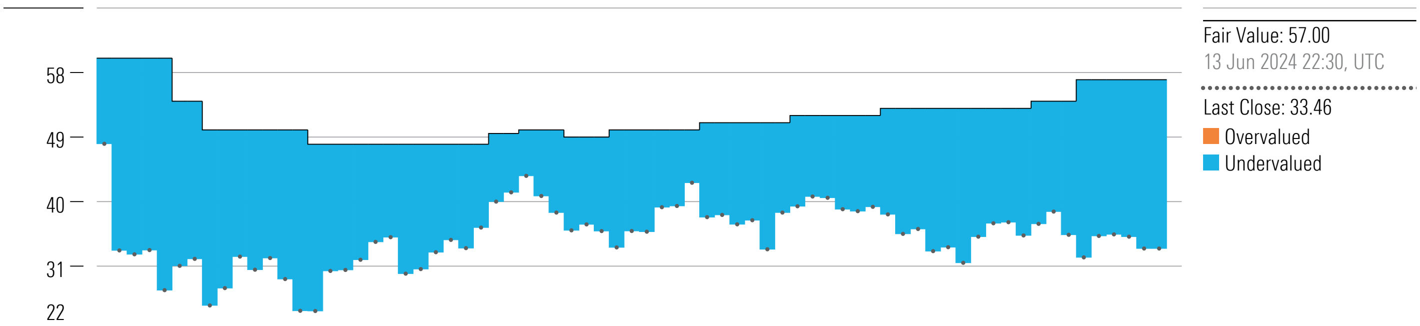
Morningstar Equity Analyst Report | Report as of 2 Nov 2024 04:19, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

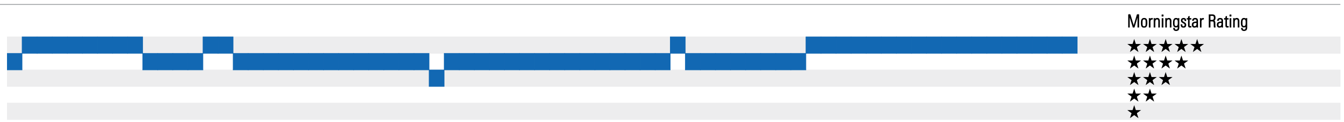
The Kraft Heinz Co KHC ★★★★★ 1 Nov 2024 21:57, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
33.46 USD 31 Oct 2024	57.00 USD 13 Jun 2024 22:30, UTC	0.59	40.49 USD Bil 1 Nov 2024	Narrow	Mid Value	Medium	Standard	2 Oct 2024 05:00, UTC

Price vs. Fair Value



	2019	2020	2021	2022	2023	YTD	
	0.64	0.72	0.72	0.78	0.70	0.59	Price/Fair Value
	-21.63	12.85	8.19	17.86	-5.23	-6.27	Total Return %



Total Return % as of 31 Oct 2024. Last Close as of 31 Oct 2024. Fair Value as of 13 Jun 2024 22:30, UTC.

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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.

Kraft Heinz Earnings: Sales Weakness Provides a Fright, but We Think Shares Offer a Treat

Analyst Note Erin Lash, CFA, Sector Director, 30 Oct 2024

Organic sales slumped 2.2%, as the combination of lower volumes and unfavorable mix (a 3.4% hit) was unable to offset higher prices (a 1.2% benefit) in the quarter.

Why it matters: Macroeconomic headwinds are inciting consumers (particularly those on the low end) to increasingly seek out value. Encouragingly, we don't think the firm is chasing short-term market share gains at the expense of investing for the long-term health of the business. Spending on technology, research and development, and marketing are up 18%, 16%, and 4%, respectively, year to date. While promotional frequency is higher than fiscal 2023, depth is essentially flat, and returns on this spending improved 6 percentage points. We attribute this to the integration of data and analytics, which we think stands to buoy the firm's standing with retailers and consumers.

The bottom line: Our $57 per share fair value estimate and narrow economic moat hold. Shares trade in the bargain bin, sitting at a 40% discount to our valuation, as the market seems to suspect volumes will remain in the doldrums amid tempered consumer spending and stepped-up competition after recent inflation-induced price hikes. However, we don't believe this angst is well-founded, as the firm has abandoned past management's directive to prioritize near-term profitability and cash flows in favor of prudently investing in its brands and capabilities to keep pace with evolving consumer trends.

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Sector	Industry
Consumer Defensive	Packaged Foods

Business Description

In July 2015, Kraft merged with Heinz to create the third-largest food and beverage manufacturer in North America behind wide-moats PepsiCo and Nestle and the fifth-largest player in the world. Beyond its namesake brands, the combined firm's portfolio includes Oscar Mayer, Velveeta, and Philadelphia. While the retail channel drives around 85% of its total sales, the firm also operates a growing presence in the foodservice arena. Outside North America, Kraft Heinz's global reach counts a distribution network in Europe and emerging markets that drives about 25% of its consolidated sales base, as its products are sold in more than 190 countries and territories.

Between the lines: Rooting out inefficiencies should fuel brand spending. Since the start of fiscal 2023, Kraft Heinz has generated $1.1 billion in savings on its path to unearth $2.5 billion by the end of fiscal 2027. This contributed to a 30-basis-point gain in adjusted gross margins to 34.3%. Our forecast calls for the firm to expend around 6% of sales, or $1.8 billion, annually on research, development, and marketing (slightly above historic levels) and still direct 3%-4% of sales to capital expenditures annually through fiscal 2033.

Business Strategy & Outlook Erin Lash, CFA, Sector Director, 12 Aug 2024

Kraft Heinz benefited from consumers' penchant for eating at home during the pandemic, with 85% of its sales driven through the retail channel. And while Kraft Heinz hasn't been immune to the weakening consumer narrative, we see the prudence in its revamped strategic road map longer term. We think this has been reflected over the past few years in its improved share position and recent shelf space gains. As a part of these efforts, since mid-2019, Kraft Heinz has prioritized the pursuit of efficiencies that prove lasting, brand spending elevation (marketing and product innovation), enhancement of its capabilities (category management and e-commerce), and scale leverage to more nimbly respond to changing market conditions, which we perceive as prudent.

