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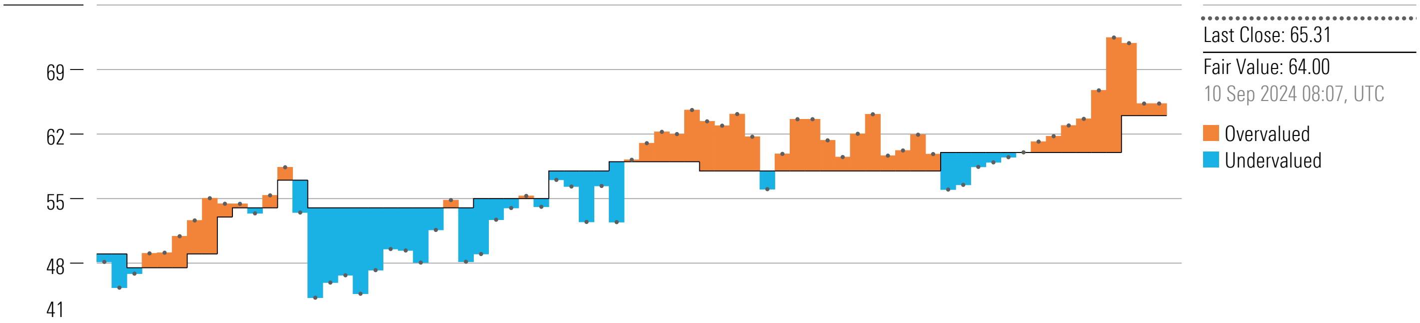
Coca-Cola Co KO ★★★ 1 Nov 2024 21:38, UTC

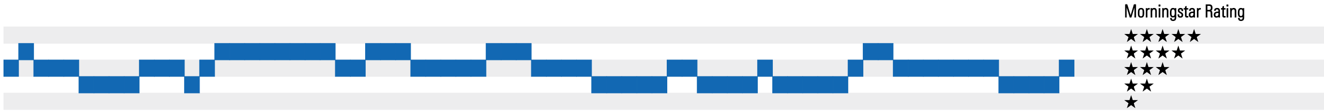
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
65.31 USD 31 Oct 2024	64.00 USD 10 Sep 2024 08:07, UTC	1.02	280.18 USD Bil 1 Nov 2024	Wide	Large Value	Low	Exemplary	2 Oct 2024 05:00, UTC

Price vs. Fair Value



	2019	2020	2021	2022	2023	YTD
Price/Fair Value	1.03	1.02	1.00	1.10	0.98	1.02
Total Return %	20.27	2.04	11.03	10.40	-4.46	13.30

Morningstar Rating



Total Return % as of 31 Oct 2024. Last Close as of 31 Oct 2024. Fair Value as of 10 Sep 2024 08:07, UTC.

Contents

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

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

Coca-Cola Earnings: Beverage Volumes Set to Rebound on Innovation and Targeted Marketing

Analyst Note Dan Su, CFA, Equity Analyst, 23 Oct 2024

Despite headwinds from consumer belt-tightening and geopolitical uncertainties, wide-moat Coca Cola delivered solid third-quarter results, including 9% and 5% growth in organic sales and comparable earnings per share, respectively. The resilient performance reaffirmed our constructive view on Coke's long-term growth outlook underpinned by its total beverage portfolio strategy and unwavering commitment to product innovation and brand investment. We plan to maintain our 2024 sales and adjusted EPS forecasts of $46 billion and $2.86, respectively, which align with management's outlook, and our 10-year forecasts for mid-single-digit annual sales growth and low 30s operating margins. We maintain our $64 fair value estimate, and shares look fully valued.

For the quarter, volumes dipped 1% on soft demand in China, Mexico, and Turkey, but Coke still outperformed wide-moat PepsiCo (with beverage volume down 2%) thanks to solid volume trends and market share gains in the US and Europe. We attribute Coke's strength in these markets to consumer-centric innovations and digitally enhanced marketing programs reinforcing the differentiated experiences associated with Coke's diverse portfolio. In particular, concerted efforts to provide healthier beverages resonated with consumers, driving volumes of Coca-Cola Zero Sugar up 11%. We expect similar initiatives, implemented in collaboration with bottlers in Latin America and Asia, to help restore volume growth in the regions.

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Sector	Industry
Consumer Defensive	Beverages - Non-Alcoholic

Business Description

Founded in 1886, Atlanta-headquartered Coca-Cola is the world's largest nonalcoholic beverage company, with a strong portfolio of 200 brands covering key categories including carbonated soft drinks, water, sports, energy, juice, and coffee. Together with bottlers and distribution partners, the company sells finished beverage products bearing Coca-Cola and licensed brands through retailers and food-service locations in more than 200 countries and regions globally. Coca-Cola generates around two thirds of its total revenue overseas, with a significant portion from emerging economies in Latin America and Asia-Pacific.

The 10% price-mix rise looked high, but once we strip away impacts from hyperinflationary markets, core pricing growth of 6% was consistent with our mid-single-digit expectation that we view as reasonable to preserve Coke's value standing. Pricing in the quarter also benefited from a favorable volume mix from developed markets where Coke product prices are higher than global averages. As emerging market volumes rebound and hyperinflationary pressure eases, we expect Coke's core pricing to normalize to 4% in 2025.

Business Strategy & Outlook Dan Su, CFA, Equity Analyst, 10 Sep 2024

We award a wide economic moat rating to Coca-Cola and expect its brand portfolio underpinning pricing power and close retailer relations, coupled with scale benefits stemming from a massive global system, to reinforce its competitive position in nonalcoholic beverages and drive excess investment returns for more than 20 years.

We are constructive on the firm's strategic focus on a total beverage portfolio and view its pivot to the nonsparkling categories (31% of Coke's 2023 volume) to bode well for healthy top-line growth (mid-single digits) over our forecast period. In addition to nurturing brands in-house (with nonsparkling concepts more than half of the innovation pipeline), the company has recently bulked up its presence in categories such as coffee and sports drinks with strategic acquisitions of strong challengers (Costa and BodyArmor, respectively) to entrenched category leaders. We expect the two-pronged growth strategy to serve Coke well. Geographical diversification offers another avenue of growth. Based on company disclosure, per capita beverage consumption in emerging markets ($144 in Asia-Pacific, $190 in Latin America) has a long way to go to catch up to the $1100 level seen in North America. We expect Coke to blend global best practices in brand and research investment with local culture and taste preference to speed up growth in these regions.

But Coke is not immune to risks. The company is vulnerable to misalignment of economic interests with large bottlers during periods of high-cost inflation, but we expect Coke's brand investments, real-time data analytics, and network services to help smooth the strains for mutual benefits. Consumer concerns and restrictive regulations have been headwinds, though we expect reformulation of classic recipes, new "better-for-you" products with natural ingredients, and expansion in under-penetrated markets including India, Southeast Asia, and Africa to help blunt the impact. Disruptions from e-commerce platforms and hard discounters continue to present challenges, which Coke has aptly responded to with proactive pack and mix management to bolster its value proposition while investing in digital capabilities.

