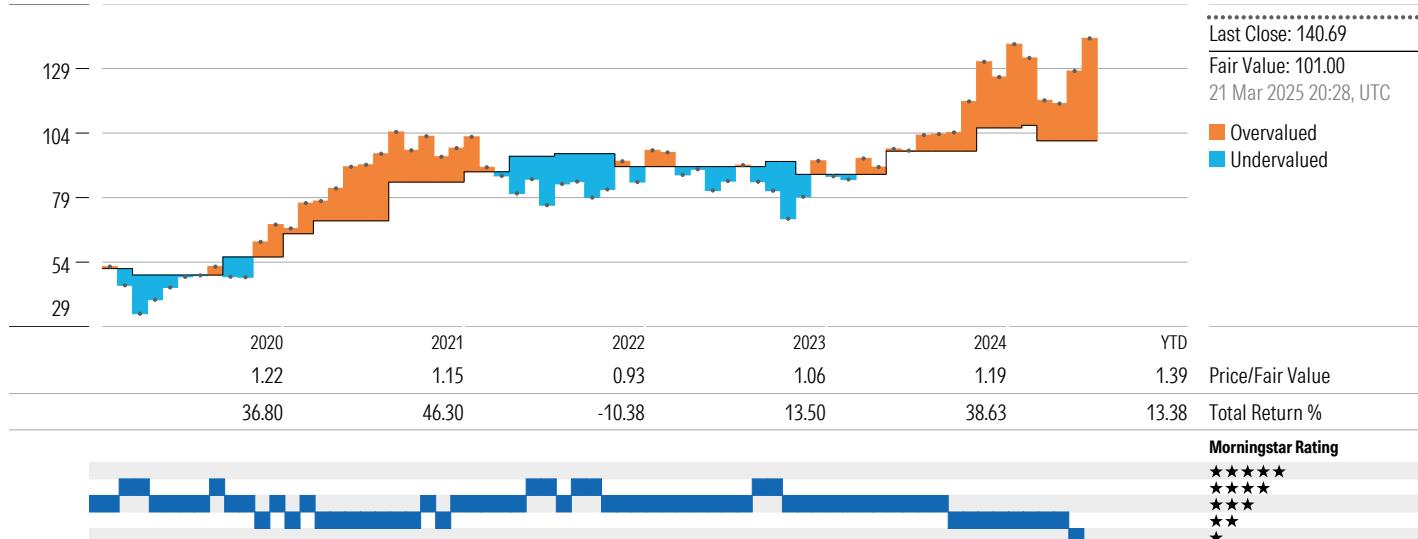


# Morgan Stanley MS ★ 27 Jun 2025 21:23, UTC

Last Price 140.69 USD 27 Jun 2025	Fair Value Estimate 101.00 USD 21 Mar 2025 20:28, UTC	Price/FVE 1.39	Market Cap 225.71 USD Bil 27 Jun 2025	Economic Moat™ Narrow	Equity Style Box Large Value	Uncertainty Medium	Capital Allocation Exemplary	ESG Risk Rating Assessment¹  4 Jun 2025 05:00, UTC
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## Price vs. Fair Value



Total Return % as of 27 Jun 2025. Last Close as of 27 Jun 2025. Fair Value as of 21 Mar 2025 20:28, UTC.

## Contents

- Analyst Note (29 Jun 2025)
- Business Description
- Business Strategy & Outlook (21 Mar 2025)
- Bulls Say / Bears Say (21 Mar 2025)
- Economic Moat (21 Mar 2025)
- Fair Value and Profit Drivers (21 Mar 2025)
- Risk and Uncertainty (21 Mar 2025)
- Capital Allocation (21 Mar 2025)
- Analyst Notes Archive
- Financials
- ESG Risk
- Appendix
- Research Methodology for Valuing Companies

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The primary analyst covering this company does not own its stock.

The ESG Risk Rating Assessment is a representation of Sustainalytics' ESG Risk Rating.

## US Banks' Stress Test Results Look Favorable, With Goldman, Wells Fargo Performing Particularly Well

**Analyst Note** Sean Dunlop, CFA, Director, 29 Jun 2025

The Federal Reserve released its annual stress test results on Friday, June 27. With significantly stronger results compared with a year ago, the shares of the 22 tested institutions traded slightly higher in after hours trading.

**Why it matters:** The test results estimate the maximum capital drawdown that banks are likely to experience during a severely adverse scenario, which in turn informs the level of stress capital buffer they are required to hold for the ensuing year.

- ▶ Lower capital requirements correspond with higher leverage and higher returns for banks, which may elect to return excess capital to shareholders, generally through share repurchases.
- ▶ After Friday's test, we estimate that the banks in our coverage will see their stress capital buffers decline by about 40 basis points on average, provided that the Fed's proposal to average stress test results over two consecutive years, in order to reduce volatility, is implemented, or 65 basis points otherwise.

**The bottom line:** A less punitive stress scenario and strong capitalization across our banking coverage means that the average bank we cover could hold as much as 5% of its market capitalization in excess capital that could theoretically be returned to shareholders.

- ▶ Wide-moat-rated Goldman Sachs and wide-moat Wells Fargo were the biggest winners, with our

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Sector	Industry
Financial Services	Capital Markets

## Business Description

Morgan Stanley is a global investment bank whose history, through its legacy firms, can be traced back to 1924. The company has institutional securities, wealth management, and investment management segments with approximately 45% of net revenue from its institutional securities business, 45% from wealth management, and 10% from investment management. About 24% of its total revenue is from outside the Americas. The company had over \$6 trillion of client assets as well as around 70,000 employees at the end of 2024.

estimates suggesting these two banks will see their stress capital buffers fall by 1.5 and 1.2 percentage points, respectively, in October.

- Our optimism is, however, tempered by overvaluation. While returning capital to shareholders can improve a firm's returns on equity regardless of price, we'd prefer that the banks don't repurchase \$1 worth of shares for \$1.25, which is what they would effectively be doing at our market-cap-weighted fair value estimates.

## Business Strategy & Outlook

Brett Horn, CFA, Senior Equity Analyst, 21 Mar 2025

Morgan Stanley has built a more stable business model, and its shift to wealth management from investment banking will continue to be a main part of the company's story over the long term. Investment banking is capital intensive, and many banks, especially the European investment banks, have had trouble generating adequate returns in that business and have purposely shrunk that business line. Morgan Stanley has remained dedicated to investment banking and has gained market share. The company had relatively strong returns on equity in its institutional securities business of about 14% from 2020 through 2024, but only averaged about 11% over the previous decade.

Wealth management and asset management tend to be relatively more stable than investment banking and have high returns on capital. Merging Citigroup's Smith Barney business into its own wealth management business after the global financial crisis was transformational and catapulted Morgan Stanley into an industry leader. Wealth management operating margins that had frequently been single digits expanded to the mid- to upper-20s and returns on equity have been in the mid-teens to 20s. The acquisitions of E-Trade and Eaton Vance in the early 2020s added both scale and additional capabilities to Morgan Stanley.

Proposed Basel III regulatory capital rules could increase risk-weighted assets by up to 20% at Morgan Stanley, which would pose some headwinds despite being well capitalized.