We think Kraft Heinz has abandoned its prior mantra of inflating profits at any cost in favor of consistently driving profitable growth. While the firm intends to realize $2.5 billion in efficiency savings through 2027 (up from $2 billion prior and including $700 million unlocked in fiscal 2023), it appears to be doing so as a way to free up resources to reinvest in its product mix rather than bolster profits. We believe this is particularly judicious as the firm works to blunt the lingering impact of inflationary headwinds related to coffee, dairy, and meats. Beyond looking to surgically extract inefficiencies, the company had been selectively raising prices and could continue to do so if conditions warrant. But it's still focusing on more effectively buoying marketing spending, targeting a 30% increase in marketing between fiscal 2020 and 2024 (including a 15% increase in fiscal 2023), which we think stands to support its brand mix and its retail relationships. These efforts are being aided by Kraft Heinz's decision to narrow its stock-keeping unit count, which was down 20% in North America the past couple of years. We forecast research, development, and marketing to amount to 6% of sales annually on average the next 10 years, or around $1.8 billion, up from a 4.5% average over the last five years.

Bulls Say Erin Lash, CFA, Sector Director, 12 Aug 2024

- Tempered exposure to private label (11% now versus 17% in 2019) and enhanced agility in responding to consumer trends should negate any lasting downdraft in Kraft Heinz's volume.
- Management has repeatedly said it doesn't intend to squander resources on unprofitable promotions at the expense of brand spending, which we see as judicious.
- The decision to focus manufacturing assets on its highest-turning products and enlist higher-cost co-manufacturers at the onset of covid-19 allowed Kraft Heinz to efficiently mend its fractured retail

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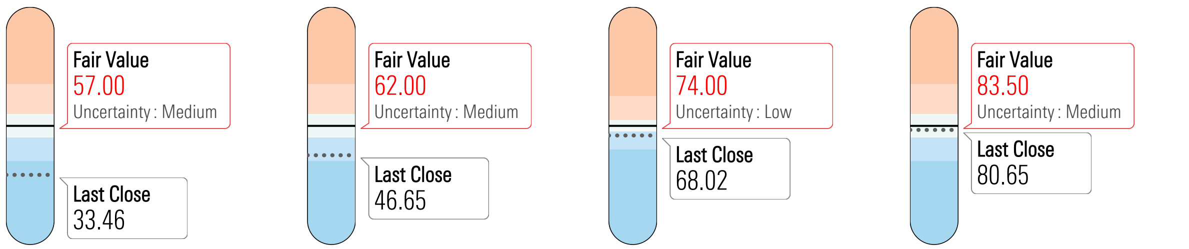
Competitors



	The Kraft Heinz Co KHC	Campbell Soup Co CPB	General Mills Inc GIS	Kellanova Co K
Economic Moat	Narrow	Wide	Narrow	Narrow
Currency	USD	USD	USD	USD
Fair Value	57.00 13 Jun 2024 22:30, UTC	62.00 26 Sep 2024 15:19, UTC	74.00 11 Jul 2024 21:16, UTC	83.50 14 Aug 2024 17:48, UTC
1-Star Price	76.95	83.70	92.50	112.73
5-Star Price	39.90	43.40	59.20	58.45
Assessment	Undervalued 1 Nov 2024	Undervalued 1 Nov 2024	Undervalued 1 Nov 2024	Fairly Valued 1 Nov 2024
Morningstar Rating	★★★★★1 Nov 2024 21:57, UTC	★★★★1 Nov 2024 21:41, UTC	★★★★1 Nov 2024 21:37, UTC	★★★1 Nov 2024 21:38, UTC
Analyst	Erin Lash, Sector Director	Erin Lash, Sector Director	Kristoffer Inton, Strategist	Erin Lash, Sector Director
Capital Allocation	Standard	Standard	Exemplary	Standard
Price/Fair Value	0.59	0.75	0.92	0.97
Price/Sales	1.57	1.44	1.97	2.59
Price/Book	0.84	3.65	4.09	7.61
Price/Earning	11.15	19.48	15.12	21.74
Dividend Yield	4.78%	3.19%	3.49%	2.79%
Market Cap	40.49 Bil	13.81 Bil	37.88 Bil	27.78 Bil
52-Week Range	31.10—38.96	39.65—52.81	61.48—75.90	50.48—81.26
Investment Style	Mid Value	Mid Value	Mid Value	Mid Blend

relationships, in our view.

Bears Say Erin Lash, CFA, Sector Director, 12 Aug 2024

- Inflation stemming from coffee, dairy, meats, wages, and transportation has yet to abate. It's possible Kraft Heinz will eventually struggle to offset the higher costs it's facing through price increases without a volume demise.
- We think competition could intensify now that supply chain disruptions have largely been rectified and consumers have been altering their spending as pocketbook pressures become more acute.
- From where we sit, the added costs associated with improving the health profile of its mix (and as such, removing artificial flavors and coloring) may constrain margins.

Economic Moat Erin Lash, CFA, Sector Director, 11 Aug 2024

After squandering its competitive edge over the first few years operating as a combined organization,

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Kraft Heinz has been on a pursuit to steady its standing in the eyes of consumers and retailers. We now think these efforts are bearing fruit, so much so that we assign the firm a narrow economic moat, based on the strength of its brand intangible assets and its cost edge.

Since the tie-up in 2015, Kraft Heinz has operated as the third-largest food and beverage firm in North America, behind wide-moats PepsiCo and Nestle, with around $18 billion in sales on its home turf in 2023 and just shy of $27 billion on a consolidated global basis. Recall that we took away the firm's moat in the August 2018 because of the prioritization the former management team placed on near-term profitability and cash flows, which came at the expense of the long-term health of the business as it shunned brand investments. This resulted in executional issues (which impaired its relationships with retailers) and innovation that wasn't keeping pace with evolving consumer trends. All of this led to its brands losing market share and shelf space at leading retailers.

But following a management shakeup in mid-2019, which saw Miquel Patricio (the former chief marketing officer of AB InBev) take the helm, Kraft Heinz has been crafting a new recipe for success. More specifically, we think the firm's revised strategic playbook—pursuing durable efficiencies, elevating brand spending (behind marketing and product innovation), enhancing capabilities (related to category management and e-commerce), and leveraging its scale to more nimbly respond to changing market conditions—is what stands to drive more lasting improvement in the business. In this context, Kraft Heinz now expends a mid-single-digit percentage of sales ($1.2 billion) on research, development, and marketing annually on average (up from low single digits historically). We see this spending as not only ensuring its products align with evolving consumer trends but also enhancing the stickiness of its retailer relationships. Despite the merits we see from these investments (with marketing, research and development, and technology spending up double digits of late), we don't lay claim that merely funneling additional resources toward R&D, marketing, and/or capital expenditures alone is sufficient to righting its ship.