Bulls Say Dan Su, CFA, Equity Analyst, 10 Sep 2024

- Coke can leverage strong bottler relationships in underpenetrated emerging markets to drive volume growth with classic recipes as well as new products tailored to local tastes.

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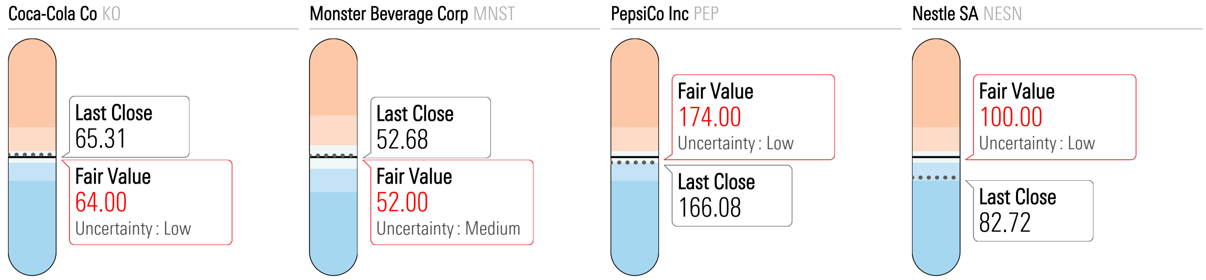
Competitors



	Coca-Cola Co KO	Monster Beverage Corp MNST	PepsiCo Inc PEP	Nestle SA NESN
Economic Moat	Wide	Narrow	Wide	Wide
Currency	USD	USD	USD	CHF
Fair Value	64.00 10 Sep 2024 08:07, UTC	52.00 12 Mar 2024 04:12, UTC	174.00 10 Oct 2024 14:47, UTC	100.00 17 Oct 2024 11:40, UTC
1-Star Price	80.00	70.20	217.50	125.00
5-Star Price	51.20	36.40	139.20	80.00
Assessment	Fairly Valued 1 Nov 2024	Fairly Valued 1 Nov 2024	Fairly Valued 1 Nov 2024	Undervalued 1 Nov 2024
Morningstar Rating	★★★1 Nov 2024 21:38, UTC	★★★1 Nov 2024 21:37, UTC	★★★1 Nov 2024 21:37, UTC	★★★★1 Nov 2024 17:24, UTC
Analyst	Dan Su, Equity Analyst	Dan Su, Equity Analyst	Dan Su, Equity Analyst	Diana Radu, Equity Analyst
Capital Allocation	Exemplary	Standard	Exemplary	Standard
Price/Fair Value	1.02	1.01	0.95	0.83
Price/Sales	6.06	7.44	2.48	2.35
Price/Book	10.57	8.77	11.69	6.47
Price/Earning	23.68	32.93	20.79	17.25
Dividend Yield	2.95%	0.00%	3.16%	3.63%
Market Cap	280.18 Bil	51.23 Bil	227.45 Bil	212.70 Bil
52-Week Range	56.06—73.53	43.32—61.23	158.03—183.41	81.10—100.82
Investment Style	Large Value	Mid Growth	Large Value	Large Blend

- Heavy investments in a digitalized supply chain and data analytics have better aligned Coke and its bottlers in product planning, manufacturing, and go-to-market strategy.
- As Costa recovers from the pandemic-related disruptions, it should help Coca-Cola gain a firmer footing in the coffee category and provide more consumer insights, given its global footprint.

Bears Say Dan Su, CFA, Equity Analyst, 10 Sep 2024

- Secular headwinds in carbonated soft drink demand in developed markets are a challenge to Coca-Cola's long-term growth outlook.
- The company's brand portfolio and product lineup in nonsparkling categories are less robust, and heavy investments are needed to bolster its competitive position.
- With two-thirds of revenue from international markets, Coke faces constant currency fluctuations that drive volatilities in reported earnings.

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Economic Moat Dan Su, CFA, Equity Analyst, 10 Sep 2024

We believe Coca-Cola has built a wide economic moat around its global beverage operations based on strong intangible assets and a significant cost advantage that will enable the company to deliver excess investment returns above its cost of capital over and beyond the next 20 years. We have modeled the company to generate returns on invested capital, or ROICs, including goodwill, that average 37% throughout the duration of our 10-year explicit forecast, comfortably surpassing our estimate of its weighted average cost of capital at 7%.

As the world's best known beverage company, Coca-Cola owns a strong portfolio of storied and iconic brands that resonate with consumers around the world, making its products the beverage of choice on both at-home and away-from-home consumption occasions. The special connection that Coca-Cola cultivates and maintains with generations of consumers has enabled the firm to dominate the carbonated soft drink, or CSD, category at the core of its business (69% of Coca-Cola's 2023 unit case volume sold). According to Euromonitor data, Coca-Cola commands a convincing lead in the CSD category with a volume share of 44% globally in 2023, 26 percentage points ahead of its main competitor wide-moat PepsiCo (18% share). Other than the flagship Coca-Cola brand, Sprite, Fanta, Diet Coke, and Coke Zero also rank as top-selling CSD brands that enjoy a loyal following. Leveraging Coca-Cola's retail relationship, the company has been able to establish a strong position in adjacent categories as well, such as water, juice, and sports drinks, with brands including Dasani, Minute Maid, and Powerade.

Coca-Cola's brand appeal results in a steady price premium over lesser-known brands that consumers are willing to pay up for, as well as low demand elasticity, thus affording Coca-Cola considerable pricing power. Unlike its lesser competitors, Coca-Cola enjoys the flexibility to pass on cost inflation using a combination of price hikes, pack variation, and channel mix shift, driving price/mix to consistently match or exceed headline inflation across its key markets. Even as the covid-19 lockdowns dealt a heavy blow to on-premises beverage consumption in 2020, overall Coke volume held up (down mid single digits from 2019, while food-service sales saw low- to midteens contraction) as consumers flocked to retailers and online marketplaces to stock up on Coke products for at-home consumption. The less favorable channel mix shift and volume notwithstanding, pricing was resilient at a mild 2% decline, with key markets in the US and Latin America still up in the low-single-digits. The notably low penetration of private-label products (a mere 5% in the US, versus high teens to low-20s across US food and beverage) in the CSD category despite a long history and massive size speaks to the enduring loyalty that Coca-Cola brands enjoy among CSD drinkers. The taste, emotional connection, and conspicuous consumption preferences associated with the Coca-Cola brands provide insulation to potential price erosion from the onslaught of competitively priced private-label products. Suffice it to say, numerous attempts from retailers—especially hard discounters—over the years have barely put a dent in Coca-Cola's ability to set price. Between 2019 and 2023 for instance, the company grew price/mix by an average of 6% while maintaining a volume increase at 2%.

