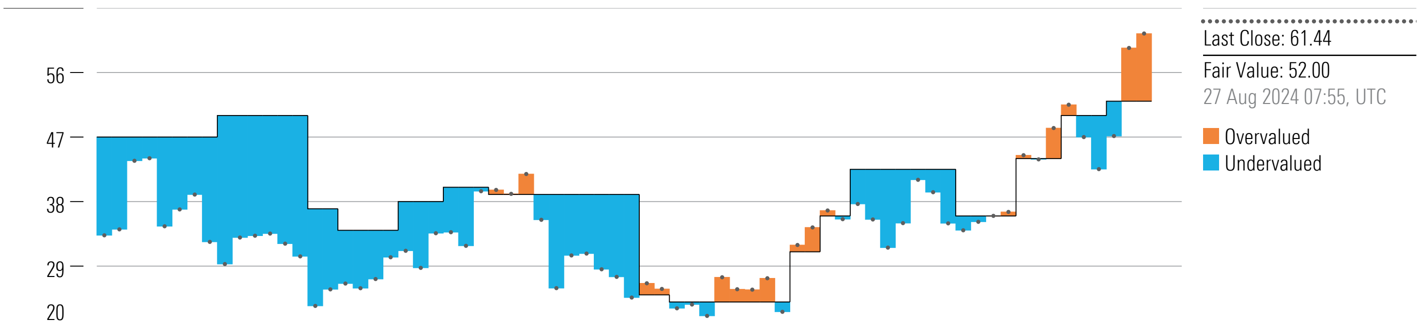
Morningstar Equity Analyst Report | Report as of 24 Oct 2024 00:03, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 1 of 22

Trip.com Group Ltd ADR TCOM ★★ 23 Oct 2024 21:30, UTC

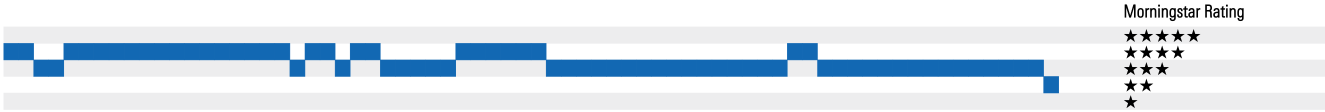
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.44 USD 23 Oct 2024	52.00 USD 27 Aug 2024 07:55, UTC	1.18	40.00 USD Bil 23 Oct 2024	Narrow	Large Growth	High	Standard	2 Oct 2024 05:00, UTC

Price vs. Fair Value



2019	2020	2021	2022	2023	YTD	
0.67	0.84	0.63	1.11	1.00	1.18	Price/Fair Value
23.95	0.57	-27.01	39.72	4.68	70.62	Total Return %

Morningstar Rating



Total Return % as of 23 Oct 2024. Last Close as of 23 Oct 2024. Fair Value as of 27 Aug 2024 07:55, UTC.

Contents

Business Description
Business Strategy & Outlook (2 May 2024)
Bulls Say / Bears Say (27 Aug 2024)
Economic Moat (2 May 2024)
Fair Value and Profit Drivers (27 Aug 2024)
Risk and Uncertainty (2 May 2024)
Capital Allocation (2 May 2024)
Analyst Notes Archive
Financials
ESG Risk
Appendix
Research Methodology for Valuing Companies

Important Disclosure

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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.

Evolving Consumer Shift Toward Services in China Should Benefit Trip.com for the Long Term

Business Strategy & Outlook Kai Wang, CFA, Senior Equity Analyst, 2 May 2024

Narrow-moat Trip.com competes in China's crowded online travel agent, or OTA, industry by leveraging the largest selection of both domestic and international hotels in China on its platform and relying on user stickiness as a one-stop shop for travel ticketing, accommodations, and packaged tours. The platform is now also generating revenue from advertisement in which it hopes to take 3%-5% of the ad market, but nearly all its revenue streams are travel-related, and coronavirus lockdowns in China has cratered demand due to the inability to travel or unwillingness to quarantine.

After better-than-expected pent-up demand after China's reopening, we believe that both international and domestic revenue should see recovery close to, if not greater than, 2019 levels. The company believes it can reach long-term non-GAAP operating margins of 20%-30% on the back of its international, outbound, and high-star hotel businesses given their higher monetization rates, but the lack of demand has affected these businesses, and total international revenue has declined to less than 5% of the mix and caused operating margin to be negative. Prior to the pandemic in 2019, international revenue were 25% of the mix and non-GAAP operating margins were 19%. We believe that reaching its long-term margin will rely heavily on the recovery, but the pandemic has been a significant headwind and has delayed its progress. We think that outbound international travel should eventually recover but visibility is still limited, there is possibility that the company could fall short of its long-term outlook.

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Sector	Industry
Consumer Cyclical	Travel Services

Business Description

Trip.com is the largest online travel agent in China and is positioned to benefit from the country's rising demand for higher-margin outbound travel as passport penetration is only 12% in China. The company generated about 78% of sales from accommodation reservations and transportation ticketing in 2020. The rest of revenue comes from package tours and corporate travel. Before the pandemic in 2019, the company generated 25% of revenue from international business, which is important to its margin expansion. Most of sales come from its online platform, but the company also maintains offline call centers. The competes in a crowded OTA industry in China, including Meituan, Alibaba-backed Fliggy, Tongcheng, and Qunar. The company was founded in 1999 and listed on the Nasdaq in December 2003.

The other key business that will drive margins is its high-star domestic hotels which generates the highest take-rate on its platform at 9%-10%. Trip.com charges low rates for its budget hotels to attract new users and directs them to its high-star hotels for future bookings as its traffic acquisition strategy, where it hopes to retain users through its wide selection of hotel, ticketing, and packaged tour options. Currently, this business has already recovered to beyond 2019 levels, and thus we believe that the imminent key catalyst for Trip.com will be its international business.