Given shifts in market expectations regarding the likelihood of a recession, investment banking revenue should taper over the next several years after a strong bounceback from cyclical lows in 2022. We continue to believe that trading revenue is abnormally high, but we think there could be several more quarters left of relatively high trading revenue as macroeconomic uncertainty leads to higher market volatility before some pronounced mean reversion occurs in the back half of our explicit forecast. We assess that asset markets are around fairly valued, which should lead to average growth in the company's investment management business over the long run.

## Bulls Say

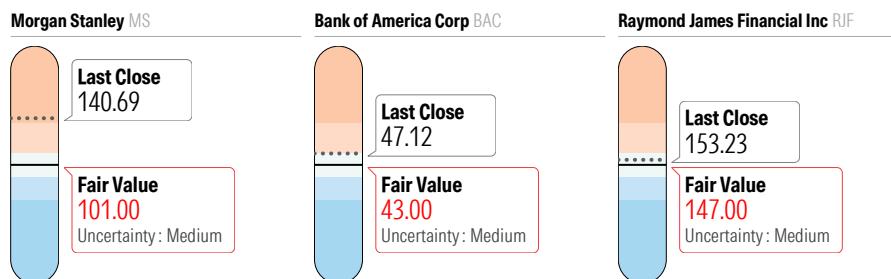
Brett Horn, CFA, Senior Equity Analyst, 21 Mar 2025

- Increases in asset prices can materially improve revenue and operating margins in the company's asset-management and wealth-management segments. There's also a sweet spot to the level of interest

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## Competitors



Economic Moat	 Narrow	 Wide	 Narrow
Currency	USD	USD	USD
Fair Value	101.00 21 Mar 2025 20:28, UTC	43.00 4 Feb 2025 23:19, UTC	147.00 12 Dec 2024 03:05, UTC
1-Star Price	136.35	58.05	198.45
5-Star Price	70.70	30.10	102.90
Assessment	Overvalued 27 Jun 2025	Fairly Valued 27 Jun 2025	Fairly Valued 27 Jun 2025
Morningstar Rating	★ 27 Jun 2025 21:23, UTC	★★★ 27 Jun 2025 21:26, UTC	★★★ 27 Jun 2025 21:29, UTC
Analyst	Brett Horn, Senior Equity Analyst	Suryansh Sharma, Senior Equity Analyst	Kevin Brown, Senior Equity Analyst
Capital Allocation	Exemplary	Standard	Standard
Price/Fair Value	1.39	1.10	1.04
Price/Sales	3.77	3.59	2.40
Price/Book	2.33	1.30	2.57
Price/Earning	16.40	13.73	14.32
Dividend Yield	2.63%	2.21%	1.24%
Market Cap	225.71 Bil	354.90 Bil	30.91 Bil
52-Week Range	90.94–142.03	33.07–48.08	104.24–174.32
Investment Style	Large Value	Large Value	Mid Blend

rates that can improve earnings.

- The E-Trade and Eaton Vance acquisitions give Morgan Stanley exposure to some interesting tailwinds, such as employee stock administration plans, mass customization of asset management products, and self-directed brokerage.
- Morgan Stanley arguably has billions of dollars in excess capital that it can use for acquisitions or return to shareholders.

### Bears Say Brett Horn, CFA, Senior Equity Analyst, 21 Mar 2025

- Operating leverage has recently led to strong earnings performance, but any pullback in revenue from a recession could also lead to material margin contraction.
- Proposed bank capital rules could lower repurchases and slow dividend growth over the next several years.
- Recent acquisitions may fail to live up to expectations. Self-directed trading activity could be at a

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cyclical high, while many asset management mergers don't lead to improved net asset inflows.

## Economic Moat Brett Horn, CFA, Senior Equity Analyst, 21 Mar 2025

We assess Morgan Stanley as having a Narrow Morningstar Moat Rating. Its status as one of the largest financial institutions by both headcount and global reach means that the company has a competitive advantage derived from the personal networks of its employees and financial product distribution channels to garner transaction mandates. The company's reputation, developed over the decades, for pricing transactions to benefit both sellers and buyers puts it in a strong position when management teams are contemplating an investment banking deal. Morgan Stanley is consistently ranked in the top 5, often the top 3, among global investment banks for revenue. Its relatively high revenue production per employee is evidence that its brand makes the company an employer of choice when financial talent is seeking a new home.

In wealth management, Morgan Stanley is considered one of the wirehouse wealth management firms in the United States along with Bank of America-Merrill Lynch, UBS, and Wells Fargo. At the end of 2024, Morgan Stanley had around \$4.7 trillion of client assets supervised by its financial advisors and another \$1.4 trillion of self-directed retail client assets.

There are two major ways of generating revenue for advisors: collecting asset-based fees and commission-based. Fee-based advisors charge clients a flat rate based on asset levels, while commission-based advisors generate commissions from transactions, such as securities trades and purchasing mutual funds. There's a trend in the wealth management industry toward more fee-based accounts than commission-based.

Wealth management firms benefit from both client asset stickiness and advisor stickiness. On the one hand, clients are often hesitant to switch advisors because of existing relationships with their current advisor, uncertainty about the potential cost-benefit trade-off of a switch, and inertia with financial management decision-making. For example, wealth management firm LPL Financial often posts an AUM retention rate above 95%. Data from McKinsey show that for advisors serving households with more than \$250,000 in assets, even the bottom-performing quartile of advisors have a client retention rate of 92%, with top-performing quartile advisors retaining 99% of clients.

On the other hand, we believe advisors tend to stay with their current firm due to the risk of losing client assets if they switch. Based on Cerulli's research, an advisor loses around 30% of client assets when switching. The 2004 Broker Protocol allows advisors to bring key client information when transitioning to new firms without being sued by former firms. Nevertheless, former firms could still limit the client documents and paperwork a switching advisor could bring, adding to the leaving advisor's client attrition. Operational logistics challenges, such as transferring client accounts and learning new technology, could deter advisors from switching. Cerulli estimates that the average tenure of an advisor

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with a firm is 10.8 years, equivalent to a 90.7% retention rate.

Advisors going independent has been an industry trend for the past decade, and we've seen wirehouse firms and broker/dealers lose advisors. The wirehouse firms lost their advisor headcount at a negative 1.6% 10-year CAGR from 2011 to 2021, and broker/dealers (national and regional broker/dealers and independent broker/dealers) recorded a smaller decline CAGR at negative 1.3%. A wealth management firm's brand can also play a role in attracting and retaining clients.

Investment banking moats (equity underwriting, debt underwriting, merger advisory, restructuring advisory) are primarily built on intangibles. Intangibles for an investment bank are in the strength of its reputation, relationships with investors, history with company executives, industry expertise, research analyst coverage, track record of successful deals, and distribution capabilities. Having a strong intangibles asset-based moat increases the probability that the investment bank will be hired for the coveted lead advisor position on an investment banking deal that comes with superior revenue share and economics compared with other investment banks in the underwriting syndicate or that provides lower value services, such as a fairness opinion on the valuation of a deal. A strong brand can also position the firm as an employer of choice for productive bankers. High-level indicators of an investment bank's intangible asset can be seen in its investment banking league table position, participation in high-profile transactions, and revenue production of its bankers.