Thanks to the strength and breadth of its brand portfolio, Coca-Cola has been able to attract to its ecosystem bottlers and distribution partners in key regions such as the US, Western Europe, Latin America, and the Asia-Pacific that have good capital, business acumen, and operational expertise. The prospects of solid pricing and volume, as well as an expected high penetration in both retail and food-service channels to ensure density of delivery and attractive returns on distribution logistics investments, are precisely what motivate the bottlers to commit capital to the 10-year renewable partnership with Coca-Cola and take charge of the heavy lifting of manufacturing and distribution. Coca-Cola only owns a sliver of the bottling and distribution capacity on the Coke system following refranchising, but the company aligns its economic interests closely with those of its bottlers with an incidence-based pricing model (whereby Coca-Cola sells concentrates and syrup to dedicated bottlers and in return takes a predetermined but undisclosed slice of the bottlers' revenue of finished beverage products). Through these arrangements, Coca-Cola exerts strong influence over innovation, product rollout, marketing, and the go-to-market strategy of its bottlers that are essential in shaping Coke's tight relationship with the retail channel and food-service providers.

As a CSD category leader, Coke products are indispensable to most retailers including grocers and convenience stores, and a key traffic driver to the beverage aisle, thus earning the Coke assortment favorable shelf allocation and placement. In return, retailers count on Coca-Cola as a strategic partner that not only reliably provides the most sought-after classic and on-trend beverage products to drive high turnover and profit growth, but also shares timely data analytics of broader consumption patterns to facilitate better planning of inventory, shelf space, and promotions in the stores. Similarly, the popularity of Coke's brands cements a dominant share in fountain beverages served at fast food locations, as the time-tested relationship built over decades has delivered commercial success for both sides. In the US, out of the 86,000 locations of the 10 largest fast food chains, 76% serve fountain drinks under the Coca-Cola banner, according to Beverage Digest. As Coca-Cola continues to invest heavily (2023 advertising budget of $5 billion, 11% of sales) behind its brand portfolio to elevate brand affinity and expand brand reach, the enhancement to Coke brands will further reinforce the strategic relationship with retailers and food-service providers, fueling a virtuous cycle.

Coca-Cola's wide economic moat is supported by more than intangible assets. We see a significant cost advantage stemming from scale as another pillar underpinning our favorable view on Coca-Cola's ability to generate economic returns. With a massive sales base of $46 billion in 2023 and an expansive global manufacturing and distribution footprint in the Coke system, Coca-Cola is in a favorable position to wring scale efficiency across the whole supply chain, resulting in a lower cost in manufacturing and distribution that is hard to match by smaller peers. This should give Coke an upper hand in pricing, both

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for established and new products. In the developed markets such as the US and Western Europe where premiumization is the key growth driver, a lower cost structure allows more investments in differentiation (in ingredients, flavors, packaging) to set Coke products apart from competition while keeping prices competitive. In emerging markets where affordability remains a hurdle for higher Coke product penetration, lower costs give Coca-Cola the room to inch down entry price points to expand its addressable consumer base. In addition, the scale and experience of a well-connected global Coke system should also enable the company to accelerate the commercialization process from budding lab ideas to thoughtful end market products, and to roll out and scale product innovation at a faster pace and a lower cost compared with rivals.

When taken together, with strong pricing power and a durable cost advantage arising from scale, we see Coca-Cola as remaining in an enviable position to extract attractive economic benefits from its own operations and bottler networks. As the management team continues to steer the global beverage giant with agility, discipline, digital savvy enabled with technology, and a sharp focus on investment returns, we expect the company to keep earning excess returns above its cost of capital over the next 20 years, in line with our wide economic moat rating.

Fair Value and Profit Drivers Dan Su, CFA, Equity Analyst, 10 Sep 2024

We are raising our fair value estimate to $64 per share from $60, mainly due to a low-single-digit uptick in 2024 adjusted EPS after we absorb Coke's second-quarter results, and the time value of money. Organic sales in the June quarter rose 15%, led by innovations, digital initiatives, and deft in-market executions, and adjusted EPS was up 7%. We now forecast 2024 sales and adjusted EPS to rise 0.8% and 7.5%, respectively, up from our prior estimates for increases of 0.5% and 5.1%. Our updated fair value estimate implies a 23 times multiple against our adjusted 2025 earnings estimate and a 2024 enterprise value/adjusted EBITDA multiple of 20 times.

Our mid-single-digit sales CAGR projection over the next 10 years is driven by strong emerging market growth (we forecast Latin America and the Asia-Pacific combined to make up 29% of overall sales by 2033, up from 23% in 2023), expansion in nonsparkling categories (water, sports, and energy drinks), and the Costa business steadily adding on offerings in the on-premises channel and for retail distribution. While 2022 and 2023 revenue growth (of 11% and 6%, respectively, on a reported basis) was largely driven by increases in price/mix as Coca-Cola flexes its pricing muscle amid cost inflation and currency headwinds, we forecast top-line growth to be more balanced between price/mix and volume in 2024 and onward—and see growth settling into the 4%-6% long-term target range set by management, which we believe is appropriate given industry dynamics. Coke has historically augmented organic growth with strategic acquisitions, and we expect the company to continue doing so in the coming years. Given a lack of information about its acquisition pipeline, however, we will refrain from incorporating mergers and acquisitions deals into our financial modeling until we gain

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better visibility.

On the profitability front, we model operating margins to widen by 260 basis points to 31.6% at the end of our 10-year forecast period, compared with 2023. In addition to gross margin expansion of roughly 150 basis points over the period—thanks to manufacturing efficiency gains (including improvements in finished goods businesses acquired in recent years such as BodyArmor)—we forecast better leverage of selling and distribution expenses (18.9% of sales by 2033 versus 19.6% in 2023). We also forecast advertising and marketing expense as a percentage of sales to fall slightly to 10.5% by 2033, compared with the 10.9% level in 2023.

Risk and Uncertainty Dan Su, CFA, Equity Analyst, 10 Sep 2024

We assign Coca-Cola a Low Morningstar Uncertainty Rating. We view strong bottler relationships as crucial to its business model and return profile, but in periods of high inflation, these relationships could be pressured as the bottlers tend to bear the brunt of cost increases. This is less of an issue in the US where local bottlers are small and have limited bargaining power, but in emerging markets—which hold the key to healthy volume growth—Coca-Cola faces much larger bottlers, such as Arca Continental and Coke Femsa, that are likely in a better position to negotiate.

Nonalcoholic beverage demand tends to be resilient through economic cycles. However, Coke has high exposure to international markets (over two thirds of both revenue and profits) that leads to stepped up volatility within its operations—resulting from shifting macroeconomic and regulatory landscapes, currency fluctuation, and geopolitical risks—compared with domestically focused peers. The international experience of management combined with bottler collaboration globally can help the firm tackle these challenges.

As consumers become increasingly health-conscious, Coke faces the challenge of reducing the health impact of its beverages without compromising on the distinct taste that sits at the core of brand loyalty. Although reformulation and revised recipes have helped slow the exodus of consumers from its sparkling drinks, the secular headwinds remain a risk that the firm will have to contend with in the coming years.