While the pandemic buoyed the firm's sales trajectory, we think its ensuing performance is a byproduct of its refreshed strategic course. Since fiscal 2020, Kraft Heinz's organic revenue has grown more than 5% on a 6% benefit from higher prices, offset by a modest 1% downdraft in volumes, inclusive of intentional efforts to cull underperforming products from its mix (which we see as judicious). And even following the recent period of pronounced price hikes (in response to robust cost inflation) in fiscal 2022 and 2023, Kraft Heinz's top line rose almost 7%, as an 11% price jump on average was chipped away by a 4% downdraft in volumes on average. However, we'd suggest the volume degradation was quite muted in light of the degree of pricing that was taken. We think this illustrates the acclaim Kraft Heinz's brands have amassed over its long history.

Beyond its top-line marks, we'd suggest the benefits from its stepped-up spending have been reflected in improving market share positions. In this context, Kraft Heinz now controls more than 61% of the

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North American spreadable cheese aisle, with its Philadelphia brand, up from 60% in 2019, as the firm has focused on moving to a cleaner ingredient lineup. Further, the firm has amassed more than 52% share of the North American dried ready meals category (primarily with its namesake macaroni and cheese brand), 100 basis points above its position five years ago. And it controls more than two thirds of the North American processed cheese segment, up from just 57% in 2019. Beyond its expanding position in these categories, Kraft Heinz also continues to dominate the North American chilled lunch kit aisle with more than 60% share, the North American cooking and table sauces segment, with nearly one quarter share, and other condiments and sauces in North America with about one third share.

We don't just think its enriched competitive position has merely been driven by brand intangible assets. Rather, we also believe Kraft Heinz possesses a cost advantage as a secondary moat source. With an expansive domestic manufacturing and distribution network, we posit Kraft Heinz operates with lower unit and distribution costs and greater supply chain efficiency than smaller peers. From where we sit, this affords Kraft Heinz consistent access to inputs that others may not have access to, affording the opportunity to consistently fulfill its orders in a timely manner and serve as a reliable vendor for retailers reluctant to risk costly out of stocks. Moreover, we surmise this position allows Kraft Heinz to replicate winning competitor products quickly while offering its fare at a lower price, exacerbating entry barriers for smaller operators with limited financial flexibility and excessive customer acquisition costs and slotting fees. In an attempt to quantify its edge, we calculate a direct operating margin, which we arrive at by removing discretionary operating costs such as advertising and R&D, noncash costs including depreciation and amortization, and nonrecurring expenses to gauge manufacturing and distribution costs. Kraft Heinz's direct operating margin stands at nearly 30%, which sits north of the 25% packaged food median among the firms within our global coverage universe, supporting our contention that it possesses a stout cost advantage.

From where we sit, the combination of its leading share positions, its renewed commitment to reinvesting behind its brands, and the scale that it boasts combine to merit a moat. But admittedly, ROICs including goodwill have been lackluster (averaging just 5.1% since fiscal 2020, relative to our 6.8% weighted average cost of capital estimate). We attribute these dreary returns to past consolidation efforts, including the take private deal for Heinz and the subsequent merger of Kraft Heinz (which buoyed its goodwill and intangibles). However, we don't think management hungers to resume acting as a consolidator in the space and expect future tie-ups will be smaller, bolt-on deals. As such, we perceive Kraft Heinz's adjusted returns on invested capital excluding goodwill as more representative of the business' prospects. In this context ROICs, excluding goodwill, have generally exceeded our 7% weighted average cost of capital estimate (averaging in the high single digits between fiscal 2016 and fiscal 2023), and we forecast returns to exceed 10% on average over the course of our explicit forecast. When taken together, we have confidence in Kraft Heinz's ability to generate moat-worthy ROICs over a 10-year horizon to support a narrow economic moat.

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Fair Value and Profit Drivers Erin Lash, CFA, Sector Director, 11 Aug 2024

We're standing firm on our $57 per share fair value estimate for Kraft Heinz after digesting mixed second-quarter results. With six months in the rearview, management moderated its organic sales forecast to flat to down 2%, from flat to up 2%, but still expects $3.01-$3.07 in adjusted earnings per share, both of which generally square with our outlook. Our intrinsic valuation implies a fiscal 2025 enterprise value/adjusted EBITDA multiple of around 14 times.

Macro pressures persist, as management expects inflationary headwinds to continue this year on top of high-single- to low-double-digit increases each of the past three years. While consumers could continue to tighten their purse strings in the face of mounting financial strains, more muted exposure to private label (at just 11% now versus 17% in 2019, materially below the high teens to low 20s across US food and beverage) and enhanced agility in aligning its mix with evolving consumer trends should blunt any lasting downdraft in Kraft Heinz's margins. As such, we forecast gross margin in the mid-30s again this year, which generally aligns with the average generated in the five years preceding the pandemic.

But we don't think Kraft Heinz is sitting still. It boosted spending on research and development—wedded in data and analytics—by 15% last year while raising marketing spending at a commensurate rate, which we applaud. The fruits of these efforts were realized in a stabilizing share position across a host of categories (qualitatively referenced) and 150 basis points of shelf space gains (including through club and dollar stores) over the past year. We expect Kraft Heinz will press forward in these pursuits, expending more than 6% of sales annually on its brands while investing around 3.5% of sales to enhance its capacity and digital competence.

We believe the ability to reliably deliver product to store shelves even as supply chains were disrupted is helping to buoy the company's previously impaired relationships with its retail partners. Even though consumers are venturing beyond their homes for food consumption and competition is intensifying now that supply/demand imbalances have largely been put to rest, we think its strategic playbook centered on increasing brand spending and bolstering its category management and e-commerce capabilities should enable Kraft Heinz to eke out top-line gains. Taking this all together, our longer-term forecast calls for 2% average annual sales growth and operating margin holding in the low 20s, which aligns with management's long-term targets for 2%-3% organic sales growth and 6%-8% adjusted EPS growth.

Risk and Uncertainty Erin Lash, CFA, Sector Director, 11 Aug 2024

When considering Kraft Heinz's ability to counter competitive and macro pressures, as well as the range of return outcomes embedded in our star rating system, we believe the firm merits a Medium Uncertainty Rating. Following a switch in its executive ranks in mid-2019, Kraft Heinz has orchestrated significant strategic changes—increasing brand spending, bolstering its category management and e-commerce capabilities, and lowering leverage—that we think position it to withstand intense

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competition.