Bulls Say Kai Wang, CFA, Senior Equity Analyst, 27 Aug 2024

- The number of Chinese passport holders is only about 10%-15% of the population, which should provide Trip.com with secular demand given the low saturation.
- International and outbound business will eventually recover and drive margins upwards. Margin expansion will be dictated by its higher-margin businesses, including international air and hotels.
- The industry will see less competition in the future than before due to current headwinds faced, and thus lesser disruptions to its long-term business plan.

Bears Say Kai Wang, CFA, Senior Equity Analyst, 27 Aug 2024

- International expansion may fall flat given greater competition beyond China's borders and could pressure margins as it prioritizes growth.
- Competition intensifies and new entrants squeeze long-term margins in the industry. Competitors such as Meituan and Alibaba-owned Fliggy in China will lead to price wars in the online travel market.
- Travel demand in general has shifted to more domestic consumption rather than international business, which means a lower margin outlook in the long term.

Economic Moat Kai Wang, CFA, Senior Equity Analyst, 2 May 2024

We assign a narrow moat rating to Trip.com due to its strong network effect in China's online travel agent industry. The network effect for Trip.com is its massive number of hotels on the platform relative to its competitors which drives consumers toward its platform as a one-stop shop for traveling needs. According to consulting firm Analysys, Trip.com was the largest OTA platform worldwide from 2018 to 2020 and the largest in China for the last 10 years in terms of gross transaction value. The platform provides the widest hotel accommodation options in China with 1.4 million hotels listed compared with its closest competitors Meituan at 360,000 and Fliggy at 200,000 hotels, as of 2019. The strength of its network effect has been evident during the pandemic. While covid-19 has decimated the OTA industry, Trip.com has been able to outperform the OTA industry as accommodation bookings and air tickets have outperformed the domestic average by 15%-20% and 5%-10%, respectively. We believe the outperformance is due to its massive hotel options and network effect relative to its competitors, which would take time to replicate. Accommodations, combined with transportation ticketing business accounted for 77% of Trip.com's revenue in 2019.

Morningstar Equity Analyst Report | Report as of 24 Oct 2024 00:03, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 3 of 22

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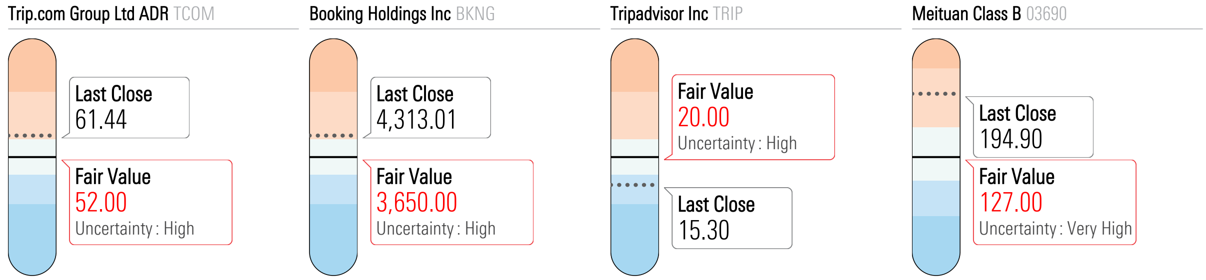
Competitors



	Trip.com Group Ltd ADR TCOM	Booking Holdings Inc BKNG	Tripadvisor Inc TRIP	Meituan Class B 03690
Economic Moat	Narrow	Narrow	None	None
Currency	USD	USD	USD	HKD
Fair Value	52.00 27 Aug 2024 07:55, UTC	3,650.00 5 Aug 2024 20:56, UTC	20.00 8 May 2024 16:11, UTC	127.00 29 Aug 2024 12:47, UTC
1-Star Price	80.60	5,657.50	31.00	222.25
5-Star Price	31.20	2,190.00	12.00	63.50
Assessment	Overvalued 23 Oct 2024	Overvalued 23 Oct 2024	Undervalued 23 Oct 2024	Overvalued 23 Oct 2024
Morningstar Rating	★★23 Oct 2024 21:30, UTC	★★23 Oct 2024 21:29, UTC	★★★★23 Oct 2024 21:41, UTC	★★23 Oct 2024 16:42, UTC
Analyst	Kai Wang, Senior Equity Analyst	Dan Wasiolek, Senior Equity Analyst	Dan Wasiolek, Senior Equity Analyst	Kai Wang, Senior Equity Analyst
Capital Allocation	Standard	Exemplary	Standard	Poor
Price/Fair Value	1.18	1.18	0.77	1.53
Price/Sales	6.12	6.81	1.23	3.51
Price/Book	2.22	—	2.51	6.62
Price/Earning	19.14	30.46	48.26	34.06
Dividend Yield	0.00%	0.60%	0.00%	0.00%
Market Cap	40.00 Bil	144.59 Bil	2.12 Bil	1,177.84 Bil
52-Week Range	31.55—69.67	2,733.04—4,395.00	12.93—28.76	61.10—217.00
Investment Style	Large Growth	Large Growth	Small Blend	Large Growth

In terms of total revenue, Trip.com dominates its competitors as 2019 (prepandemic) revenue was CNY 35.7 billion compared with its closest competitor, Meituan's hotel and in-store business, at CNY 22.3 billion and Tongcheng Travel CNY 7.3 billion. Trip.com's revenue and high market share compared with its peers is reflective on its hotel coverage and network effect. Furthermore, its market share is bolstered by 43% and 21.84% ownership in competitors Qunar and Tongcheng, respectively. We estimate that Trip.com has just under 50% GMV market share for accommodation reservation bookings on its platform in China, and if combined with Qunar and Tongcheng, its market share increases to 65%-70% in 2019.

Despite many competitors in the industry, acquisition channels and demographics are different for each platform which also contributes Trip.com's business moat. Trip.com's strategy is fundamentally different from other competitors as low-star hotels are viewed as traffic acquisition channels on Trip.com's

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platform for its high-star hotels where monetization and margins are higher. We believe that this contributes to its network effect where consumers view Trip.com as the platform for high quality travel accommodations and a one-stop shop in the long term. The market for low-star hotels is highly competitive and while other platforms are looking to make profit, Trip.com hopes to only break even so that it can drive traffic toward its high-star offerings according to management.