With the ubiquity of smartphones and social media, food and beverage brands are constantly under consumer scrutiny. Any marketing message or business practice that's perceived to be inconsistent with the company’s positioning could be brought under the limelight, and without timely and appropriate response, result in temporary or long-term brand damage. That said, we don't see environmental, social, or governance risks to materially affect Coke's operations or investment returns.

Capital Allocation Dan Su, CFA, Equity Analyst, 10 Sep 2024

We assign an Exemplary Capital Allocation Rating for Coca-Cola, based on our view that the company

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has a sound balance sheet, a good track record of investments for long-term value creation, and an appropriate shareholder distribution practice blending cash dividends and share repurchases.

First, we view Coca-Cola as in good financial health. Its balance sheet is solid, with net debt/adjusted EBITDA at 2 times in 2023, and we expect the metric to stay within a reasonable range longer term. This, coupled with a solid cash position and projected strong cash flows to the firm over the next five years averaging 26% of sales, gives us confidence that the company is aptly suited to weather macroeconomic volatilities and to invest for long-term growth.

On the investment front, with top-line growth stated as the top priority, the company has been astute in channeling resources to fortify its competitive position in the broad ready-to-drink beverage market, driving organic growth with returns-focused marketing and innovation spending, and augmenting its existing portfolio with selective acquisitions. Advertising expenses briefly dipped below $3 billion (8.4% of sales) in 2020 as Coke scaled back activities in anticipation of poor returns given the dine-out demand collapse during the covid-19 lockdowns. They rebounded to $4.3 billion (10% of sales) in 2022 and to $5 billion (11% of sales) in 2023, which is consistent with prepandemic levels. We expect the company to continue investing roughly 10%-11% of sales on advertising and marketing to bolster its brand prowess and build closer connections with consumers. Innovation is another investment focus, which management has called out as critical to Coke’s leadership position. While the exact research budget is undisclosed, the company has articulated its commitment to research and product development spending, with a particular focus on nonsparkling products (currently making up over half of the innovation pipeline), which should help Coca-Cola bulk up its position outside the core sparkling business. Management also stepped up acquisitions in past years, taking full control of fast-growing brands BodyArmor (sports drink) in 2021 and Fairlife (value-added milk) in 2020, with deals valued at $6.6 billion and $1.8 billion respectively. While valuation looks on the high side (4.7 times and 3.7 times sales, respectively) at first glance, management had taken the prudent approach of first establishing a minority position in both targets—a 15% stake in BodyArmor in 2018 and a 42.5% stake in Fairlife in 2012—before pulling the trigger on the full acquisition. We are more constructive on the BodyArmor deal given the brand’s strong volume growth (110% five-year CAGR before acquisition, per Beverage Digest), 10% share in the US market (after Gatorade at 63% and Powerade at 16%, per Euromonitor), and its strategic value for Coke in the sports drink category. However, we are less positive about the Fairlife deal, given already intense competition in the milk market and a variety of plant-based milk products that are making inroads. Moreover, the milk cow mistreatment controversy (at dairy farms of a Fairlife supplier) that started in 2019 and the $21 million settlement costs that parent company Coke agreed to pay in 2022 provided a glimpse of the supply chain challenges associated with this business, which in our view constrains its returns potential.

On the shareholder distribution front, Coca-Cola has consistently returned cash to shareholders through cash dividends and share buybacks. Over the next 10 years, we expect dividend payment to grow alongside earnings expansion, with the dividend payout ratio stabilizing around 70%, which we view as prudent. Share buybacks have fluctuated from year to year in the past, and we expect the trend to persist in the future. We stick to our view that buybacks create value for shareholders only when executed at market prices below the intrinsic value, and it's not necessary to commit to a fixed target amount.

Analyst Notes Archive

Coca-Cola: Ruling of $6 Billion Tax Liabilities To Be Appealed; Fair Value Estimate Maintained Dan Su, CFA, Equity Analyst, 2 Aug 2024

Wide-moat Coca-Cola issued a statement on Aug. 2 confirming that the US Tax Court has ruled to support the position of the US Internal Revenue Service that the beverage giant owes $2.7 billion in taxes ($6 billion including interests) relating to the 2007-09 period. However, the market appeared unfazed, with shares up 1% in trading. We think the absence of material price movements on the news is at least partly due to Coke's detailed disclosure regarding the ongoing tax case in recent filings that eased investor angst. We also think that the market appears to side with Coke's own assessment of the tax situation, with the firm's tax reserve related to the dispute at a more modest $450 million.

We are maintaining our $60 per share fair value estimate, as we plan to hold off incorporating the disputed tax liabilities into our model, given Coke's decision to appeal, and limited visibility on this process and the eventual outcome. Shares look moderately overvalued.

The long-standing tax dispute with the IRS began in 2015 when it notified Coke of tax liabilities associated with foreign income for the 2007-09 period. At the center of the dispute was the categorization of payments from Coke's international bottlers for tax purposes. The IRS viewed those as royalty income, but Coke contended that the payments were dividends paid by bottlers given Coke's minority stakes, based on a previous agreement between the firm and the tax authority.

While we think Coke has a strong case, we have already incorporated higher taxes for future international income in light of the global minimum tax (15%) and a likely scenario that the IRS will implement new methodology for payments from Coke's bottlers. As such, our tax rate assumption for the 10-year forecast period is 21%, versus the 18.7% average in the past five years since Coke refranchised most of its bottlers.

Coca-Cola Earnings: Consumer-Led Innovation and Digital Engagement Fuel Revenue Expansion Dan Su, CFA, Equity Analyst, 23 Jul 2024

We plan to raise our $60 per share fair value estimate for wide-moat Coca-Cola by a low-single-digit percentage after digesting its strong second-quarter results and updated outlook. However, we view the stock as fully valued even after the planned increase in intrinsic valuation. Organic sales rose 15%, led by innovations, digital initiatives, and deft in-market executions, and adjusted earnings per share were up 7%. This was with a softer consumer backdrop in the US and continued instability and macro challenges across Europe, Latin America, and Asia. Coke remains poised to fuel volume and pricing growth, aided by its total beverage portfolio approach, steadfast investments in product innovation, and brand marketing. We plan to tick up our 2024 sales and adjusted EPS estimates by low-single-digit percentages to align with management's raised guidance, while our 10-year projection for mid-single-digit sales growth and a low-30s average operating margin remains in place.

For the quarter, volume rose 2% despite a 9% price increase. We attribute the resilient volume trends to Coke's consumer-centric innovations (zero-sugar recipes, reformulated Fanta and Sprite, returnable bottles), coupled with customer activation and engagement programs (including digital engagements) touting the differentiated experiences associated with its wide-ranging beverage portfolio and packaging innovation. These efforts have mitigated volume headwinds from softer demand in away-from-home channels in the US and a proactive pruning of unprofitable water brands in China. Pricing looks elevated at first glance, but after we strip away impacts from hyperinflation (notably in Argentina) and a higher sales mix from vertically integrated businesses, where the company controls stages of the supply chain. Core price increases in most markets are in the mid-single-digit range. We view this as a reasonable level to help Coke protect its value proposition as cost pressure continues to ease.