We see little evidence of moats in developed financial markets for institutional securities trading by investment banks and broker/dealers. Financial instruments in developed markets often have fairly transparent pricing and high levels of liquidity (the ability to trade without significantly affecting the financial instrument's price). The tight trading spreads of equities on financial exchanges and increased electronification of fixed-income trading are examples of the decreased profit potential for institutional broker/dealers. Increased profits may be had in more opaque areas of trading, such as bespoke derivatives or block trades, but they often come with greater risk for the broker/dealer. For example, a close-to-ideal situation for a broker/dealer would be to execute two offsetting trades simultaneously, such as buying shares from a client who wants to sell out of a position and immediately selling those shares to another client who wants to buy them. However, in a block trade where the investment bank buys a large chunk of shares from a selling shareholder, those shares would sit on the investment bank's balance sheet while looking for investors to buy those shares. In the time that the shares are on the investment bank's balance sheet, the value of the shares could decrease and produce a loss on that block trade.

Even high revenue and operating margins in institutional trading don't necessarily indicate an economic moat that generates excess returns on capital. For a couple of global investment banks with USD billions in institutional trading revenue and operating margins that can be 10 percentage points higher than smaller investment banks, they can have returns on capital that are volatile and in the high-

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single digits to low-double digits, which is not significantly different from the cost of capital needed to support the business. Broker/dealers often have to hold an inventory of financial instruments on their balance sheet to facilitate client transactions, such as fixed-income securities. Financial regulators have increased the amount of generally more expensive capital, such as shareholders' equity or long-dated corporate bonds, that are used to fund the inventory of financial instruments at large banks with trading operations to reduce their solvency risk and liquidity risk. So, even if the revenue and operating margins of an investment bank's institutional trading business are high, returns on capital can be low, which signals the lack of a moat that generates excess economic returns.

We believe 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. For the industry overall, the average narrow redemption (retention) rate, which does not include exchange redemptions, has been 25% or less (75% or greater) annually during the past five-, 10-, 15-, 20-, 25-, and 30-year periods. While traditional asset managers tend to rely more on investor inaction to keep redemption rates low, alternative asset managers use lockup periods to prevent investors from redeeming part or all of their investments for prolonged periods. Private equity funds tend to have the longest lockup periods of seven-10 years compared with what is more common quarterly redemption periods for most hedge funds and credit alternatives offerings after a period of time invested with a fund (albeit generally with a cap on period-level redemptions).

Asset managers can improve on the switching cost advantage inherent in their business with organizational attributes (such as product mix, distribution channel concentration, and geographic reach) and intangible assets (such as strong and respected brands and manager reputations derived from successful records of investment performance), which can provide them with a degree of differentiation from their peers.

We generally refer to all these things—the organizational attributes and the more common intangibles—as intangible assets that can either add to or subtract from the switching cost advantage that might be inherent in an asset manager's business model. For example, firms that offer niche products with significantly higher switching costs—such as retirement accounts, alternative funds with lockup periods, and tax-managed strategies—that allow them to hold on to assets longer are generally viewed as having intangibles that clearly separate them from peers. Meanwhile, the depth and breadth of product mix, distribution channel concentration, geographic reach, and successful investment performance records are all visible attributes. Still, it tends to be harder to make a direct connection to their influence on switching costs. It can generally be inferred that firms with above-average

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investment performance will tend to see lower redemption rates. At the same time, companies with diversified offerings can offset flows out of one asset class or geography with flows into another during market cycles.

While the industry's barriers to entry are not particularly significant, the barriers to success are extremely high. It not only takes time and skill to put together a long enough record of investment performance to start gathering assets but even more time to build the scale necessary to remain competitive. This has generally provided the larger, more established asset managers with an advantage over the smaller players in the industry, 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 US 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 both portfolio and overall firm performance.

Asset stickiness (the degree to which assets remain with a manager over time) can be a primary differentiator between wide- and narrow-moat firms, as 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.

## Fair Value and Profit Drivers Brett Horn, CFA, Senior Equity Analyst, 21 Mar 2025

We are lowering our fair value estimate for Morgan Stanley to \$101 per share from \$107 after making some adjustments to our projections based on current capital market conditions. Our fair value estimate equates to a forward price/earnings ratio of 11.7 times and a price/tangible book ratio of 2.6 times.

We project a net revenue compound annual growth rate of over 2.5% during the next five years. We forecast most revenue lines annually increasing at low- to mid-single-digit percentage rates, except for trading revenue that we believe will contract slightly after a period of likely overearning. We forecast assets under management growing at a 6%-8% compound annual growth rate over the next five years

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from asset price appreciation and the shift to wealth management fee-based assets from commission-based assets. We expect investment banking revenue to grow at a 2.5% compound annual growth rate after recovering from recent cyclical lows but entering a period of heightened economic uncertainty.

We have net interest income growing at a 8% compound annualized growth rate as the effects of normalized short-term interest rates is more than offset by the impacts of balance sheet growth. We forecast institutional trading to contract over the next five years. We believe recent trading revenue has been abnormally high at many investment banks, so it will take multiple years of growth in the global economy and at Morgan Stanley for the current trading revenue level to be considered normal.

We model across-a-cycle operating margins of around 26%, which is a bit short of management's target for an expense ratio (or bank efficiency ratio) of less than 70%. We calculate Morgan Stanley earning about a 18% return on average tangible common equity and having a long-term gross leverage ratio of 12-13 times. Last, we use a cost of equity of 9% in our discounted cash flow model.

## Risk and Uncertainty Brett Horn, CFA, Senior Equity Analyst, 21 Mar 2025

Morgan Stanley has performed well over the previous several years and any missteps under new leadership could reverse recently positive market sentiment. Management has more than doubled its wealth management segment operating margins in recent years from about 12% in 2012 and is aiming for over 30% in the long run. The company also booked extremely strong fixed income trading results of \$7 to \$9 billion since 2020 compared with \$4 to \$5 billion before 2020. With the company doing so well on multiple metrics, there's arguably more room to disappoint than surprise to the upside.

While we believe Morgan Stanley's acquisitions of Eaton Vance and E-Trade have good strategic rationale, the company has been integrating two relatively large organizations at the same time. Part of the reason for the acquisitions is that they're complementary to Morgan Stanley's existing businesses, but being complementary does mean some degree of difference. For example, E-Trade is more of an online brokerage that caters to do-it-yourself investors, while Morgan Stanley has historically operated a full-service wealth manager.

Morgan Stanley has moderate exposure to environmental, social, and governance risks. The largest social issue for Morgan Stanley and many other investment banks is their ability to attract and retain high-quality talent. Additionally, many investment banks are notorious for their long work hours. This is factored into our model in a relatively high compensation ratio. Investment banks and wealth management firms can often have product governance issues stemming from their trading operations. Regulatory fines and litigation expenses are a normal part of business that we generally incorporate into our valuation model.

Our Morningstar Uncertainty Rating for Morgan Stanley is Medium, as the company has increased the diversity and stability of its earnings.