Trip.com's dominance with high-star hotels appears to be paying off. While Meituan indicated that it has become the leader in the hotel booking industry in terms of the number of rooms booked and implied that it has taken market share, we believe that Meituan's metric is based on low-star hotels and hourly rooms where monetization rate is much lower than that at Trip.com. We estimate that Trip.com has 50%-plus the market share for high-star hotels where the take rate is 9%-10% compared with 5%-6% for low-star hotels. As a result, we estimate that Trip.com's room nights booked were about 300 million-320 million compared with Meituan's 392.4 million, but domestic accommodation revenue were CNY 10.5 billion versus Meituan's CNY 5.5 billion estimate in 2019 despite having more room nights booked.

In addition, the average daily rate, or ADR, for both low-star and high-star hotels is different for Trip.com and Meituan based on how each company classifies their listings. For both classifications, ADR is higher for Trip.com than Meituan as high-star and low-star is CNY 600 and under CNY 300, respectively, for Trip.com—compared with slightly above CNY 200 and CNY 150, respectively, for Meituan. This would imply that hotels on Trip.com's platform are skewed toward the higher end and implying that market share for high-star hotels is even higher. Furthermore, the higher ADR and monetization rate contribute to a higher commission per transaction which contribute to Trip.com's market share. Given that customers are using Trip.com's platform to book higher-star hotels relative to its competitors, we believe that Trip.com has branded itself as the platform for better quality offerings that takes up the mindshare of Chinese consumers.

Implications on how consumers view Trip.com's platform can also be seen through its transportation ticketing business. The transportation business, excluding Skyscanner and international flights, is essentially domestic airlines and ground transportation (that is high-speed rail, trains, buses) that is accessible to other OTA platforms and identical substitutes. Government regulations prevent OTAs from taking a commission from state-owned enterprise ground transportation, and for domestic airline ticketing only fixed booking fees of CNY 5-CNY 10 are allowed after the industry revamped the amount of commission allotted for OTAs, which implies that revenue become directly correlated with transaction volume. In 2019, domestic transportation ticketing revenue for Trip.com was CNY 8.1 billion in 2019 compared with CNY 4.5 billion for Tongcheng. Given identical substitutes and difference in revenue, we believe that this is illustrative of the mindshare and popularity of Trip.com as a platform relative to competitors who can offer the same service.

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We assign Trip.com a narrow moat rating, rather than wide, as ROIC has been declining in recent years due to lower take rates and increasing competition from direct channels and relatively low barrier to entry. Since late 2015, larger airlines in China have decided to increase their direct sales portions and lower the commissions to online travel agents. By 2017, the three largest Chinese airlines had reduced commission to agencies by 50% after two years, and now according to management, the platforms are only taking CNY 5 per transaction for booking fees. The airlines are also expanding to accommodation-reservation services, with the goal of cross-selling with air tickets. Despite greater options in hotel selection and international flights, there are no patents nor nonreplicable barriers to Trip.com's success, albeit that it will take time and resources to forge the same relationships and network effect Fliggy remains an Alibaba service and Tongcheng is partially backed by Tencent as well which means that other existing peers have the resources.

Trip.com has also taken active steps to enhance its network internationally. It acquired Skyscanner on November 2016 for GBP 1.4 billion which searches international travel options and compares prices. In April 2019, Ctrip announced it will issue new shares to Naspers for its 42.5% stake in MakeMyTrip, India's largest online travel company, bringing Ctrip's stake in MakeMyTrip to 49%. In addition, Ctrip has access to more international hotels through its partnership with Booking.com, which holds 5% of Trip.com

The major competition is from Meituan, Tongcheng, Fliggy, Tuniu, and Mafengwo, which are still much smaller. There is potential that Trip.com lose market share in the long term given that smaller companies will likely grow faster but its greater high-star hotel and international options, which have higher margins and monetization rate, should retain customers for Trip.com and increase ROIC again once covid-19 wanes.

We can also look to the US OTA industry as an example how certain companies have been able to ward off competitors. The network effects for Booking Holdings, Airbnb, and Expedia are driven by the large amount of travel supply content on their platforms that incentivizes travelers to visit and book. As these platforms get more visitors it motivates suppliers to list more content, and as more content is available it drives more use. This traffic allows these operators to improve the user experience quicker than smaller peers, which also improves the network and is tough to replicate. The supplier relationships also require sales and servicing, which is another hurdle to replicating, as is the scaling of supply content. We believe that given Trip.com's scale and size, it is better positioned to maintain these relationships with its suppliers as well.

Until 2013, Trip.com's return on invested capital was historically much higher than its weighted average cost of capital. Due to heavy competition with Qunar and eLong in 2014 and 2015, Trip.com's margins declined significantly, and ROIC decreased from over 80% to negative 2.8% in 2014 and 1.9% in 2015.

As the company started to consolidate Qunar, which was loss-making, and increase its investment in customer services (new call centers, easier cancelation policies), its ROIC became lower than WACC. We forecast that ROIC surpasses WACC by 2024 as the pandemic improves and as its higher-margin international businesses recovers.

According to Morningstar Sustainalytics, the highest environmental, social, and governance risk is corporate governance for Trip.com. We have not seen any indication that an adverse material corporate governance event is likely to occur and that this will impact the company's moat source of network effect.

However, there was an incident prior where the risk may come from the value-added services scandal in late 2017-18 when consumers complained about hidden charges where the company bundled services such as insurance and other extras with airfares and other bookings on the platform. Only when confronted by regulators when they banned these “value-added services” did Trip.com (Ctrip then) stop such practices. There was also another incident where footage surfaced online of infants getting abused and fed wasabi at a childcare center for employees. Though the center was run by a third party, video of the abuse caused backlash among the public and netizens. Management blamed these incidents for revenue shortfall where it grew only 9%-11% and short of expectations of 16%. Given prior questionable behavior from management, another incident could prompt further outrage or regulatory clampdown.