Inflation stemming from logistics, labor, raw materials, and packaging has yet to be entirely stifled; management has qualitatively suggested that it expects costs to be higher in fiscal 2024, on top of high-single- to low-double-digit increases each of the past three years. But we think Kraft Heinz is more aptly suited to combat these pressures. While consumers could maintain a tight grip on their purse strings to weather rising costs, more-muted exposure to private label (11% now versus 17% in 2019, materially below the high teens to low 20s across US food and beverage) and enhanced agility in aligning its mix with evolving consumer trends should blunt any lasting downdraft in Kraft Heinz's margins. Further, we don't think price hikes are the firm's singular ploy to dull the impact. We think Kraft Heinz now sees the value in surgically extracting inefficiencies, unearthing $700 million in savings in fiscal 2023, with a target for gross productivity savings of $2.5 billion through fiscal 2027.

While we don't see risks stemming from environmental, social, and governance issues as particularly germane, Kraft Heinz could be forced to recall its fare if quality standards fall short. In addition, the firm could come under increased regulatory oversight if authorities laser in on curbing obesity.

Capital Allocation Erin Lash, CFA, Sector Director, 11 Aug 2024

We assign Kraft Heinz a Standard Capital Allocation Rating, underpinned by the prudent steps taken since former CEO Miguel Patricio took the helm to shore up its balance sheet. In addition, we believe its investments more recently are proving fair and distributions appropriate. This is a shift from the priorities of past management, where near-term cash flows and profitability trumped investments in the firm's long-term competitive position, as it failed to direct sufficient resources to support its intangible assets.

As Kraft Heinz was still reeling from the unfavorable headlines resulting from its fourth-quarter 2018 earnings announcement surrounding a profit contraction, a Securities and Exchange Commission investigation of its procurement accounting (which has since been put to rest), and a reduction in its quarterly dividend to $0.40 per share from $0.625, it announced a change in leadership. Bernardo Hees was replaced as CEO in June 2019 by Patricio, who had spent the prior two decades at Anheuser-Busch InBev, serving as president of Asia from 2008 to 2012 and chief marketing officer from 2012 to 2018. Patricio stepped down in December 2023, though he continues to serve as executive chair. Carlos Abrams-Rivera—who joined the firm in 2020 and most recently served as executive vice president and president of North America—has taken the reins. Abrams-Rivera boasts an extensive career in the consumer packaged goods industry, with time at Campbell Soup and Mondelez, and thus strikes us as a sound fit for the role. Because he has been intimately involved in scripting and executing the firm’s strategic playbook, we don’t expect Kraft Heinz will veer off its current course under his watch.

Beyond its priorities for cash to recharge its legacy operations, a significant amount of attention

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continues to center on Kraft Heinz's appetite for a deal and where its interests might lie, particularly now that leverage has fallen below its 3 times target. However, building on the previously announced sales of three Indian brands and its natural cheese business in Canada for around $1.8 billion in the aggregate, Kraft Heinz subsequently sold its natural, grated, cultured, and specialty cheese business to Lactalis for $3.2 billion and its nut business, including the Planters brand, to Hormel for $3.35 billion. We don't think either transaction was inked at fire-sale prices. Kraft Heinz garnered a respectable 1.8 times trailing 12-month sales and 12 times adjusted EBITDA for its natural cheese operations. Its nut business amassed a generous 3 times fiscal 2020 sales and 15 times adjusted EBITDA. We expect management could continue parting ways with less profitable brands. We think these endeavors would serve to focus resources (both financial and personnel) on the highest-return opportunities while also affording the opportunity to reduce the debt load with the proceeds from these initiatives.

Despite its intent to reduce leverage and reinvest in the business, we don't believe Kraft Heinz intends to shirk on returning cash to shareholders. The board has authorized $3 billion in share repurchases, which we view as a prudent use of cash, given that shares trade at a discount to our intrinsic valuation. In addition, we forecast mid-single-digit annual increases in the dividend, implying an average payout ratio of about 50% over our 10-year explicit forecast.

Analyst Notes Archive

Kraft Heinz: Even Amid the Macro and Competitive Malaise, We Think Shares Look Tasty Erin Lash, CFA, Sector Director, 30 Aug 2024

With shares trading 40% below our $57 fair value estimate and boasting a 4%-5% dividend yield, we think investors should stock up on narrow-moat Kraft Heinz. During the first four years as a combined business, the firm was plagued by an outsize desire to take a hatchet to its cost structure to augment near-term profits and cash flows versus investing for the long term. However, we believe the current regime has been unwavering that cost savings aren't just intended to aid margins but to fuel spending behind its brands and capabilities.

In this vein, we think trepidation around owning shares is anchored in whether weak consumer spending amid an intense competitive landscape could incite Kraft Heinz to opt for unprofitable promotions to buoy volumes at the expense of judicious brand spending. However, we don't posit Kraft Heinz is keen to go down that path. For one, it has been boosting spending on research and development—wedded in data and analytics—marketing, and technology by high-single to low-double-digit levels for an extended period, which we applaud. And we think it will continue expending 6% of sales annually on its brands and investing 3.5% of sales to enhance its capacity and digital competence. Further, we're encouraged by management's repeated contentions that it doesn't intend to squander resources and chase short-term market share gains. When taken together, the fruits of

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these efforts have manifest in improving market share. As examples, in dried ready meals, its namesake macaroni and cheese has amassed more than 50% share in North America, up 100 basis points the past five years, and it holds about two thirds of the North American processed cheese market, up from about 57% in 2019.

Against this, we think Kraft Heinz is poised to realize low-single-digit organic sales growth annually while holding operating margins in the low-20s, versus the flat sales and high-teens average operating margins we think it would take to justify the current stock price.

Kraft Heinz Earnings: Long-Term Focus Should Enable It to Navigate Bumpy Waters; Shares Attractive Erin Lash, CFA, Sector Director, 31 Jul 2024

The weakening consumer narrative percolated throughout narrow-moat Kraft Heinz's second-quarter results. Organic sales slipped 2.4% on a more than 3% retraction in volumes. And management responded it intends to astutely promote to tighten price gaps in certain categories (estimated at 30%-40% of its US mix) to counter the tough consumer spending backdrop.

We expect these efforts will be funded through its productivity gains, which have until now manifested in improving profitability. In this context, adjusted gross margins edged up 210 basis points to 35.5%, with 190 basis points attributable to unlocked efficiencies. We don't think Kraft Heinz will abandon this course, with the firm targeting $500 million in annual cost savings but doing so in a lasting manner (in contrast to its prior regime that sought to blindly root out costs).

Importantly, Kraft Heinz is unlikely to prioritize near-term volume and market share at the expense of the long-term health of the business, from where we sit, as the pains from doing so when the merger was inked have yet to fade. We posit the firm is judiciously fueling investments in research and development (up 13% in the quarter), marketing (9%), and technology (17%). We expect these efforts will persist; our forecast calls for it to direct more than 6% of sales each year to its brands and spend 3%-4% of sales to augment its fixed-asset base and digital prowess. And while these investments could dent profits from time to time, we see this as a prudent means to support its brand standing in the eyes of consumers and retailers.