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## Capital Allocation Brett Horn, CFA, Senior Equity Analyst, 21 Mar 2025

Our Morningstar Capital Allocation Rating for Morgan Stanley is Exemplary. In our opinion, the company's balance sheet is sound, its capital investment decisions are exceptional, and its capital return strategy is appropriate. At the end of 2024, the company had a common equity Tier 1 capital ratio of 15.9%. This ratio is calculated based on risk-weighted assets, so it is a reasonable measure of capital adequacy for comparison with peers. Morgan Stanley's 15.9% is on the higher end for banks and is above the company's required statutory ratios.

The company's capital investment decisions are exceptional. At the end of 2024, the company had over \$23 billion of goodwill and intangibles with much of it from the acquisitions of Smith Barney, E-Trade, and Eaton Vance. Smith Barney was a transformative deal for Morgan Stanley and has been a key driver of the company's strategy and outperformance over the previous decade. More recent acquisitions of Eaton Vance and E-Trade also have the potential to further the company's shift to higher return on capital and steadier investment management revenue, give Morgan Stanley capabilities to compete with the largest financial sector companies, and gives the company exposure to secular tailwinds in workplace services and mass customization of asset management products.

We assess the company's capital return strategy as appropriate. Morgan Stanley has historically returned more capital through share repurchases than dividends, which we think makes sense for a firm with a large investment banking business. With a greater portion of earnings coming from steadier investment management activities, the company has increased its dividend payout over time, including a doubling of the dividend in 2021. The firm holds more capital than many of its peers, which is reducing returns on capital, but that's largely been due to restrictions on capital returns that regulators had placed on all banks in the US

Ted Pick, who joined Morgan Stanley in 1990, became CEO in 2024. Pick has been co-president of Morgan Stanley, head of the institutional securities business, and co-head of the firm's strategy. He was a leader in the institutional securities business when there was significant skepticism over whether the company would be able to streamline its fixed-income securities. Over the previous decade, the company has fairly consistently earned over \$5 billion in annual fixed income, currencies, and commodities trading revenue compared with the early to mid-2010s when \$4 billion was often mentioned as a benchmark of success.

James Gorman, who had been CEO since early 2010, is executive chairman. Gorman has been with the firm since 2006 and held responsibilities associated with the company's wealth management, investment management, operations, and corporate strategy. Before joining Morgan Stanley, he was an executive in Merrill Lynch's private client business. Gorman's time at Merrill should prove invaluable, as Morgan Stanley's wealth-management business significantly increased in importance following the Smith Barney acquisition. More recent acquisitions in employee stock plan administration services and

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discount brokerage further emphasize the importance of investment services experience for the company.

Historically, Morgan Stanley earned returns above its cost of capital. Management has greatly bolstered its credibility over the past several years by delivering on its wealth management operating margin and fixed-income trading goals. We also believe management has taken a reasonable approach to not cave in to the pressure of analysts and investors to increase its guidance targets, as much of the company's earnings and operating margins depend on macro factors that the company can't control. This arguably conservative guidance policy should lead to relatively less disappointment in the currently unpredictable macroeconomic environment.

## Analyst Notes Archive

### Morgan Stanley Earnings: Trading Revenue Drives Record-Setting Quarter, but Shares Still Expensive

Brett Horn, CFA, Senior Equity Analyst, 11 Apr 2025

Narrow-moat-rated Morgan Stanley reported strong first-quarter results, highlighted by record-setting net revenue generated by the Institutional Securities business, as it took full advantage of the heightened volatility in the trading environment. Despite the strong quarterly results and recent selloff of the stock alongside broader equity markets, we continue to see shares as modestly overvalued compared with our \$101 per share fair value estimate. The company reported net income to common shareholders of \$4.2 billion, or \$2.60 per diluted share, on \$17.7 billion of net revenue. Net revenue increased 9% sequentially and 17% year over year as trading volumes spiked amid continued developments in tariff policies that have the potential to disrupt long-standing globalization trends. We believe that trading revenue should ultimately correct from its currently elevated level over the long run. However, we note that this trend may persist in the near term until markets attain more clarity on global trading policies and the second-order effects they have on geopolitical uncertainty. Investment banking revenue grew 8% from the year-ago quarter, which we view favorably as heightened macroeconomic uncertainty typically exhibits downward pressure on merger activity, with IPO markets also depressed relative to historic averages. We continue to believe that 2024 was only the early innings of a recovery in dealmaking and investment banking revenue, but would note that the current backdrop has the potential to delay any sort of normalization by a few years. The wealth management segment, which we view as the crown jewel of the company, continued its momentum. While client assets ticked down 3% from the previous quarter, we viewed this as a solid outcome during a quarter when major indexes had begun to trade down. Further, we would note that management continues to execute on its initiative to raise client assets, booking a further \$93.8 billion in net inflows.

### US Blanket Tariffs Pose Significant Macroeconomic Risks and Are Unconditionally Bad for US Banks

Suryansh Sharma, Senior Equity Analyst, 3 Apr 2025

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President Donald Trump unleashed a barrage of tariffs on US trading partners that were significantly more aggressive and broader in scope than the market's expectation. US banks reacted negatively to the tariff announcements, and the US bank index was down more than 8%. Why it matters: The banking business is inherently tied to the macroeconomic performance of the US economy, and any negative impact on the economy will eventually percolate through the US banking industry's profitability. Economic slowdowns (or recessions) have a materially adverse impact on the US banking industry's loan growth, credit costs, investment banking fees, trading profitability, and asset management fees. The bottom line: Given the significant uncertainty associated with the tariff announcements, we are currently in the wait-and-see stance and do not plan to materially change our fair value estimates for US banks. While there are selective opportunities, US banks are fairly valued on average even after today's sharp correction, and we think investors should wait for a bigger margin of safety before going all-in into the sector. Big picture: If the current tariff regime remains in place in the long run, the US banking industry will certainly be hit hard, and the probability of recession will increase substantially. We estimate a midteens percentage fair value estimate decrease for the sector in a bear-case scenario, but the bank stocks can correct significantly more than that in the near term, given the hit to their profitability.

**Morgan Stanley Earnings: Outlook Remains Positive, and Market Has Priced It In** Michael Wong, CFA, Director, 16 Jan 2025

Narrow-moat-rated Morgan Stanley reported strong 2024 results, and we expect results to remain fairly strong for the foreseeable future. However, we believe the market has priced in this view over the previous two quarters, and we see the shares as slightly overvalued compared with our \$106 fair value estimate. Morgan Stanley reported net income of \$12.8 billion, or \$7.95 per diluted share, on \$61.8 billion of net revenue for 2024. Net revenue even surpassed 2021's previous record, thanks to strength in trading and growth in wealth management client assets to \$6.2 billion from \$4.9 billion in 2021. There's likely still room for growth in investment banking as the economy remains strong. We still believe that trading revenue is above normal levels and that it could experience slow growth or even a slight reset lower going forward. Management said net interest income in the first quarter of 2025 will likely be around the fourth quarter's level and noted that low-cost sweep deposit balances increased for the second quarter in a row, which could be positive for all wealth management firms and retail brokerages if this marks a turning point for sweep deposits. We don't currently view interest rates remaining relatively high as being that impactful to Morgan Stanley through its net interest income line, but if higher interest rates cause a prolonged market correction, then investment management fees would take a step back. Political uncertainty in the US could temporarily disrupt capital-raising and merger activity, but given generally looser regulations, as long as new policies aren't a material detriment to the economy, we expect investment banking activity to grow over the medium term.