Fair Value and Profit Drivers Kai Wang, CFA, Senior Equity Analyst, 27 Aug 2024

Our fair value estimate is USD 52 or HKD 416. Valuation will be largely determined by the level of recovery, especially in international air ticketing and hotels in 2024, and whether it is able to successfully expand its overseas platform without sacrificing profitability. The company wants its overseas platform to contribute 15%-20% of total revenue, from 6% currently. While we are encouraged that the expansion will raise revenue growth to mid-20% levels from 2023-28, we would like to see it expand without heavily diluting operating margin. There are some policy tailwinds as visa restrictions are being lifted, but whether demand can continue its rapid pace remains to be seen.

Domestic business and accommodation have recovered much faster than the international business. We expect 2024 international revenue to recover to 80% of 2019 levels. Operating margins from the international air and hotel businesses should also drive margin expansion.

Other business such as Skyscanner, packaged-tours, and corporate travel are smaller factors in determining Trip.com’s fair value, but we assume that they recover to 2019 levels as well. The business already recovered beyond 2019 levels in the first quarter of 2023. Regardless, the main determinant of Trip.com’s fair value will be its operating margins, which are dictated by the amount of bookings of its higher monetization rate products: international air, international hotels, and high-star hotels.

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We do not believe that a recovery in domestic travel or activity will necessarily represent greater valuation for Trip.com as monetization is minimal for the domestic travel business. Domestic air ticketing has a take-rate of 1%-2% and most ground transportation have close to 0 take-rate.

Risk and Uncertainty Kai Wang, CFA, Senior Equity Analyst, 2 May 2024

We assign Trip.com a Morningstar Uncertainty Rating of High.

Although there has been some market consolidation in the industry in the last 10 years, including eLong and Qunar being acquired by Trip.com in 2015, competition is still fierce as Meituan and Fliggy have ample resources to compete. Should there be new peers, we expect margin decline as we saw Trip.com's competition with Qunar and eLong squeeze its operating margin into negative territory in 2014 from over 30% in 2011. This would also undermine Trip.com's long-term outlook of 20%-30% operating margins which would lower our fair value estimate. Despite lesser competition in the industry currently, new entrants could pose as a risk to Trip.com.

Capital Allocation Kai Wang, CFA, Senior Equity Analyst, 2 May 2024

Our Morningstar Capital Allocation Rating for Trip.com is Standard.

Trip.com's balance sheet strength is sound. The company has stuck to its core business and refrained from venturing into other separate businesses that is common for Chinese internet companies. Trip.com has invested in Skyscanner, eLong, Qunar, and MakeMyTrip, which have all contributed to expanding its network effect.

Trip.com acquired 37.6% of eLong in May 2015 which reinforced Trip.com's market position in hotel booking, as eLong was the second-largest online hotel booking service provider in China at the time. The deal also complemented Trip.com's high-end hotel inventories with eLong's mid- to low-end segment. Then in October 2015, Trip.com completed a share exchange with Baidu to obtain approximately 45% of the aggregate voting interest of Qunar in exchange for Trip.com's newly issued ordinary shares. The transaction further strengthened the firm's position in the online flight and hotel booking market in China, and added more international flights on its platform.

The company acquired global metasearch platform Skyscanner in 2016, which has led to greater traffic acquisition. Combined with Trip.com investment in India's online travel agent MakeMyTrip, these acquisitions will help expand Trip.com's international presence. The company generated higher adjusted ROIC than its WACC before the pandemic, and we expect to see reversion as the industry recovers.

Trip.com has executed a number of value-accretive share-repurchase programs in the past but the company is keen to invest for both organic growth and acquisitions in order to expand its international

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market. We would not be surprised to see additional bolt-on acquisitions in the future that fit its long-term strategy.

Analyst Notes Archive

Trip.com Earnings: Fair Value Up 4% as Margins Expand and Revenue Defies China's Macro Slowdown Kai Wang, CFA, Senior Equity Analyst, 27 Aug 2024

We raised our fair value estimate for Trip.com to $52 (HKD 416) per share from $50 (HKD 400) after it reported second-quarter revenue of CNY 12.8 billion, slightly above its guidance midpoint of CNY 12.7 billion. Adjusted operating margin was 27.8% this quarter, flat sequentially, but improved by 130 basis points year on year. The company’s CNY 15.6 billion guidance midpoint for third-quarter revenue represents 13.5% growth year on year. We are encouraged to see that its guidance defies current macroeconomic headwinds in China within the retail sector. In addition, we forecast operating margin (including share-based expenses) to increase by 150 basis points sequentially to 29.3% next quarter. Although third quarters usually have the highest operating margins due to seasonality, Trip.com also expects its personnel costs to increase minimally at 0%-5% year on year. We have slightly lowered our operating costs assumptions in the outer years, which explains the valuation increase. We believe China’s consumers are shifting their spending toward services rather than products and goods, and see Trip.com as the best-in-class company in China that offers travel services. For investors who still wish to gain exposure to China’s spending, we recommend shifting away from the retail goods sector and toward services, given changing consumer preferences.

We expect revenue next quarter to be driven by accommodation and tour businesses. We forecast accommodation will grow robustly at 24% year on year, driven by continued pent-up demand for traveling in more rural areas. Mid-to-high-end hotels should still account for about 80% of domestic hotel revenue. We forecast packaged tours to grow 23% year on year as travelers are now paying for experiences. However, we expect the transportation segment to be a laggard and to grow only 4% year on year next quarter as there is less demand for value-added services and consumers are electing only to purchase tickets.