Coca-Cola Earnings: Solid Volume on Innovation and Digital Engagement; Currency Headwinds Persist Dan Su, CFA, Equity Analyst, 30 Apr 2024

We plan to maintain our $60 fair value estimate for wide-moat Coca-Cola after digesting the company's first-quarter results. Sales were up 3%, led by innovation across the soda and nonsparkling portfolio and by deft in-market execution. Adjusted earnings per share rose 7% on refranchising benefits and operational efficiency gains. Despite a softer consumer backdrop in the lower-income cohort in the US and continued instability and macro challenges across Europe, Latin America, and Asia, we think Coke's total beverage portfolio approach, in addition to product innovations and brand investments, should continue to fuel volume and pricing growth. We plan to maintain our 2024 forecasts for growth of 1% in sales and 5% in adjusted EPS, incorporating mid-single-digit currency headwinds and the impact of refranchising. Our 10-year projections for mid-single-digit sales growth and low 30s average operating margins also remain in place. The shares look fairly valued.

Organic revenue (excluding currency impact and acquisitions) grew 11%, led by double-digit price/mix growth in Europe and Latin America. Volume held up (1%) backed by strong digital engagement and innovation in sodas as well as in dairy, juice (zero- and low-sugar recipes), and tea. We believe the still-elevated price/mix is due to hyperinflation in multiple markets, notably Turkey, Nigeria, and Argentina. We expect this metric to moderate to the mid-single-digit range over the next few quarters, in line with trends in the beverage industry, as Coke is committed to preserving its value proposition. Operating margin narrowed sharply to 18.9% from 30.7% a year ago due to sizable one-time items, including higher contingency payments for the Fairlife acquisition (due in 2025) and impairment charges for sports drink brand Bodyarmor. However, underlying profitability remained strong, with adjusted operating margin widening 60 basis points to 32.4% on favorable mix and expense leverage.

Coca-Cola Earnings: Focus on Volume Expansion Prudent for Long-Term Sales and Profit Growth Dan Su, CFA, Equity Analyst, 13 Feb 2024

We don't plan any material changes to our $60 fair value estimate for wide-moat Coca-Cola after digesting its 2023 results, as sales growth of 6% and adjusted EPS of $2.69 matched our estimates. Despite a softening consumer backdrop and intense competition in the beverage aisle, we think Coca-Cola remains well-positioned to capture growth in the coming years thanks to heavy investments in innovations and brands, and deft in-market executions that assert its competitive standing globally. For 2024, we view management's outlook for mid-single-digit sales growth as reasonable after adjusting for the impact of refranchising but plan to trim our adjusted EPS estimate by a low-single-digit percentage due to worse-than-expected near-term currency headwinds. Our 10-year projections for mid-single-digit sales growth and low-30s average operating margins remain in place.

Impressively, Coca-Cola delivered a 12% organic revenue growth in 2023 based on a broad-based, 2% beverage volume expansion, better than the 1% contraction at wide-moat peer PepsiCo. We attribute the volume resilience to Coke's consumer-valued innovations in ingredients, formulas, and packaging, as well as smart digital marketing that resonates with consumers globally. Dynamic region-specific pricing and agile channel strategies have helped Coke preserve its value proposition amid macro and geopolitical challenges. Adjusted operating margins expanded 40 basis points to 29.1% thanks to easing input cost inflation and better expense leverage, keeping the firm on track to increase this metric to 30% by 2026, according to our projection.

For 2024, we expect a more balanced price/volume mix, with a 2% volume growth forecast consistent with the average pace of expansion over the past five years, in addition to a 3% price hike that we view as realistic given management comments that pricing in most markets (except Argentina and parts of Middle East) normalized in the December quarter.

Coca-Cola Earnings: Innovation and Brand Investment Buoyed Sales Expansion; Shares Undervalued Dan Su, CFA, Equity Analyst, 24 Oct 2023

We plan to maintain our $60 fair value estimate for wide-moat Coca Cola after digesting slightly-better-than expected third-quarter results, driven by beverage innovations, brand investments and deft in-market execution. Organic revenue grew 11%, edging our 10% estimate while adjusted EPS growth of 7% matched our expectation. Coke nudged up 2023 organic revenue and adjusted EPS growth guidance ranges to 10%-11% (from 9%-10%) and 7%-8% (from 5%-6%), which we view as achievable, and we are tweaking our own 2023 estimates to align with the improved outlook. Our 10-year projections for mid-single-digit sales growth and low 30s average operating margins remain in place. After a 3% intra-day price pop, shares still trade at a 10% discount to our intrinsic valuation and we suggest long-term investors to consider buying this name.

Despite a 9% price increase in the quarter (10% year to date), volume (up 2%) held up well, which we attribute to consumer-centric innovations (in recipes, ingredients, and packaging), sharper brand investments (60% digital) that resonate with consumers, and astute in-market execution (including region-specific pricing and marketing events, and cooler and in-store display investments in emerging markets). Management highlighted its priority in preserving volume growth (even in hyperinflationary markets such as Argentina and Turkey), indicating a clear focus on value proposition for the longer term, which we view as prudent. On profitability, adjusted operating margins expanded 20 basis points to 29.7% mainly due to expense leverage and a margin boost from refranchising in Cambodia and Vietnam in 2022. With another refranchising (in the Philippines) scheduled in the next six months, we think Coke is well on track to further shrink its own bottling footprint and achieve better margins and capital efficiency.

Coca-Cola Earnings: Resilient Volume Buttressed by Innovation and In-Market Execution Dan Su, CFA, Equity Analyst, 26 Jul 2023

We plan to raise our $58 fair value estimate for wide-moat Coca Cola by a low-single-digit percentage after digesting better-than expected second-quarter results, driven by beverage innovations and in-market execution in both premium and value offerings globally. Organic revenues grew 11% and adjusted EPS was up 17% (excluding currency impact), both ahead of our estimates (10% and 14%, respectively). Coke nudged up 2023 guidance for organic revenue to 8%-9% (from 7%-8%) and adjusted EPS growth to 5%-6% (from 4%-5%), which we view as achievable, and we plan to update our own 2023 estimates to approximate the new outlook. Our 10-year projections for mid-single-digit sales growth and low 30s average operating margins remain in place. Shares are trading in a range we'd consider fairly valued.