With six months in the rearview, management moderated its organic sales forecast to flat to down 2%, from flat to up 2%, but still expects $3.01-$3.07 in adjusted earnings per share, which squares with our outlook. As such, we see little to warrant a change in our $57 fair value estimate, outside of time value. With the shares trading about 40% below our intrinsic valuation, we think shares are a bargain.

Kraft Heinz: We Upgrade Moat to Narrow as Revamped Strategic Course Yields Gains; Shares Appetizing Erin Lash, CFA, Sector Director, 13 Jun 2024

We believe Kraft Heinz has finally broken the shackles of its past, and we now assign the firm a narrow

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The Kraft Heinz Co KHC ★★★★★ 1 Nov 2024 21:57, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
33.46 USD 31 Oct 2024	57.00 USD 13 Jun 2024 22:30, UTC	0.59	40.49 USD Bil 1 Nov 2024	Narrow	Mid Value	Medium	Standard	2 Oct 2024 05:00, UTC

moat based on its brand intangible assets and cost edge. Since abandoning past management's directive to prioritize near-term profitability and cash flows, Kraft Heinz has, over the past five years, prudently pursued durable efficiencies, elevated brand spending (behind marketing and product innovation to a mid-single-digit level of sales that is more commensurate with peers), enhanced its capabilities (related to category management and ecommerce), and leveraged its scale to respond more nimbly to changing market conditions.

While its top-line marks have been affected by intentional (but judicious) efforts to cull underperforming products as well as higher prices to blunt inflation's malaise, we think the strides made are evidenced by improving market share. For one, in dried ready meals, its namesake macaroni and cheese brand has now amassed more than 50% share on its home turf, up 100 basis points over the past five years. For another, it holds about two thirds of the market (up from about 57% in 2019) in North American processed cheese. Beyond juicing its brands with retailers and end consumers, we also think its expansive domestic manufacturing and distribution network results in lower unit and distribution costs and greater supply chain efficiency than smaller peers, warranting a cost advantage.

Taken together, these factors underpin the bump in our fair value estimate to $57 per share from $54, rendering the stock undervalued. We suspect the market anticipates a material volume contraction amid a challenging economy (higher inflation and weakening consumer spending) and competitive environment (increased promotions by other brands and private label) following recent price hikes. However, we think its renewed commitment to extracting excess costs to fuel brand spending should benefit its long-term top-line prospects and its competitive standing.

Kraft Heinz Earnings: Despite Muted Sales, Sequential Volume Uptick Signals Merits of Brand Spending Erin Lash, CFA, Sector Director, 1 May 2024

We saw promising features in Kraft Heinz’s first-quarter results despite the market’s displeasure (with the shares down by a mid- to high-single-digit percentage intraday). Even as it navigates a challenging landscape, management stuck to its 2024 forecast for flat to 2% organic sales growth and $3.01-$3.07 in adjusted earnings per share, which squares with our outlook. As such, we see little impetus to change our $54 fair value estimate, outside of time value. With the shares trading about 35% below our intrinsic valuation, we think investors should consider stocking up on this no-moat name.

The bright spot was the fruits of the company's efforts to rebuild margins, with adjusted gross margin up 170 basis points in the quarter to 34.5%, in line with the fiscal 2016-18 average. Although sales continued to languish, down 50 basis points on an organic basis, we see some green shoots. For one, volume was off only 3.2% in the aggregate, 120 basis points ahead of the 4.4% decline in the fourth quarter of fiscal 2023 and the fourth consecutive quarter of improvement in this metric.

We expect Kraft Heinz will gain more traction here, given its commitment to investing to support the

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business over the long haul. This was evidenced in stepped-up marketing (up 13%), research and development (25%), and technology (20%) spending, even as the company faces unrelenting inflationary headwinds around coffee, dairy, and meats. We view brand support as central to damping intense competitive pressures, particularly given consumers' increasing financial constraints. We expect the firm will continue these efforts; we forecast it to direct more than 6% of sales each year to its brands and spend 3%-4% of sales to enrich its fixed-asset base and digital prowess. To fuel these investments, we think Kraft Heinz will adroitly pursue opportunities for further cost savings, a core component of its strategic playbook since mid-2019.

Kraft Heinz Earnings: Sales Stifled by Pinched Consumer, but Investments to Buoy Long-Term Results Erin Lash, CFA, Sector Director, 14 Feb 2024

The market soured on no-moat Kraft Heinz following mixed fourth-quarter marks, sending shares down by a mid-single-digit percentage. While its adjusted gross margin popped 260 basis points to 34.8%, organic sales slipped 0.7% on a 4.4% degradation in volume. This shortfall was particularly acute on its home turf (around three quarters of its total sales), where organic sales fell 3% on a 5.5% downdraft in volumes. Beyond a few one-time factors (related to trade timing and retail inventories, which compressed sales by 150 basis points), management was also forthright that consumers are struggling under the weight of higher interest rates and a reduction in SNAP benefits.

The combination of Kraft Heinz’s fiscal 2023 results, the outlook for fiscal 2024 (flat to 2% organic sales growth—which squares with our forecast—and a 1%-3% uptick in adjusted EPS, slightly outpacing our preprint profit estimates), and time value should warrant a low-single-digit percentage bump to our $53 fair value estimate. With shares trading around a 30% discount to our valuation, while offering a 4% dividend yield, we think investors should stock up.

We surmise Kraft Heinz is working vigorously to thwart looming challenges. For one, it boosted spending on research and development—wedded in data and analytics—by 15% last year, while raising marketing spending at a commensurate rate, which we applaud. The fruits of these efforts were realized in a stabilizing share position across a host of categories (qualitatively referenced) and 150 basis points of shelf space gains (including through club and dollar stores) over the past year. We don’t expect Kraft Heinz will back down from these pursuits; we think it will expend more than 6% of sales annually on its brands, while investing around 3.5% of sales to enhance its capacity and digital competence. Further, we’re encouraged by management’s assertion it doesn’t intend to squander resources on unprofitable promotions, which we see as judicious.