Trip.com Earnings: Fair Value Up 14% After Margin Expansion Revisions, but Growth Momentum Slowing Kai Wang, CFA, Senior Equity Analyst, 21 May 2024

We raise our fair value estimate by 14% to USD 50 (HKD 400) per share from USD 44 (HKD 352) after Trip.com reported first-quarter revenue and operating margin that were 3% and 520 basis points better than our expectations, respectively. Our valuation change reflects margin expansion revisions in our estimates of 100-200 basis points for the next five years. These come after the company guided to a 31% operating margin in the second quarter of 2024, which was also 300 basis points better than our previous forecast, due to operating leverage that appears to be recurring as Trip.com sees greater transaction volume. However, Trip.com guided to 11%-16% revenue growth year on year for the second quarter of 2024, less than our previous estimate of 24%, and we believe it reflects slowing travel momentum. While the midteens guidance still represents robust growth, we believe outsize pent-up demand is normalizing and the company will seek other growth drivers now. We lower our revenue growth forecast to 15% from 20% for the remainder of 2024.

Factors contributing to a lower-than-expected revenue guidance include disappointing average room prices, given the lower demand and higher supply, leading to a decline in commissions. We estimate that average prices will be about 10% lower for the next quarter. In addition, we no longer anticipate international travel reaches 90%-100% of prepandemic levels. Trip.com expects it to reach about 80% in 2024. Nevertheless, international bookings for hotel and air ticketing both increased by 100% year on year for the quarter, while for domestic bookings, each increased by 20% year on year. We still believe that the Chinese travel sector remains strong, and while Trip.com's revenue growth may not be as robust as anticipated, we believe the underlying strength of the industry should provide a long-term tailwind. Trip.com shares are currently trading in 3-star territory.

Trip.com Earnings: Increasing Fair Value by 22% As International Revenue Begins to Ramp Aggressively Kai Wang, CFA, Senior Equity Analyst, 22 Feb 2024

We raise our fair value estimate for Trip.com to USD 44 (HKD 352) from USD 36 (HKD 290) after the firm said on its fourth-quarter earnings call that it will aggressively expand its overseas platform. The aim is for the platform to increase its contribution to overall revenue to 15%-20%, from the 6% currently, in the span of 3-5 years. The company also reiterated a long-term non-GAAP operating margin target of 25%-30%—or a GAAP operating margin of 20%-26%—including stock compensation expenses. This may imply that it may not have to sacrifice significant profitability while expanding its business. Trip.com’s international outbound revenue has also recovered to about 90% of prepandemic levels, above the industry average of 70%, which should suggest market share gains on the nondomestic end. Our new fair value estimate reflects a more favorable outlook for international travel and assumes that international revenue can grow at a 23% CAGR from 2023-28, revised from 18% previously. We expect only minor changes to our domestic revenue growth forecast as Trip.com again expects it should decelerate to the high teens year over year in 2024, from 103% growth in 2023. Despite our fair value increase, we view the shares as fairly valued, but suggest position accumulation upon a pullback as China’s travel sector remains resilient amid the country's macroeconomic headwinds.

Trip.com reported fourth-quarter revenue of CNY 10.3 billion, which was in line with our estimate but slightly off the high end of its guidance range of CNY 10.5 billion. For first-quarter 2024, it guided to 26% revenue midpoint growth year on year, which is also in line with our forecast. Sales and marketing expenses would be about 25% of revenue in the long term, which is a slight uptick from 23% in the December quarter, likely due to more promotional campaigns for its overseas platform, as we expect it to begin competing aggressively with major global online travel agencies such as Booking and Expedia.

Trip.com Earnings: International Outbound Travel Is Main Revenue Driver in 2024 As Demand Moderates Kai Wang, CFA, Senior Equity Analyst, 21 Nov 2023

We maintain our fair value estimate of USD 36 (HKD 290) for Trip.com after it reported third-quarter 2023 revenue of CNY 13.74 billion, which was in line with Refinitiv consensus estimates. Operating margin of 29% was 100-200 basis points better than guidance due to seasonality, but should revert to the midteens next quarter as Trip.com expects operating margin to moderate at mid-20% for the long term. Trip.com guided to a fourth-quarter 20%-26% increase on fourth-quarter 2019 revenue, suggesting that there is further travel demand. However, its revenue outlook of above 10% increase year on year in 2024 supports our view that travel demand has moderated since the beginning of the year—given disappointing Golden Week results that showed only a 10% increase over the 2019 level in air travelers. We still believe that Trip.com should see long-term revenue growth, but believe shares are fairly priced currently given both demand and operating margin moderation.

We expect fourth-quarter accommodation and transportation revenue to increase 35% and 20% above 2019 levels, respectively. As the travel industry normalizes in 2024, international outbound travel remains the main catalyst in the near term for Trip.com. International travel has returned to 80% of revenue, mainly due to air ticket prices that are 20%-30% above 2019 levels as overall China outbound travel volume has only recovered to 50% of prepandemic levels. However, travel bottlenecks remain as the flight capacity recovery is still only 50% and visa applications to Europe and the U.S. are still slow. Trip.com hopes for improvements on the visa application side after the annual Asia-Pacific Economic Cooperation, or APEC, summit recently. We expect full-year 2024 international revenue to recover fully, with the potential to surpass 2019 levels should bottlenecks become fully resolved.

Trip.com: Lowering Fair Value by 15% As China Travel Recovery Is Likely Running Out of Steam Kai Wang, CFA, Senior Equity Analyst, 4 Oct 2023

We lower our fair value estimate for Trip.com by 15% to USD 36 (HKD 290) from USD 42.50 (HKD 339), due to our view that the recovery for travel demand may be fizzling out. We estimate that both ground and air transportation are at significantly lower-than-expected levels and believe that weakness during Golden Week 2023 is likely an inflection point for the deceleration of travel demand. There appears to be a significant decline in the number of travelers compared with 2019, which could signal some upcoming weakness for the fourth quarter. We believe this could linger into 2024 and beyond and could also disrupt margin expansion progress. Therefore, we lowered our revenue in 2024 by 7% to CNY 51.9 billion, based on the reduction of accommodation revenue estimates by 11% and transportation estimates by 3% next year. While long-term revenue would still gradually grow, we take a much less bullish stance in the near term in terms of its growth trajectory, given the recent Golden Week data.