# Morgan Stanley MS ★ 27 Jun 2025 21:23, UTC

Last Price 140.69 USD 27 Jun 2025	Fair Value Estimate 101.00 USD 21 Mar 2025 20:28, UTC	Price/FVE 1.39	Market Cap 225.71 USD Bil 27 Jun 2025	Economic Moat™  Narrow	Equity Style Box  Large Value	Uncertainty Medium	Capital Allocation Exemplary	ESG Risk Rating Assessment¹  4 Jun 2025 05:00, UTC
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## Morgan Stanley: FVE up to \$106 From \$97 After Adjusting for Client Assets and Regulatory Capital

Michael Wong, CFA, Director, 18 Nov 2024

We've increased our fair value estimate for narrow-moat-rated Morgan Stanley to \$106 per share from \$97. This implies a forward price/earnings ratio of about 12.5 times and a price/tangible book ratio of 2.4 times. Of the \$9 increase in our fair value estimate, approximately \$2 is from earnings accumulated since our previous valuation update, \$3 is from higher client asset levels after strong equity market returns, \$2 is from higher forecast institutional securities revenue, and \$2 is from incorporating a 10% increase in regulatory capital levels compared with our previous model that included a 20% increase. We're projecting a net revenue compound annual growth rate of over 4.5% during the next five years. We forecast assets under management growing at a 6%-7% compound annual growth rate over the next five years from asset price appreciation and the shift to wealth management fee-based assets from commission-based assets. We have investment banking revenue growing at an 8.5% CAGR as it recovers from recent cyclical lows. We have net interest income hovering around \$8 billion to \$9.5 billion as a decline in short-term interest rates decreases yields on earning assets and funding costs. We forecast institutional trading to be nearly flat over the next five years. We believe recent trading revenue has been abnormally high at many investment banks, so it will take multiple years of growth in the global economy and at Morgan Stanley for the current trading revenue level to be considered normal. We model across-a-cycle operating margins of around 30%. This operating margin is consistent with management's target for an expense ratio (or bank efficiency ratio) of less than 70%. We calculate Morgan Stanley earning about a 20% return on average tangible common equity and having a long-term gross leverage ratio of 11-12 times. Last, we use a cost of equity of 9% in our discounted cash flow model.

## Republican Win Largely Positive for Capital Markets and Investment-Services Firms Michael Wong, CFA, Director, 15 Nov 2024

We believe the election of Donald Trump as president and Republican control of the US Senate and House will be largely positive for capital markets and investment-services firms. We will adjust our valuation models as government policies solidify, but with a rally of over 10% for multiple capital markets companies after the election, we believe potential tailwinds have largely been incorporated into share prices. We view most capital markets and investment-services firms as fairly valued to slightly overvalued. In terms of investment banking, the Republican Party has historically been more friendly toward mergers than the Democratic Party. Investment banks in general, and M&A-focused investment banks like Evercore and Lazard especially, will benefit from higher M&A volume. Equity underwriting should remain strong as long as the stock market holds up, while there's more uncertainty around fixed-income underwriting with the yield curve steepening. A likely steepening yield curve should add to net interest income. The Federal Reserve is cutting rates on the short end, and the 10-year

# Morgan Stanley MS ★ 27 Jun 2025 21:23, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment <sup>1</sup>
140.69 USD 27 Jun 2025	101.00 USD 21 Mar 2025 20:28, UTC	1.39	225.71 USD Bil 27 Jun 2025	Narrow	Large Value	Medium	Exemplary	4 Jun 2025 05:00, UTC

US Treasury yield is picking up after the election, as the market is pricing in likely higher inflation in the long term. While the Federal Reserve should continue to cut interest rates, the market is pricing in a more gradual pace of cuts, which benefits some companies with a relatively higher proportion of interest-earning assets tied to short-term interest rates. If the stock market is able to hold on to recent gains, and especially if the market continues to trend upward, wealth-management and retail brokerages should report new records in client assets, which are the foundation of earnings growth.

## The New World of Direct Indexing and Mass Personalization: Potential Disruption Can't Be Ignored

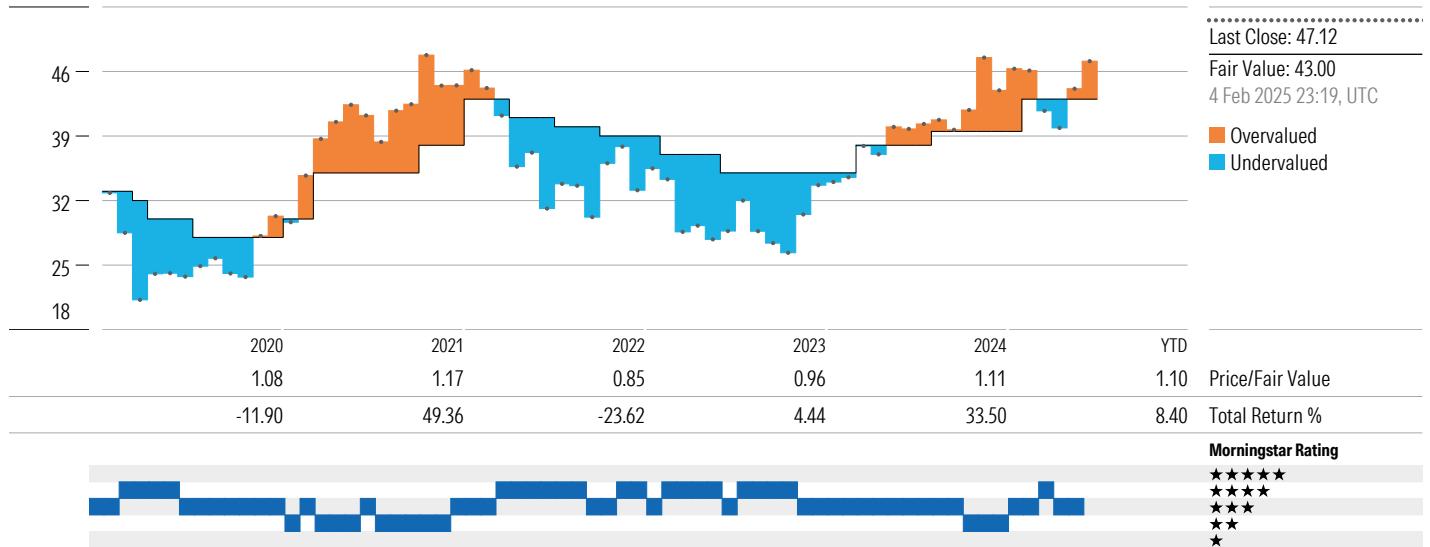
Michael Wong, CFA, Director, 11 Nov 2024

Direct indexing in some form has existed for decades, but advances in technology have recently broadened its availability. With its arguable superiority to existing passive index funds and exchange-traded funds, investment industry leaders are positioning for the opportunities and threats it unleashes. While there have already been hundreds of billions of dollars dedicated to direct indexing offerings, numerous firms such as BlackRock and Morgan Stanley have acquired direct indexing capabilities in anticipation of further rapid growth. Informed by our case studies and analysis, we calculate a broad range of outcomes for the growth of direct indexing. At the low end, direct-to-retail investor direct indexing offerings could remain a niche product of unfulfilled potential similar to robo-advisors with annual revenue in hundreds of millions. Though, at the high end, direct indexing and mass personalization could be as momentous as the advent of exchange-traded funds, restructuring the investment services ecosystem. If direct indexing becomes widespread, we believe the winners will be the retail brokerages and robo-advisors. Traditional active and passive asset managers will likely be hit by direct indexing. And index providers, financial data firms, and wealth management service providers could face opportunities and threats from the growth of direct indexing. We see little effect on the profits of wealth management firms.

