to double digits as Colombia expanded its connected base by 1.5%.

Since Millicom acquired UNE, the second-largest cable-TV operator in Colombia, it has been upgrading its network from heavily copper to a hybrid fiber coaxial, or HFC, network. While it has been growing its HFC-based subscribers, it has been losing copper-based ones at a faster rate. In the first quarter, it had net subscriber growth for the first time, which accelerated in the second quarter, and we believe this can continue to improve.

The firm continues to extend its HFC network in other countries as well, and the cost of this buildout is pressuring margins. Thus, EBITDA margin was only 35.8% in the quarter, which is below our full-year projection of 36.7%. However, we think this buildout is important, as it is helping provide the growth for the future. This is demonstrated by the pickup in connected cable-TV homes and the increase in full-year guidance for home connections to 400,000 from 300,000, though half of this increase is from an acquisition in Guatemala.

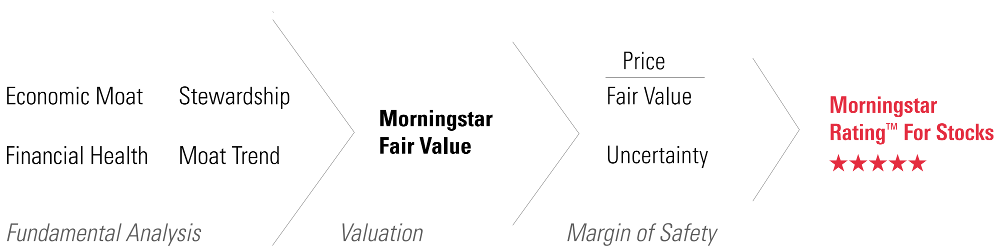
Colin Plunkett, CFA | colin.plunkett@morningstar.com

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.

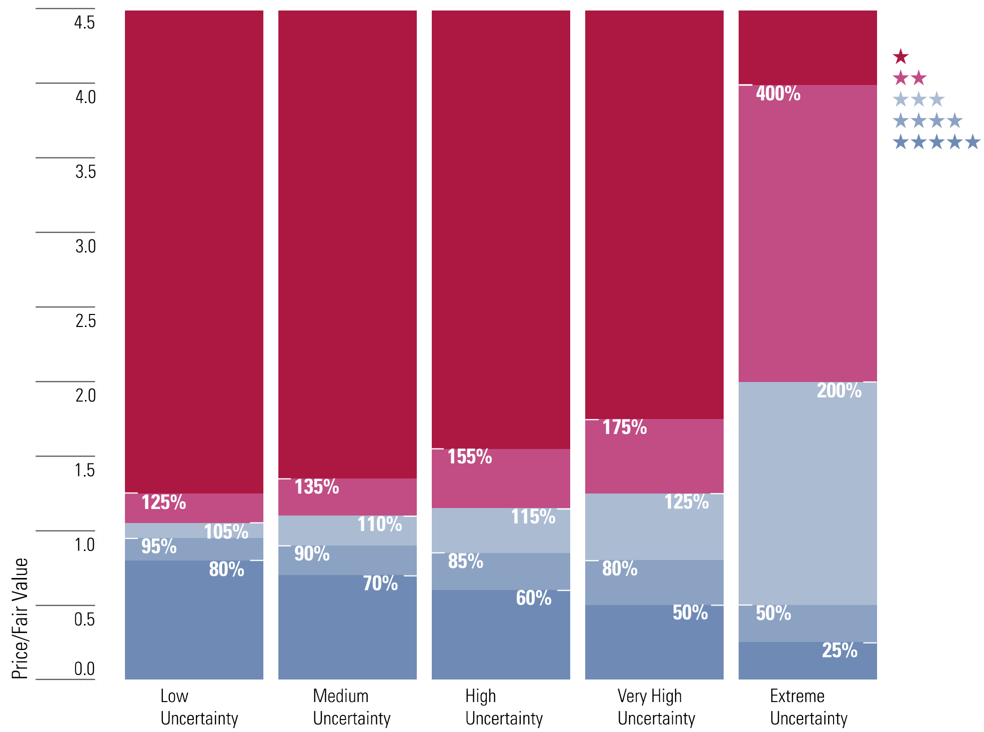
Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case and a 25% probability that the company will perform worse than 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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Please note that investments in securities are subject to market and other risks, and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in the future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost. A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's uncertainty rating serves as a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

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+1 312 696-6869
equitysupport@morningstar.com

MORNINGSTAR®

22 West Washington Street
Chicago, IL 60602 USA