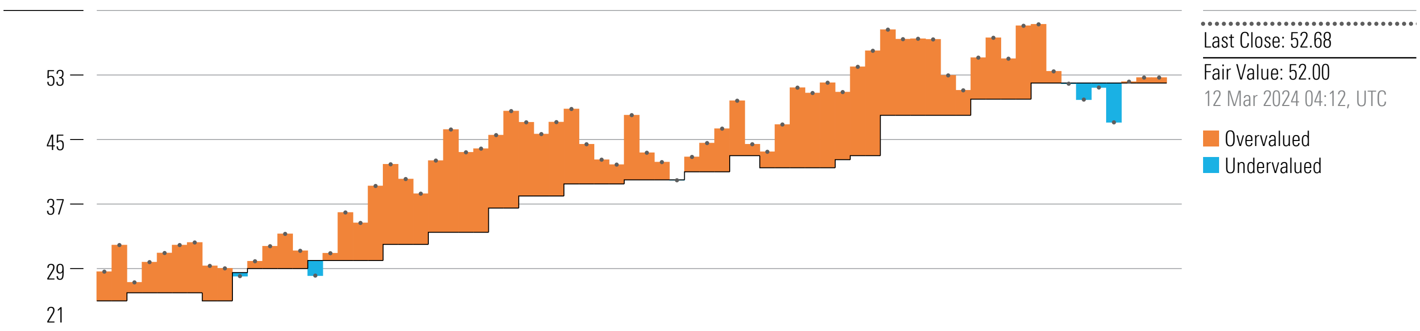
Key topline growth drivers are consumer-centric innovations, including refreshed Minute Maid juice offerings and alcoholic ready-to-drink beverages under the Jack & Coke and Schweppes brands, and astute in-market executions with products and prices tailored to different channels and regions. Bottlers' digital investments to connect 6.5 million traditional retailers year to date also helped unlock new volumes. As such, despite a 10% price mix increase (consistent with pricing reported by wide-moat peer PepsiCo), volumes were flat even as consumers are tightening their purse strings. We anticipate limited new price hikes in the coming quarters, as cost inflation eases (mid-single digit increases in commodity basket for 2023). While management acknowledged a slight uptick in promotions, we view the soft drink aisle remains rational and believe Coke is well-positioned with its dual-pronged strategies on premium and value products. We expect Coke to plow more in brand investments to stay connected to consumers, with such spending at 11% of sales in 2023 (versus 10% in 2022), to reinforce brand intangibles that are core to Coke's long-term competitive standing.

Morningstar Equity Analyst Report | Report as of 2 Nov 2024 04:25, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC.

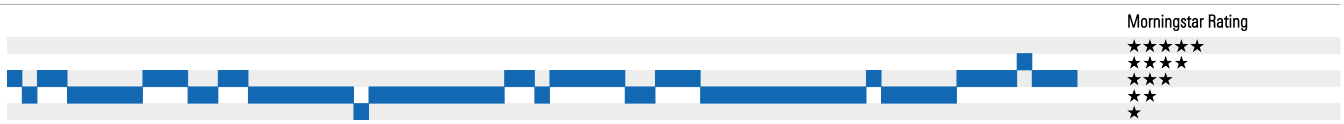
Coca-Cola Co KO ★★★ 1 Nov 2024 21:38, UTC

Competitors Price vs. Fair Value

Monster Beverage Corp MNST

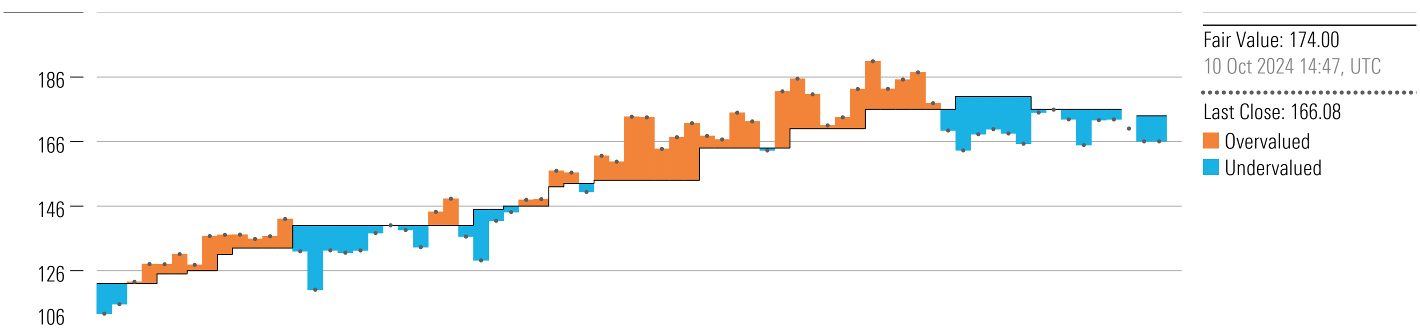


	2019	2020	2021	2022	2023	YTD
Price/Fair Value	1.10	1.38	1.20	1.22	1.15	1.01
Total Return %	29.11	45.52	3.85	5.72	13.48	-8.56

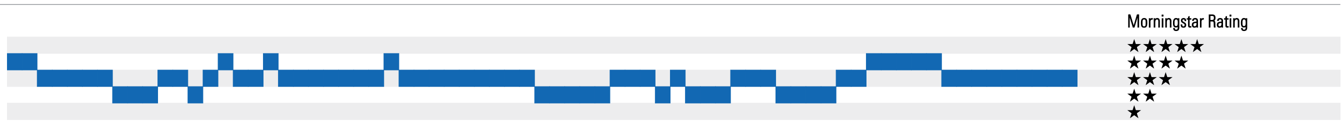


Total Return % as of 31 Oct 2024. Last Close as of 31 Oct 2024. Fair Value as of 12 Mar 2024 04:12, UTC.

PepsiCo Inc PEP



	2019	2020	2021	2022	2023	YTD
Price/Fair Value	1.03	1.06	1.13	1.06	0.94	0.95
Total Return %	27.14	11.45	20.00	6.61	-3.25	0.13



Total Return % as of 31 Oct 2024. Last Close as of 31 Oct 2024. Fair Value as of 10 Oct 2024 14:47, UTC.

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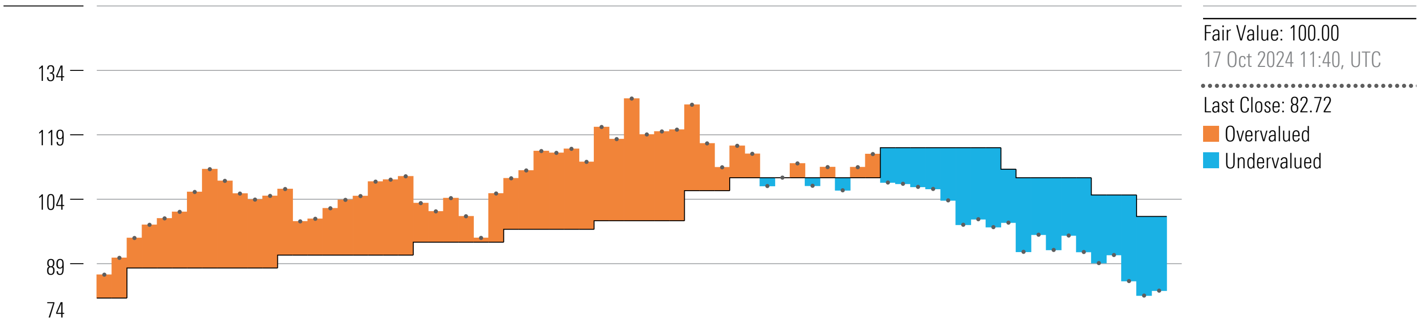
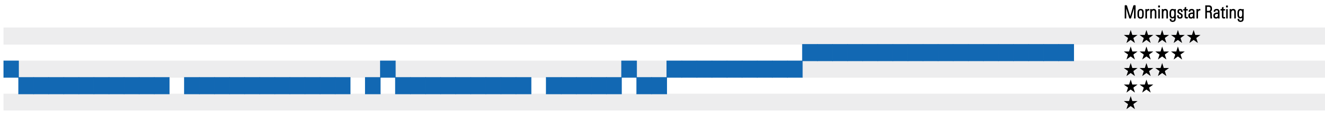
Coca-Cola Co KO ★★★ 1 Nov 2024 21:38, UTC