# Morgan Stanley MS ★ 27 Jun 2025 21:23, UTC

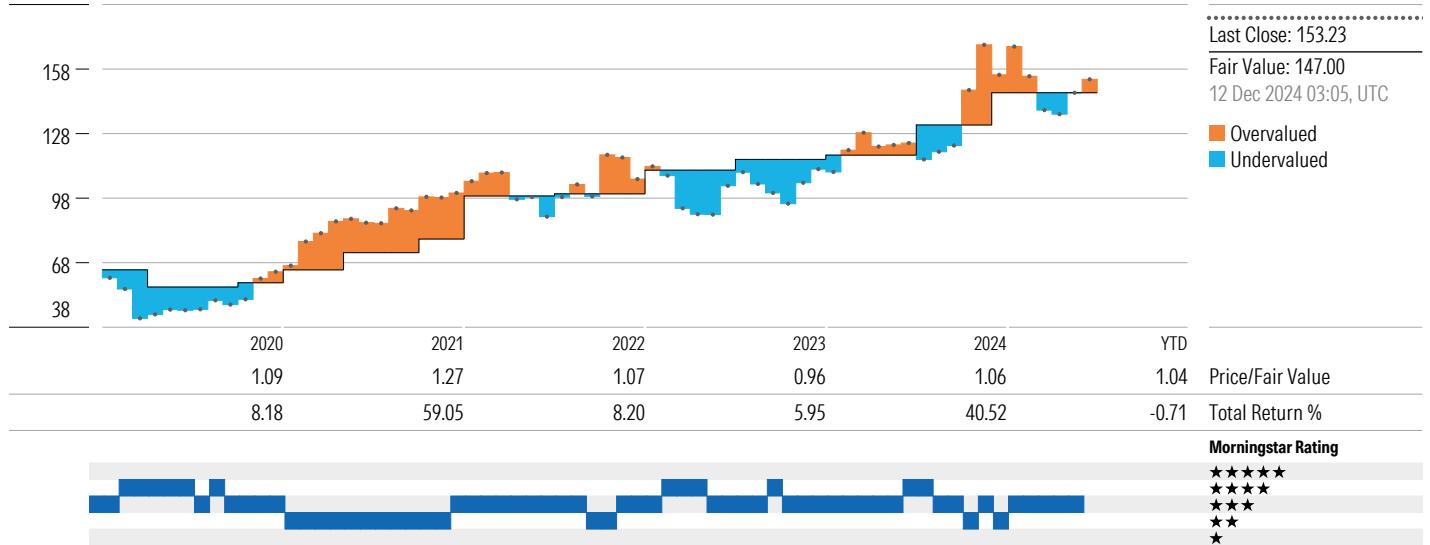
## Competitors Price vs. Fair Value

### Bank of America Corp BAC



Total Return % as of 27 Jun 2025. Last Close as of 27 Jun 2025. Fair Value as of 4 Feb 2025 23:19, UTC.

### Raymond James Financial Inc RJF



Total Return % as of 27 Jun 2025. Last Close as of 27 Jun 2025. Fair Value as of 12 Dec 2024 03:05, UTC.

# Morgan Stanley MS ★ 27 Jun 2025 21:23, UTC

Last Price 140.69 USD 27 Jun 2025	Fair Value Estimate 101.00 USD 21 Mar 2025 20:28, UTC	Price/FVE 1.39	Market Cap 225.71 USD Bil 27 Jun 2025	Economic Moat™  Narrow	Equity Style Box  Large Value	Uncertainty Medium	Capital Allocation Exemplary	ESG Risk Rating Assessment <sup>1</sup>  4 Jun 2025 05:00, UTC
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## Morningstar Valuation Model Summary

### Financials as of 20 Mar 2025

	Actual			Forecast				
	2022	2023	2024	2025	2026	2027	2028	2029
Fiscal Year, ends 31 Dec								
Net Interest Income (USD Mil)	9,327	8,230	8,611	9,973	10,970	11,519	11,980	12,459
Non Interest Income (USD Mil)	44,341	45,913	53,150	55,318	57,500	60,155	59,783	57,709
Total Pre-Provision Revenue (USD Mil)	53,668	54,143	61,761	65,291	68,470	71,674	71,763	70,168
Provision for Loan Losses (USD Mil)	280	532	264	399	439	461	479	498
Operating Expenses (USD Mil)	39,299	41,798	43,901	46,286	48,153	50,046	51,330	51,873
Operating Income (USD Mil)	14,089	11,813	17,596	18,607	19,878	21,168	19,954	17,796
Net Income Available to Common Stockholders (USD Mil)	11,029	9,087	13,390	14,555	15,553	16,565	15,108	13,463
Adjusted Net Income (USD Mil)	10,540	8,530	12,800	13,965	14,963	15,975	14,518	12,873
Weighted Average Diluted Shares Outstanding (Mil)	1,713	1,646	1,611	1,611	1,611	1,611	1,611	1,611
Earnings Per Share (Diluted) (USD)	6.15	5.18	7.95	8.67	9.29	9.92	9.01	7.99
Adjusted Earnings Per Share (Diluted) (USD)	6.15	5.18	7.95	8.67	9.29	9.92	9.01	7.99
Dividends Per Share (USD)	2.96	3.26	3.55	3.70	3.70	3.70	3.70	3.70

### Margins & Returns as of 20 Mar 2025

	Actual			Forecast					
	3 Year Avg	2022	2023	2024	2025	2026	2027	2028	2029
Net Interest Margin %	0.8	0.8	0.7	0.8	0.8	0.9	0.9	0.9	0.9
Efficiency Ratio %	73.8	73.2	77.2	71.1	70.9	70.3	69.8	71.5	73.9
Provision as % of Loans	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1

### Growth & Ratios as of 20 Mar 2025

	Actual			Forecast					
	3 Year Avg	2022	2023	2024	2025	2026	2027	2028	2029
Net Interest Income Growth %	2.3	15.9	-11.8	4.6	15.8	10.0	5.0	4.0	4.0
Non Interest Income Growth %	0.9	-14.2	3.6	15.8	4.1	3.9	4.6	-0.6	-3.5
Total Pre-Provision Revenue Growth %	—	-10.2	0.9	14.1	5.7	4.9	4.7	0.1	-2.2
Operating Expenses Growth %	—	-2.0	6.4	5.0	5.4	4.0	3.9	2.6	1.1
Operating Income Growth %	—	-28.4	-16.2	48.9	5.7	6.8	6.5	-5.7	-10.8
Net Income Growth %	-4.2	-26.6	-17.6	47.3	8.7	6.9	6.5	-8.8	-10.9
Earnings Per Share Growth %	-0.4	-23.4	-15.8	53.3	9.1	7.1	6.8	-9.1	-11.3