Kraft Heinz Earnings: Its Surgical Pursuit of Cost Savings to Fuel Brand Investments Buoys Results Erin Lash, CFA, Sector Director, 1 Nov 2023

Even though the sun is setting on CEO Miguel Patricio’s time at the helm of no-moat Kraft Heinz, we

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The Kraft Heinz Co KHC ★★★★★ 1 Nov 2024 21:57, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
33.46 USD 31 Oct 2024	57.00 USD 13 Jun 2024 22:30, UTC	0.59	40.49 USD Bil 1 Nov 2024	Narrow	Mid Value	Medium	Standard	2 Oct 2024 05:00, UTC

surmise the imprint he is leaving on the business will persist. Before he came on board, Kraft Heinz was plagued by its outsize desire to root out costs blindly in favor of juicing near-term sales and cash flows, without any regard for investing to support the long-term health of the business. In stark contrast, Kraft Heinz's third-quarter results (1.7% organic sales growth, nearly 400 basis points of expansion in the adjusted gross margin to 34%, and a 280-basis-point jolt in the adjusted operating margin to 17.7%) came in spite of a 25% increase in marketing expense, an 8% bump in research and development expense, and a 24% increase in technology spending. And we think management is keen to unearth further cost savings to boost spending behind its brands and capabilities, with incoming CEO Carlos Abrams-Rivera (one of the architects of this playbook) set to take the reins.

But beyond this, we also think Patricio and his team have judiciously prioritized debt paydown, with net leverage falling below its 3 times target a year ahead of plan. When combined with its robust cash generation (free cash flow averaged in the midteens as a percentage of sales the last three years—levels we think can hold over our forecast), we posit this should unlock opportunities for enhanced financial flexibility to beef up its return to shareholders (in addition to investing in its existing operations), with our forecast calling for mid-single-digit increases in its annual dividend in short order.

With just two months left in its fiscal year, our $53 fair value estimate shouldn't see much change outside of time value nor should our long-term outlook for 2%-3% annual sales growth and low-20s operating margins. Despite a mid-single-digit bump on the results, we view shares as attractive, trading at a 40% discount to our intrinsic valuation while offering a 4%-plus dividend yield.

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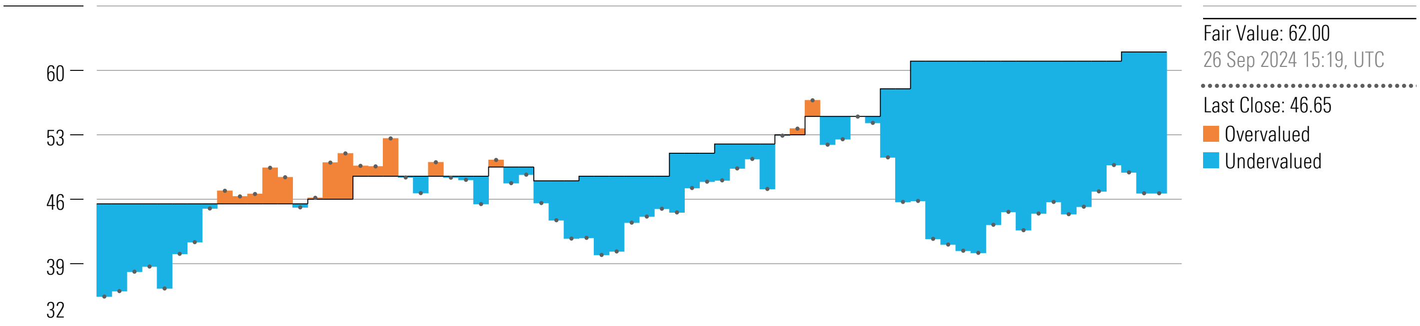
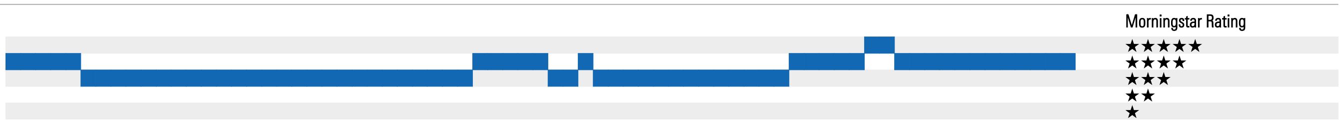
The Kraft Heinz Co KHC ★★★★★ 1 Nov 2024 21:57, UTC

Competitors Price vs. Fair Value

Campbell Soup Co CPB

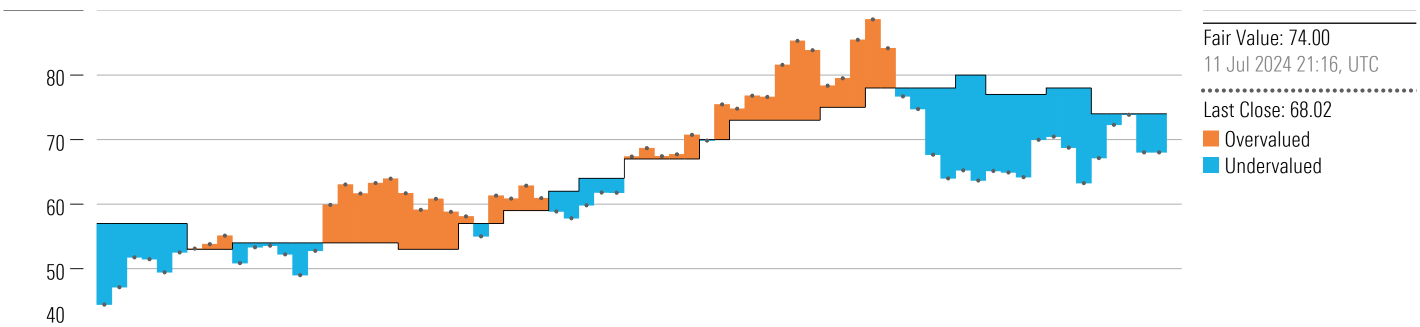


	2019	2020	2021	2022	2023	YTD
Price/Fair Value	1.09	1.00	0.90	1.03	0.71	0.75
Total Return %	54.05	0.67	-7.05	33.99	-21.22	11.33

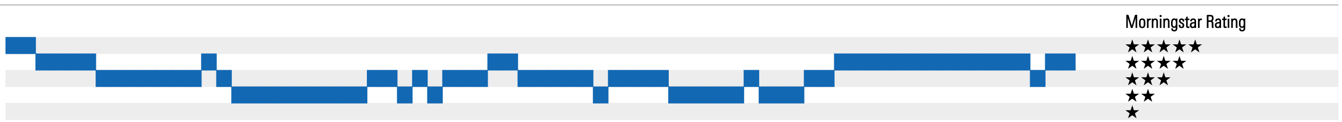


Total Return % as of 31 Oct 2024. Last Close as of 31 Oct 2024. Fair Value as of 26 Sep 2024 15:19, UTC.