Competitors Price vs. Fair Value

Nestle SA NESN



	2019	2020	2021	2022	2023	YTD	
	1.19	1.11	1.29	0.98	0.84	0.83	Price/Fair Value
	34.37	2.08	24.87	-13.73	-6.23	-12.09	Total Return %



Total Return % as of 01 Nov 2024. Last Close as of 01 Nov 2024. Fair Value as of 17 Oct 2024 11:40, UTC.

Morningstar Equity Analyst Report | Report as of 2 Nov 2024 04:25, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 16 of 24

Coca-Cola Co KO ★★★ 1 Nov 2024 21:38, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
65.31 USD 31 Oct 2024	64.00 USD 10 Sep 2024 08:07, UTC	1.02	280.18 USD Bil 1 Nov 2024	Wide	Large Value	Low	Exemplary	2 Oct 2024 05:00, UTC

Morningstar Historical Summary

Financials as of 30 Sep 2024

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
Revenue (USD Bil)	46	44	42	36	34	37	33	39	43	46	36	46
Revenue Growth %	-1.8	-3.7	-5.5	-13.5	-5.3	8.6	-11.4	17.1	11.3	6.4	1.8	3.0
EBITDA (USD Bil)	11.78	12.43	10.66	9.00	10.26	13.10	12.72	15.47	13.83	15.61	12.30	15.47
EBITDA Margin %	25.6	28.1	25.5	24.9	29.9	35.1	38.5	40.0	32.2	34.1	34.6	33.4
Operating Income (USD Bil)	10.27	9.55	9.44	8.89	9.79	10.27	9.73	11.04	12.04	13.08	11.16	13.51
Operating Margin %	22.3	21.6	22.6	24.6	28.5	27.6	29.5	28.6	28.0	28.6	31.4	29.2
Net Income (USD Bil)	7.10	7.35	6.53	1.25	6.43	8.92	7.75	9.77	9.54	10.71	8.44	10.41
Net Margin %	15.4	16.6	15.6	3.5	18.8	23.9	23.5	25.3	22.2	23.4	23.8	22.5
Diluted Shares Outstanding (Mil)	4,450	4,405	4,367	4,324	4,299	4,314	4,323	4,340	4,350	4,339	4,321	4,323
Diluted Earnings Per Share (USD)	1.60	1.67	1.49	0.29	1.50	2.07	1.79	2.25	2.19	2.47	1.95	2.41
Dividends Per Share (USD)	1.22	1.32	1.40	1.48	1.56	1.60	1.64	1.68	1.76	1.84	1.46	1.92

Valuation as of 31 Oct 2024

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Price/Sales	4.1	4.2	4.3	5.3	6.3	7.1	7.1	6.8	6.5	5.7	6.7	6.1
Price/Earnings	23.5	27.4	25.1	44.1	64.9	29.4	28.4	29.2	27.9	23.9	29.2	27.1
Price/Cash Flow	17.4	17.2	20.5	24.9	29.4	24.6	26.6	20.0	24.2	21.6	28.1	51.0
Dividend Yield %	2.89	3.07	3.38	3.23	3.29	2.89	2.99	2.84	2.77	3.12	2.66	2.93
Price/Book	5.5	7.1	6.8	8.8	11.1	12.7	12.7	11.5	12.1	9.6	12.0	10.6
EV/EBITDA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Operating Performance / Profitability as of 30 Sep 2024

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
ROA %	7.8	8.1	7.4	1.4	7.5	10.5	8.9	10.8	10.2	11.3	—	10.2
ROE %	22.4	26.3	26.9	6.2	37.8	49.6	40.5	46.2	40.5	42.8	—	39.4
ROIC %	9.9	10.6	9.5	2.0	10.5	15.0	13.9	16.9	15.3	17.1	—	15.6
Asset Turnover	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.5	0.5	—	0.5

Financial Leverage

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Debt/Capital %	38.6	52.6	56.3	64.6	59.9	59.2	67.5	62.4	60.2	57.8	61.9	—
Equity/Assets %	32.9	28.4	26.4	19.4	20.4	22.0	22.1	24.4	26.0	26.6	25.0	—
Total Debt/EBITDA	3.5	3.5	4.3	5.3	4.3	3.3	3.4	2.8	2.8	2.7	3.8	—
EBITDA/Interest Expense	24.4	14.5	14.5	10.6	10.8	13.8	8.9	9.7	15.7	10.2	10.0	9.4

Morningstar Analyst Historical/Forecast Summary as of 09 Sep 2024

Financials

			Estimates		
Fiscal Year, ends 31 Dec 2023	2022	2023	2024	2025	2026
Revenue (USD Mil)	43,004	45,754	46,101	48,344	50,728
Revenue Growth %	11.3	6.4	0.8	4.9	4.9
EBITDA (USD Mil)	13,384	14,390	15,219	16,909	18,001
EBITDA Margin %	31.1	31.5	33.0	35.0	35.5
Operating Income (USD Mil)	12,124	13,262	13,928	14,679	15,529
Operating Margin %	28.2	29.0	30.2	30.4	30.6
Net Income (USD Mil)	10,792	11,664	12,484	13,124	13,821
Net Margin %	25.1	25.5	27.1	27.2	27.2
Diluted Shares Outstanding (Mil)	4,350	4,339	4,322	4,311	4,290
Diluted Earnings Per Share(USD)	2.48	2.69	2.89	3.04	3.22
Dividends Per Share(USD)	1.76	1.84	1.94	2.06	2.22

Forward Valuation

			Estimates		
	2022	2023	2024	2025	2026
Price/Sales	6.4	5.6	6.1	5.8	5.5
Price/Earnings	25.6	21.9	22.5	21.4	20.2
Price/Cash Flow	—	—	—	—	—
Dividend Yield %	2.8	3.1	3.0	3.2	3.4
Price/Book	11.5	9.9	9.9	9.1	8.3
EV/EBITDA	22.5	19.4	20.2	18.2	17.1

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Coca-Cola Co KO ★★★ 1 Nov 2024 21:38, UTC

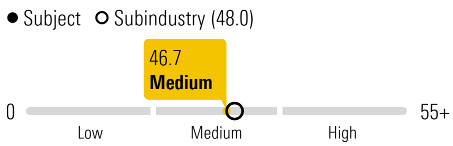
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
65.31 USD 31 Oct 2024	64.00 USD 10 Sep 2024 08:07, UTC	1.02	280.18 USD Bil 1 Nov 2024	Wide	Large Value	Low	Exemplary	2 Oct 2024 05:00, UTC