Morningstar Equity Analyst Report | Report as of 24 Oct 2024 00:03, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 11 of 22

Trip.com Group Ltd ADR TCOM ★★ 23 Oct 2024 21:30, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.44 USD 23 Oct 2024	52.00 USD 27 Aug 2024 07:55, UTC	1.18	40.00 USD Bil 23 Oct 2024	Narrow	Large Growth	High	Standard	2 Oct 2024 05:00, UTC

According to China's Civil Aviation Administration the cumulative number of air travelers as of the fifth day during Golden Week 2023 increased 196% year on year, but only 10.73% compared with 2019. The number of flights increased by 114.7% year on year, but only by 2.45% versus 2019. We also estimate that the cumulative traffic flow for China's main highways was 49.7% higher year on year, but 38% below 2019 levels.

More importantly, the daily average number of travelers for Golden Week 2023 is only 55.91 million compared with 87.13 million in 2019, which, in our opinion, may contradict the increase in air traffic flow data. We believe there could be some restatement of historical numbers that makes the traffic flow comparison to 2019 seem inflated. But even with restated numbers, the reported improvement is still below our expectations of a 40% increase relative to 2019 numbers—and low compared with the 33% increase in air traffic during the weeklong Labor Day holiday in May.

Trip.com Earnings: Continued Margin Expansion Is a Positive but We Await More Attractive Entry Point Kai Wang, CFA, Senior Equity Analyst, 5 Sep 2023

We maintain our fair value estimate of USD 42.50 (HKD 339) for Trip.com after it reported better-than-expected second-quarter revenue of CNY 11.2 billion, which was 5% better than the Refinitiv consensus estimate. The company continued to expand its operating margin to 26.5%, an increase of 150 basis points sequentially, as previously expected, and we are encouraged that it believes 25%-30% operating margins can be maintained in the long term given industry consolidation and better per unit economics. We expect Trip.com to see further margin expansion and secular demand, given its international business that represents another catalyst for long-term growth—and which still hasn't yet returned to prepandemic levels. We believe it remains one of the few companies still seeing pent-up demand within the China internet sector but we also expect its recovery story to be priced in already, given only a 5% upside to our fair value estimate from the Sept. 1 closing price. However, if its share price pulls back, we suggest investors capitalize on more attractive entry points and accumulate a position for the long term.

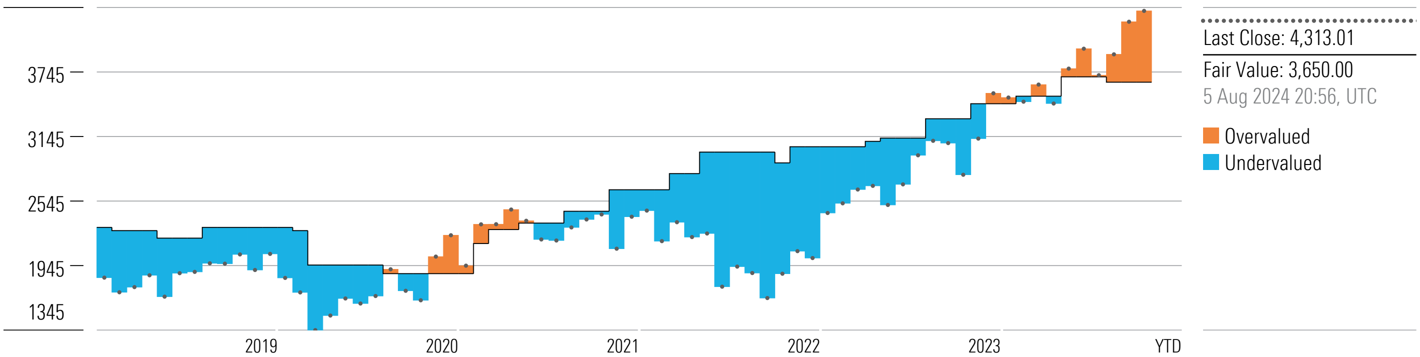
Trip.com guided for further growth next quarter driven by continued pent-up demand on the back of domestic hotels and transportation. It expects revenue of CNY 13.6 billion, an increase of 98% year on year. We forecast gross and operating margins to be 80%-81% and 26%-27%, respectively. We expect domestic room bookings and flight revenue to increase to 160% and 150%, respectively, relative to 2019 prepandemic levels. The number of outbound bookings on Trip.com remains weak at only 60% of prepandemic second-quarter 2019 levels, but was still greater than the industrywide rate of 37% this quarter. The company hopes the international business can recover by the fourth quarter. Our base-case scenario expects it to not reach prepandemic levels until at least later in the first half in 2024, and an earlier recovery would be a positive surprise.

Morningstar Equity Analyst Report | Report as of 24 Oct 2024 00:03, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 12 of 22