General Mills Inc GIS



	2019	2020	2021	2022	2023	YTD
Price/Fair Value	0.99	1.11	1.01	1.15	0.85	0.92
Total Return %	42.58	13.48	18.06	27.56	-19.62	8.07



Total Return % as of 31 Oct 2024. Last Close as of 31 Oct 2024. Fair Value as of 11 Jul 2024 21:16, UTC.

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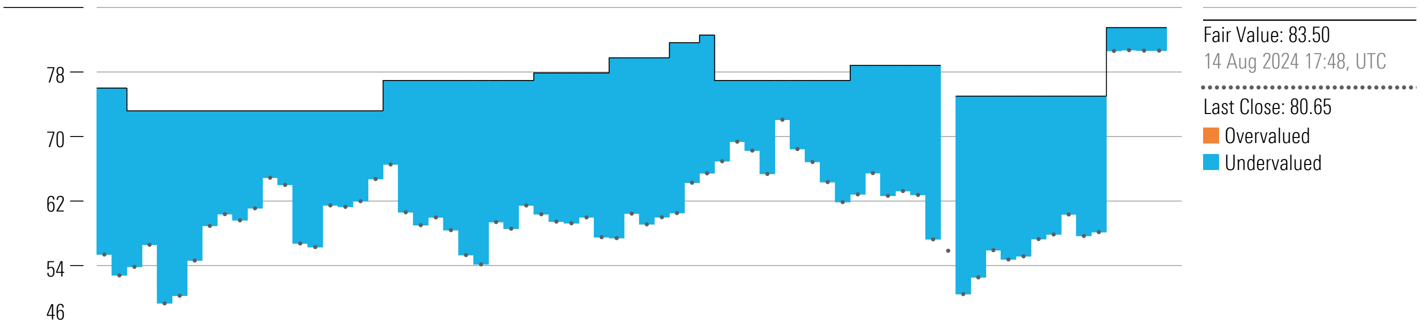
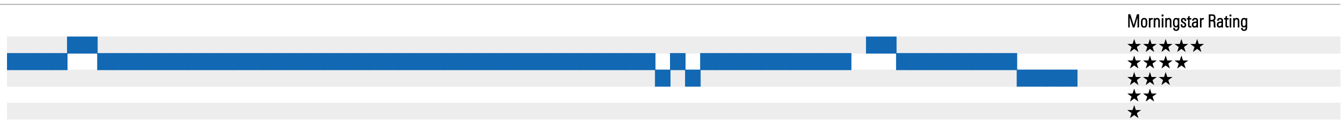
The Kraft Heinz Co KHC ★★★★★ 1 Nov 2024 21:57, UTC

Competitors Price vs. Fair Value

Kellanova Co K



	2019	2020	2021	2022	2023	YTD
Price/Fair Value	0.89	0.76	0.76	0.87	0.75	0.97
Total Return %	25.28	-6.72	7.23	14.22	-8.39	47.27



Total Return % as of 31 Oct 2024. Last Close as of 31 Oct 2024. Fair Value as of 14 Aug 2024 17:48, UTC.

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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)	18	18	26	26	26	25	26	26	26	27	19	26
Revenue Growth %	-0.1	0.7	43.4	-0.9	0.7	-4.9	4.8	-0.5	1.7	0.6	-2.6	-3.8
EBITDA (USD Mil)	2,275	3,074	7,410	7,715	-9,054	5,016	3,393	4,665	4,820	5,506	2,493	3,923
EBITDA Margin %	12.5	16.8	28.2	29.6	-34.5	20.1	13.0	17.9	18.2	20.7	12.9	15.0
Operating Income (USD Mil)	1,889	2,639	5,619	6,106	6,082	5,447	5,850	5,315	4,696	5,181	4,112	5,281
Operating Margin %	10.4	14.4	21.4	23.4	23.2	21.8	22.3	20.4	17.7	19.5	21.3	20.2
Net Income (USD Bil)	1.04	0.63	3.60	10.94	-10.19	1.94	0.36	1.01	2.36	2.86	0.61	1.37
Net Margin %	5.7	-1.5	13.0	42.0	-38.8	7.8	1.4	3.9	8.9	10.7	3.2	5.2
Diluted Shares Outstanding (Mil)	598	786	1,226	1,228	1,219	1,224	1,228	1,224	1,235	1,235	1,212	1,223
Diluted Earnings Per Share (USD)	1.74	-0.34	2.78	8.91	-8.36	1.58	0.29	0.82	1.91	2.31	0.50	1.11
Dividends Per Share (USD)	—	1.70	2.35	2.45	2.50	1.60	1.60	1.60	1.60	1.60	1.20	1.60

Valuation as of 31 Oct 2024

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Price/Sales	—	2.8	4.0	3.6	2.0	1.5	1.6	1.7	1.9	1.7	1.6	1.6
Price/Earnings	—	-47.6	33.9	24.3	5.1	-3.6	-87.0	19.2	41.5	15.3	22.5	30.1
Price/Cash Flow	—	24.0	23.4	22.5	37.5	10.6	8.7	11.0	11.4	12.7	10.5	9.9
Dividend Yield %	—	2.34	2.69	3.15	5.81	4.98	4.62	4.46	3.93	4.33	4.56	4.78
Price/Book	—	1.5	1.8	1.6	0.8	0.8	0.9	0.9	1.0	0.9	0.9	0.8
EV/EBITDA	0.0	38.2	18.2	16.2	-9.2	13.5	20.1	14.1	14.3	11.7	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 %	4.5	-0.4	2.8	9.1	-9.1	1.9	0.4	1.1	2.6	3.2	—	1.5
ROE %	21.7	-0.9	5.9	17.8	-17.3	3.8	0.7	2.0	4.8	5.8	—	2.8
ROIC %	9.5	1.2	4.9	12.5	-10.1	3.5	1.7	3.0	4.4	5.1	—	2.8
Asset Turnover	0.8	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	—	0.3

Financial Leverage

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Debt/Capital %	66.4	27.6	34.1	30.1	37.3	35.3	35.9	29.9	28.3	28.1	28.6	—
Equity/Assets %	19.0	46.9	47.6	54.8	49.9	50.9	50.2	52.8	53.8	54.8	54.6	—
Total Debt/EBITDA	4.4	9.4	4.4	4.1	-3.4	5.8	8.3	4.7	4.2	3.6	8.1	—
EBITDA/Interest Expense	4.7	2.3	6.5	6.3	-7.1	3.7	2.4	2.3	5.2	6.0	3.6	4.3