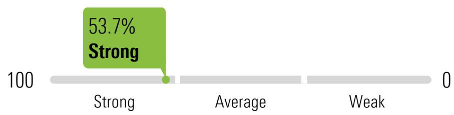
ESG Risk Rating Breakdown

Exposure	
Company Exposure[1]	46.7
– Manageable Risk	41.9
Unmanageable Risk[2]	**4.8**

Management	
Manageable Risk	41.9
– Managed Risk[3]	22.5
Management Gap[4]	**19.4**

Overall Unmanaged Risk	**24.2**

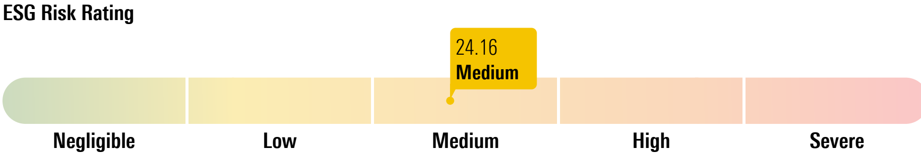




- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

- Management 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 53.7% 4. Management Gap assesses risks that are not managed, but are considered manageable 5. ESG Risk Rating Assessment = Overall Unmanaged Risk = Management Gap plus Unmanageable Risk

ESG Risk Rating Assessment[5]

ESG Risk Rating is of Oct 02, 2024. Highest Controversy Level is as of Oct 08, 2024. Sustainalytics Subindustry: Soft Drinks. 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/.

Peer Analysis 02 Oct 2024

Peers are selected from the company's Sustainalytics-defined Subindustry and are displayed based on the closest market cap values

Company Name	Exposure	Scale	Management	Scale	ESG Risk Rating	Scale
Coca-Cola Co	46.7 | Medium	0 – 55+	53.7 | Strong	100 – 0	24.2 | Medium	0 – 40+
Monster Beverage Corp	45.0 | Medium	0 – 55+	29.9 | Average	100 – 0	32.9 | High	0 – 40+
Nestle SA	55.7 | High	0 – 55+	64.2 | Strong	100 – 0	22.7 | Medium	0 – 40+
PepsiCo Inc	57.1 | High	0 – 55+	68.7 | Strong	100 – 0	20.8 | Medium	0 – 40+
Keurig Dr Pepper Inc	48.1 | Medium	0 – 55+	55.6 | Strong	100 – 0	24.0 | Medium	0 – 40+

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Appendix
Historical Morningstar Rating

Coca-Cola Co KO 1 Nov 2024 21:38, UTC

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
★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★
Dec 2019	Nov 2019	Oct 2019	Sep 2019	Aug 2019	Jul 2019	Jun 2019	May 2019	Apr 2019	Mar 2019	Feb 2019	Jan 2019
★★★	★★★	★★★	★★	★★	★★	★★	★★★	★★★	★★★	★★★★	★★★

Monster Beverage Corp MNST 1 Nov 2024 21:37, UTC

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
★	★★	★★	★★	★★	★★	★★	★★	★★★	★★★	★★	★★
Dec 2019	Nov 2019	Oct 2019	Sep 2019	Aug 2019	Jul 2019	Jun 2019	May 2019	Apr 2019	Mar 2019	Feb 2019	Jan 2019
★★★	★★★	★★★	★★	★★	★★	★★	★★	★★★	★★★	★★	★★★

PepsiCo Inc PEP 1 Nov 2024 21:37, UTC

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
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Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
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Dec 2019	Nov 2019	Oct 2019	Sep 2019	Aug 2019	Jul 2019	Jun 2019	May 2019	Apr 2019	Mar 2019	Feb 2019	Jan 2019
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Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
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Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth 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.

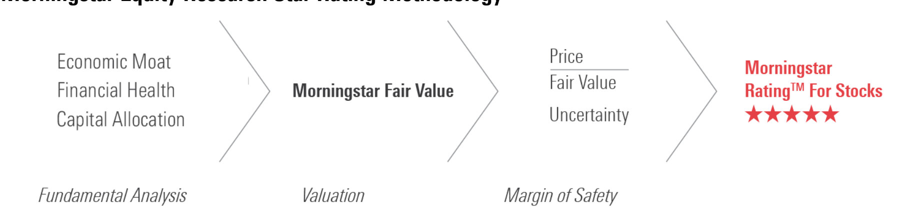
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return 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 outcomes for the intrinsic value of a company, and any-

Morningstar Equity Research Star Rating Methodology



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thing 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.

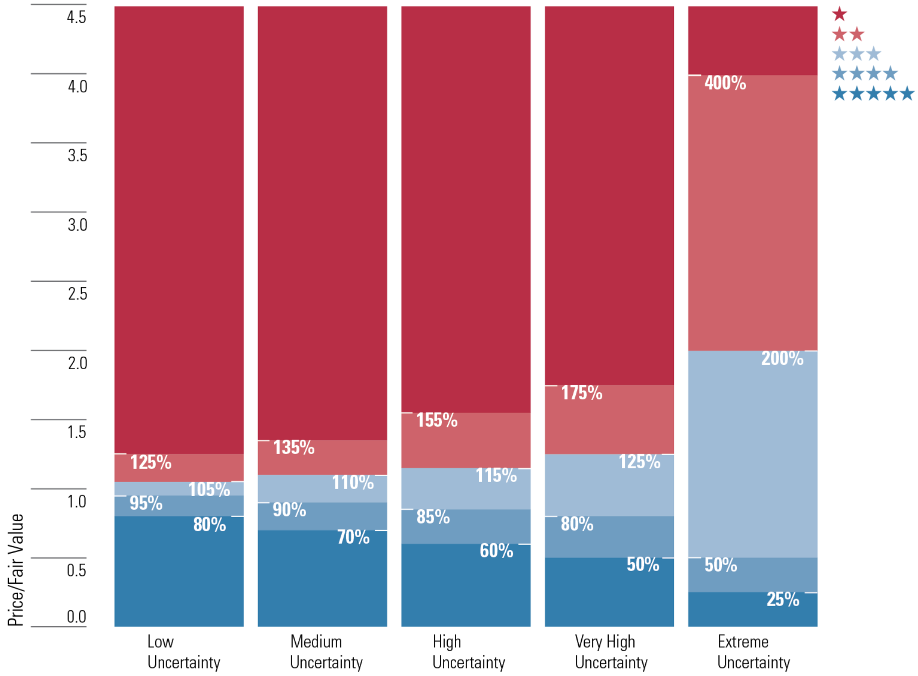
4. Market Price

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 Star Rating for Stocks

Morningstar Equity Research Star Rating Methodology



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 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.

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, and shareholder distributions. Analysts consider compan-

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ies' 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/

Ratings should not be used as the sole basis in evaluating a company or security. Ratings involve unknown risks and uncertainties which may cause our expectations not to occur or to differ significantly from what was expected and should not be considered an offer or solicitation to buy or sell a security.

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