Trip.com Group Ltd ADR TCOM ★★ 23 Oct 2024 21:30, UTC

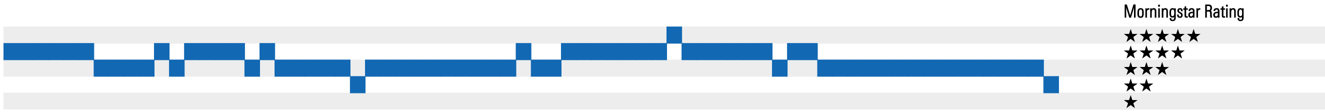
Competitors Price vs. Fair Value

Booking Holdings Inc BKNG



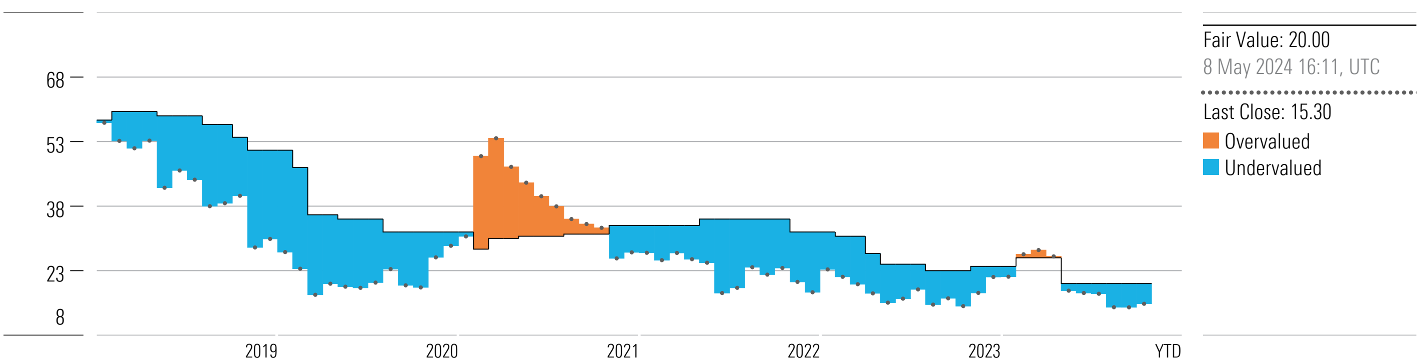
	2019	2020	2021	2022	2023	YTD	
	0.89	1.19	0.91	0.66	1.03	1.18	Price/Fair Value
	19.24	8.45	7.72	-16.00	76.02	22.33	Total Return %

Morningstar Rating



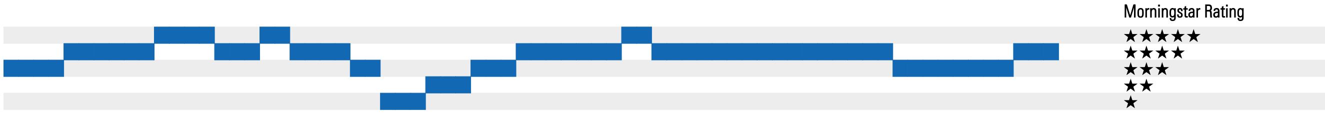
Total Return % as of 23 Oct 2024. Last Close as of 23 Oct 2024. Fair Value as of 5 Aug 2024 20:56, UTC.

Tripadvisor Inc TRIP



	2019	2020	2021	2022	2023	YTD	
	0.60	0.90	0.81	0.56	0.90	0.77	Price/Fair Value
	-37.19	-5.27	-5.28	-34.04	19.74	-28.94	Total Return %

Morningstar Rating



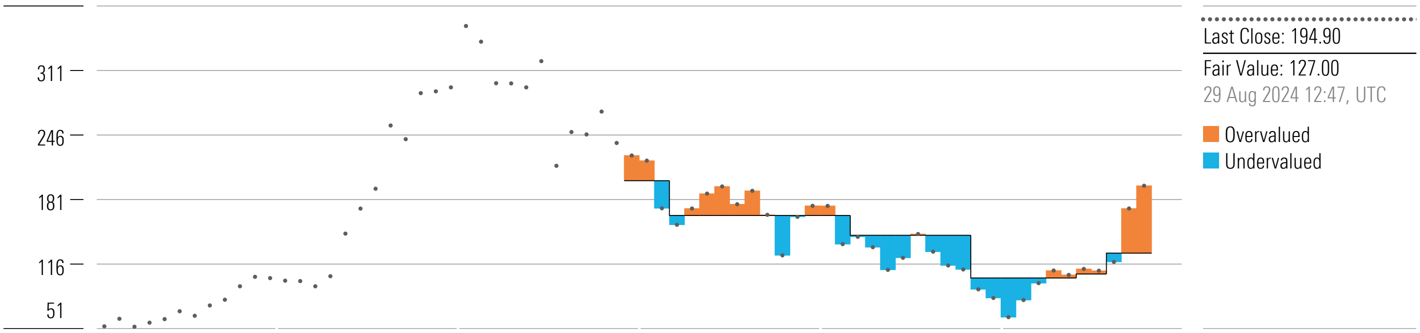
Total Return % as of 23 Oct 2024. Last Close as of 23 Oct 2024. Fair Value as of 8 May 2024 16:11, UTC.

Morningstar Equity Analyst Report | Report as of 24 Oct 2024 00:03, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 13 of 22

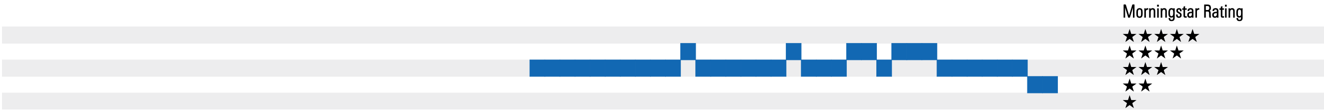
Trip.com Group Ltd ADR TCOM ★★ 23 Oct 2024 21:30, UTC

Competitors Price vs. Fair Value

Meituan Class B 03690



	2019	2020	2021	2022	2023	YTD	
	—	—	1.13	1.06	0.80	1.53	Price/Fair Value
	132.12	188.52	-23.33	-22.49	-53.12	137.97	Total Return %



Total Return % as of 23 Oct 2024. Last Close as of 23 Oct 2024. Fair Value as of 29 Aug 2024 12:47, UTC.