Morningstar Analyst Historical/Forecast Summary as of 09 Aug 2024

Financials

Fiscal Year, ends 31 Dec 2023	2022	2023	Estimates 2024	2025	2026
Revenue (USD Mil)	26,485	26,640	26,474	27,036	27,743
Revenue Growth %	1.7	0.6	-0.6	2.1	2.6
EBITDA (USD Mil)	6,014	6,345	6,433	6,615	6,838
EBITDA Margin %	22.7	23.8	24.3	24.5	24.7
Operating Income (USD Mil)	5,081	5,384	5,442	5,608	5,811
Operating Margin %	19.2	20.2	20.6	20.7	21.0
Net Income (USD Mil)	3,439	3,675	3,803	3,961	4,158
Net Margin %	13.0	13.8	14.4	14.6	15.0
Diluted Shares Outstanding (Mil)	1,235	1,235	1,228	1,208	1,180
Diluted Earnings Per Share(USD)	2.78	2.98	3.10	3.28	3.52
Dividends Per Share(USD)	1.60	1.60	1.68	1.76	1.86

Forward Valuation

	2022	2023	Estimates 2024	2025	2026
Price/Sales	1.9	1.7	1.5	1.5	1.5
Price/Earnings	14.6	12.4	10.8	10.2	9.5
Price/Cash Flow	—	—	—	—	—
Dividend Yield %	3.9	4.3	5.0	5.3	5.6
Price/Book	1.0	0.9	0.8	0.8	0.8
EV/EBITDA	11.5	10.1	9.2	9.0	8.7

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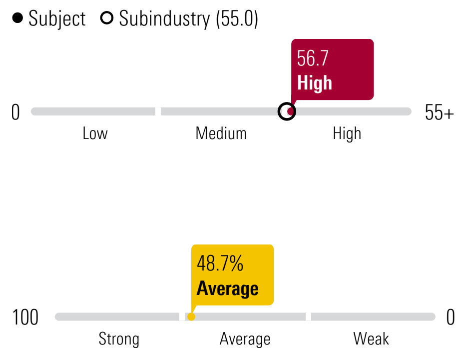
The Kraft Heinz Co KHC ★★★★★ 1 Nov 2024 21:57, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
33.46 USD 31 Oct 2024	57.00 USD 13 Jun 2024 22:30, UTC	0.59	40.49 USD Bil 1 Nov 2024	Narrow	Mid Value	Medium	Standard	2 Oct 2024 05:00, UTC

ESG Risk Rating Breakdown

Exposure	
Company Exposure[1]	56.7
– Manageable Risk	52.7
Unmanageable Risk[2]	**4.0**
Management	
Manageable Risk	52.7
– Managed Risk[3]	25.6
Management Gap[4]	**27.0**
Overall Unmanaged Risk	**31.0**



- 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 48.7% 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: Packaged Foods. 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			Management			ESG Risk Rating		
The Kraft Heinz Co	56.7 | High	0	55+	48.7 | Average	100	0	31.0 | High	0	40+
Campbell Soup Co	55.9 | High	0	55+	56.8 | Strong	100	0	26.3 | Medium	0	40+
General Mills Inc	52.8 | Medium	0	55+	54.9 | Strong	100	0	25.8 | Medium	0	40+
Kellanova Co	54.1 | Medium	0	55+	57.9 | Strong	100	0	25.0 | Medium	0	40+
Nestle SA	55.7 | High	0	55+	64.2 | Strong	100	0	22.7 | Medium	0	40+

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Appendix
Historical Morningstar Rating

The Kraft Heinz Co KHC 1 Nov 2024 21:57, 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
—	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★
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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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Campbell Soup Co CPB 1 Nov 2024 21:41, 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
—	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★
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General Mills Inc GIS 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
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Kellanova Co K 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
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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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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.

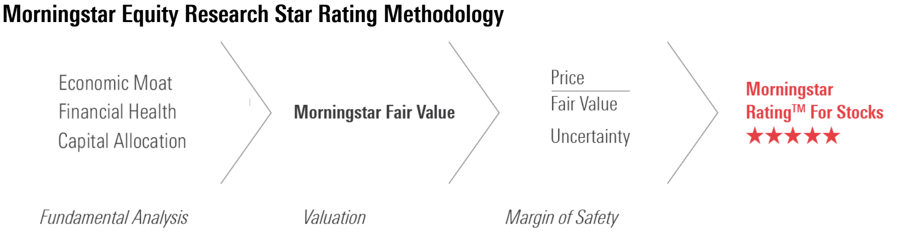
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return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

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.

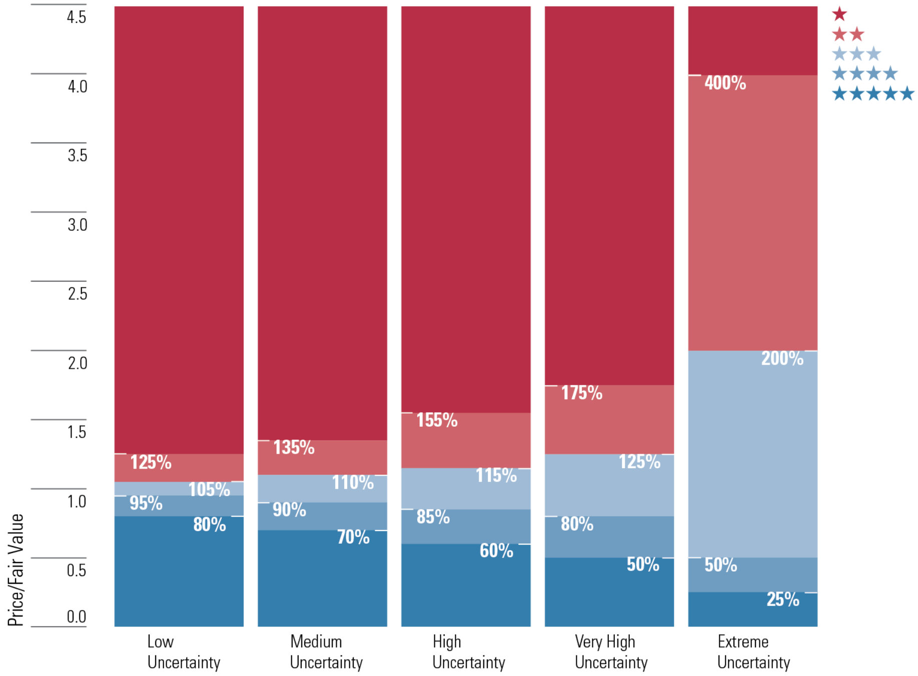
4. Market Price

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.

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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.

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