### Valuation as of 20 Mar 2025

	Actual			Forecast				
	2022	2023	2024	2025	2026	2027	2028	2029
Price/Earning	13.8	18.0	15.8	16.2	15.1	14.2	15.6	17.6
Price/Book	—	—	—	—	—	—	—	—
Price/Tangible Book	2.2	2.3	2.8	3.6	3.5	3.4	3.3	3.2
Dividend Yield %	3.5	2.8	2.6	2.6	2.6	2.6	2.6	2.6
Dividend Payout %	51.2	67.6	47.9	42.7	39.8	37.3	41.1	46.3

### Operating Performance / Profitability as of 20 Mar 2025

	Actual			Forecast				
	2022	2023	2024	2025	2026	2027	2028	2029
Fiscal Year, ends 31 Dec								
ROA %	0.9	0.8	1.1	1.2	1.2	1.3	1.1	1.0
ROE %	10.7	9.1	13.2	14.5	16.0	16.5	14.6	12.7
Return on Tangible Equity %	15.1	12.8	18.5	20.8	23.5	24.3	21.3	18.2

# Morgan Stanley MS ★ 27 Jun 2025 21:23, UTC

Last Price 140.69 USD 27 Jun 2025	Fair Value Estimate 101.00 USD 21 Mar 2025 20:28, UTC	Price/FVE 1.39	Market Cap 225.71 USD Bil 27 Jun 2025	Economic Moat™  Narrow	Equity Style Box  Large Value	Uncertainty Medium	Capital Allocation Exemplary	ESG Risk Rating Assessment <sup>1</sup>  4 Jun 2025 05:00, UTC
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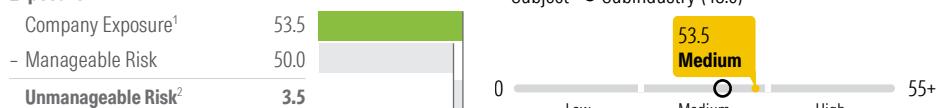
Financial Leverage (Reporting Currency)	Actual			Forecast											
	2022	2023	2024	2025	2026	2027	2028	2029							
Fiscal Year, ends 31 Dec															
Equity/Assets %	8.5	8.3	8.6	7.7	7.8	7.7	7.7	7.6							
Forecast Revisions as of	2025	2026	2027												
Prior data as of 28 Sep 2023	Current	Prior	Current	Prior	Current	Prior	Current	Prior							
Fair Value Estimate Change (Trading Currency)	101.00	89.19	—	—	—	—	—	—							
Net Interest Income (USD Mil)	9,973	8,401	10,970	8,191	11,519	8,188									
Total Pre-Provision Revenue (USD Mil)	65,291	54,401	68,470	55,488	71,674	56,917									
Operating Income (USD Mil)	18,607	13,512	19,878	15,143	21,168	16,256									
Net Income (USD Mil)	—	9,962	—	10,935	—	11,782									
Earnings Per Share (Diluted) (USD)	8.67	6.21	9.29	7.12	9.92	6.88									
Adjusted Earnings Per Share (Diluted) (USD)	8.67	6.21	9.29	7.12	9.92	6.88									
Dividends Per Share (USD)	3.70	-3.25	3.70	-3.40	3.70	-3.40									
Key Valuation Drivers as of 20 Mar 2025	Discounted Cash Flow Valuation as of 20 Mar 2025														
Cost of Equity %	9.0	USD Mil													
Stage II Net Income Growth Rate %	3.5	0													
Stage II Incremental ROIC %	15.0	0													
Perpetuity Year	15	0													
Additional estimates and scenarios available for download at <a href="https://pitchbook.com/">https://pitchbook.com/</a> .															
Other Adjustments															
<b>Equity Value</b> <b>161,021</b>															
Projected Diluted Shares															
<b>Fair Value per Share (USD)</b> <b>101.00</b>															

# Morgan Stanley MS ★ 27 Jun 2025 21:23, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment¹
140.69 USD 27 Jun 2025	101.00 USD 21 Mar 2025 20:28, UTC	1.39	225.71 USD Bil 27 Jun 2025	Narrow	Large Value	Medium	Exemplary	 4 Jun 2025 05:00, UTC

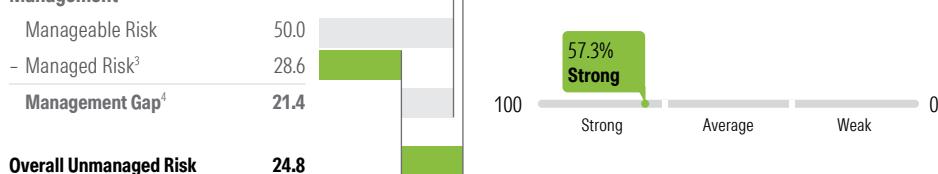
## ESG Risk Rating Breakdown

### Exposure



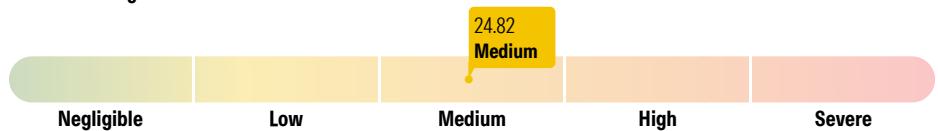
- ▶ Exposure represents a company's vulnerability to ESG risks driven by their business model
- ▶ Exposure is assessed at the Subindustry level and then specified at the company level
- ▶ Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

### Management



- ▶ Management measures a company's ability to manage ESG risks through its commitments and actions
- ▶ Management assesses a company's efficiency on ESG programs, practices, and policies
- ▶ Management score ranges from 0-100% showing how much manageable risk a company is managing

## ESG Risk Rating



ESG Risk Ratings measure the degree to which a company's value is impacted by environmental, social, and governance risks, by evaluating the company's ability to manage the ESG risks it faces.

1. A company's Exposure to material ESG issues 2. Unmanageable Risk refers to risks that are inherent to a particular business model that cannot be managed by programs or initiatives 3. Managed Risk = Manageable Risk multiplied by a Management score of 57.3% 4. Management Gap assesses risks that are not managed, but are considered manageable 5. ESG Risk Rating Assessment = Overall Unmanaged Risk + Unmanageable Risk

## ESG Risk Rating Assessment<sup>5</sup>



ESG Risk Rating is of Jun 04, 2025. Highest Controversy Level is as of Jun 08, 2025. Sustainalytics Subindustry: Investment Banking and Brokerage. Sustainalytics provides Morningstar with company ESG ratings and metrics on a monthly basis and as such, the ratings in Morningstar may not necessarily reflect current Sustainalytics' scores for the company. For the most up to date rating and more information, please visit: [sustainalytics.com/esg-ratings/](https://sustainalytics.com/esg-ratings/).

## Peer Analysis 04 Jun 2025

Company Name	Exposure	Management	ESG Risk Rating
<b>Morgan Stanley</b>	53.5   Medium	57.3   Strong	24.8   Medium
Bank of America Corp	53.0   Medium	59.1   Strong	23.8   Medium
The Goldman Sachs Group Inc	53.7   Medium	56.8   Strong	25.2   Medium
Raymond James Financial Inc	46.4   Medium	38.0   Average	29.6   Medium
Stifel Financial Corp	49.7   Medium	44.9   Average	28.7   Medium

## Appendix

### Historical Morningstar Rating

#### Morgan Stanley MS 27 Jun 2025 21:23, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	★	★★	★★	★★	★★	★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★	★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★	★★★	★★★★	★★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★	★★★	★★★★	★★★★	★★★	★★★★	★★★★	★★★	★★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★	★★★	★★★	★★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★	★★★

#### Bank of America Corp BAC 27 Jun 2025 21:26, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	★★★	★★★	★★★★	★★★	★★★	★★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★★	★★★	★★★	★★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★	★★★

#### Raymond James Financial Inc RJF 27 Jun 2025 21:29, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★	★★	★★★	★★★	★★★★	★★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★	★★★	★★★★	★★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★	★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★	★★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★

# 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, 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 shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm 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.

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 singlepoint star rating.

## 1. 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 (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or 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 the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

## 2. 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 five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest,

after taxes (EBI) and the 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.

## 3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating is designed to capture the range of potential outcomes for a company's intrinsic value. This rating is used to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating is aimed at identifying the confidence we should have in assigning a fair value estimate for a given stock.

Our Uncertainty Rating is meant to take into account anything that can increase the potential dispersion of future

## Morningstar Equity Research Star Rating Methodology



# Research Methodology for Valuing Companies

outcomes for the intrinsic value of a company, and anything that can affect our ability to accurately predict these outcomes. The rating begins with a suggested rating produced by a quantitative process based on the trailing 12-month standard deviation of daily stock returns. An analyst overlay is then applied, with analysts using the suggested rating, historical rating data, and their own knowledge of the company to inform them as they make the final Uncertainty Rating decision. Ultimately, the rating decision rests with the analyst. Analysts take into account many characteristics when making their final decision, including cyclical factors, operational and financial factors such as leverage, company-specific events, ESG risks, and anything else that might increase the potential dispersion of future outcomes and our ability to estimate those outcomes.

Our recommended margin of safety—the discount to fair value demanded before we'd recommend buying or selling the stock—widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the potential dispersion of outcomes, 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 are: Low, Medium, High, Very High, and Extreme.

## Margin of Safety

Qualitative Analysis	Uncertainty Ratings	★★★★★ Rating	★ Rating
Low	20% Discount	25% Premium	
Medium	30% Discount	35% Premium	
High	40% Discount	55% Premium	
Very High	50% Discount	75% Premium	
Extreme	75% Discount	300% Premium	

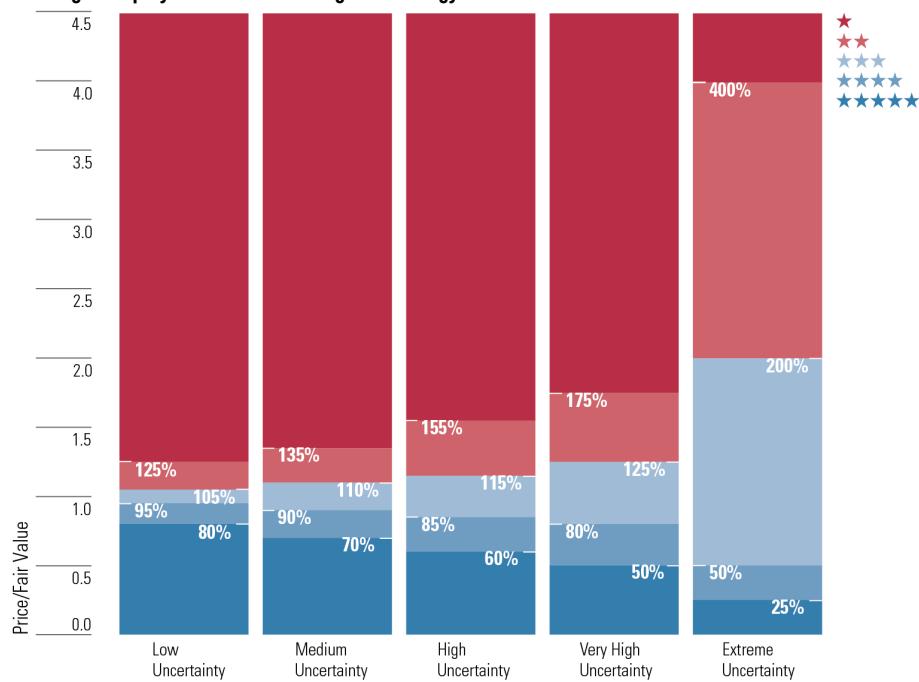
Our uncertainty rating is based on the interquartile range, or the middle 50% of potential outcomes, covering the 25th percentile–75th percentile. This means that when a stock hits 5 stars, we expect there is a 75% chance that the intrinsic value of that stock lies above the current market price. Similarly, when a stock hits 1 star, we expect there is a 75% chance that the intrinsic value of that stock lies below the current market price.

## 4. Market Price

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

For more details about our methodology, please go to <https://shareholders.morningstar.com>

## Morningstar Equity Research Star Rating Methodology



## 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 re-calculated 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 multi-year 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.

## Other Definitions

**Last Price:** Price of the stock as of the close of the market of the last trading day before date of the report.

**Capital Allocation Rating:** Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments,

# Research Methodology for Valuing Companies

and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

**Capital Allocation Rating:** Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

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**Sustainalytics ESG Risk Rating Assessment:** The ESG Risk Rating Assessment is provided by Sustainalytics; a Morningstar company.

Sustainalytics' ESG Risk Ratings measure the degree to which company's economic value at risk is driven by environment, social and governance (ESG) factors.

Sustainalytics analyzes over 1,300 data points to assess a company's exposure to and management of ESG risks. In other words, ESG Risk Ratings measures a company's unmanaged ESG Risks represented as a quantitative score.

Unmanaged Risk is measured on an open-ended scale starting at zero (no risk) with lower scores representing less unmanaged risk and, for 95% of cases, the unmanaged ESG Risk score is below 50.

Based on their quantitative scores, companies are grouped into one of five Risk Categories (negligible, low, medium, high, severe). These risk categories are absolute, meaning that a 'high risk' assessment reflects a comparable degree of unmanaged ESG risk across all subindustries covered.

The ESG Risk Rating Assessment is a visual representation of Sustainalytics ESG Risk Categories on a 1 to 5 scale. Companies with Negligible Risk = 5 Globes, Low Risk = 4, Medium Risk = 3 Globes, High Risk = 2 Globes, Severe Risk = 1 Globe. For more information, please visit [sustainalytics.com/esg-ratings/](https://sustainalytics.com/esg-ratings/)

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