Morningstar Equity Analyst Report | Report as of 24 Oct 2024 00:03, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

Trip.com Group Ltd ADR TCOM ★★ 23 Oct 2024 21:30, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.44 USD 23 Oct 2024	52.00 USD 27 Aug 2024 07:55, UTC	1.18	40.00 USD Bil 23 Oct 2024	Narrow	Large Growth	High	Standard	2 Oct 2024 05:00, UTC

Morningstar Historical Summary

Financials as of 30 Jun 2024

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
Revenue (CNY Bil)	7.35	10.90	19.25	26.80	30.97	35.67	18.32	20.02	20.04	44.51	24.68	48.74
Revenue Growth %	36.4	48.3	76.6	39.2	15.6	15.2	-48.7	9.3	0.1	122	20.7	50.6
EBITDA (CNY Bil)	0.38	3.62	-0.29	5.69	4.41	12.21	2.06	2.51	5.44	13.80	8.67	15.56
EBITDA Margin %	5.2	33.3	-1.5	21.3	14.2	34.3	11.2	12.5	27.2	31.0	35.1	31.9
Operating Income (CNY Bil)	-0.02	0.58	-1.33	3.21	3.07	5.63	-0.82	-0.86	0.71	11.93	6.87	13.58
Operating Margin %	-0.3	5.3	-6.9	12.0	9.9	15.8	-4.5	-4.3	3.5	26.8	27.8	27.9
Net Income (CNY Mil)	243	2,508	-1,418	2,155	1,112	7,011	-3,247	-550	1,403	9,918	8,145	14,057
Net Margin %	3.3	23.0	-7.4	8.0	3.6	19.7	-17.7	-2.8	7.0	22.3	33.0	28.8
Diluted Shares Outstanding (Mil)	306	379	473	574	567	642	601	634	657	671	683	677
Diluted Earnings Per Share (CNY)	0.79	7.11	-3.00	3.84	1.96	11.50	-5.40	-0.87	2.14	14.78	11.93	20.73
Dividends Per Share (CNY)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Valuation as of 30 Sep 2024

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Price/Sales	7.6	11.1	8.6	6.8	4.0	3.9	4.3	4.8	8.4	5.3	5.8	5.8
Price/Earnings	44.6	-10,000.0	112.4	476.2	33.7	73.0	-44.4	25.8	-59.2	26.8	20.1	20.1
Price/Cash Flow	17.9	35.8	85.5	27.2	15.5	15.3	19.0	-25.8	61.7	64.9	13.3	13.3
Dividend Yield %	—	—	—	—	—	—	—	—	—	—	—	—
Price/Book	4.2	9.7	2.1	1.9	1.2	1.4	1.3	0.9	1.4	1.3	2.1	2.1
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 Jun 2024

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
ROA %	0.9	3.3	-1.1	1.4	0.6	3.6	-1.7	-0.3	0.7	4.8	3.5	6.0
ROE %	2.7	9.3	-2.4	2.8	1.3	7.4	-3.2	-0.5	1.3	8.5	6.5	11.3
ROIC %	0.8	4.9	-1.4	1.9	0.6	4.4	-2.3	-0.6	0.6	6.1	4.5	7.6
Asset Turnover	0.3	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.2	0.1	0.2

Financial Leverage

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Debt/Capital %	45.6	29.2	32.6	25.6	21.8	16.4	18.9	9.5	10.9	13.8	13.6	—
Equity/Assets %	30.5	37.5	49.5	52.3	46.7	51.7	53.6	57.2	58.6	55.8	52.7	—
Total Debt/EBITDA	30.4	8.6	-141.3	8.0	13.6	4.2	27.9	20.6	8.6	3.3	6.9	—
EBITDA/Interest Expense	2.3	12.0	-0.4	4.4	2.9	7.3	1.2	1.6	3.6	6.7	8.6	7.6

Morningstar Analyst Historical/Forecast Summary as of 27 Aug 2024

Financials

			Estimates		
Fiscal Year, ends 31 Dec 2023	2022	2023	2024	2025	2026
Revenue (CNY Mil)	20,039	44,510	52,664	62,193	70,918
Revenue Growth %	0.1	122.1	18.3	18.1	14.0
EBITDA (CNY Mil)	3,580	14,370	19,081	17,740	20,429
EBITDA Margin %	17.9	32.3	36.2	28.5	28.8
Operating Income (CNY Mil)	88	11,324	13,626	16,944	19,665
Operating Margin %	0.4	25.4	25.9	27.2	27.7
Net Income (CNY Mil)	1,403	9,918	13,410	12,873	15,360
Net Margin %	7.0	22.3	25.5	20.7	21.7
Diluted Shares Outstanding (Mil)	657	672	684	688	688
Diluted Earnings Per Share(CNY)	2.14	14.76	19.60	18.71	22.33
Dividends Per Share(CNY)	0.00	0.00	0.00	0.00	0.00

Forward Valuation

			Estimates		
	2022	2023	2024	2025	2026
Price/Sales	7.8	3.7	5.4	4.6	4.0
Price/Earnings	111.7	17.3	22.3	23.4	19.6
Price/Cash Flow	—	—	—	—	—
Dividend Yield %	—	—	—	—	—
Price/Book	1.4	1.4	2.2	2.0	1.8
EV/EBITDA	44.9	10.6	13.4	14.5	12.6

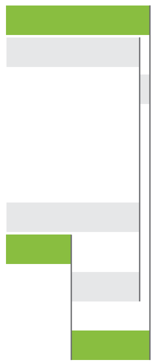
Morningstar Equity Analyst Report | Report as of 24 Oct 2024 00:03, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

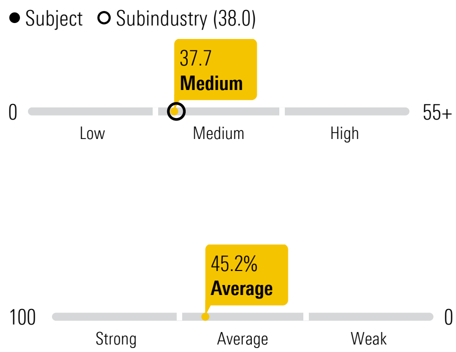
Trip.com Group Ltd ADR TCOM ★★ 23 Oct 2024 21:30, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.44 USD 23 Oct 2024	52.00 USD 27 Aug 2024 07:55, UTC	1.18	40.00 USD Bil 23 Oct 2024	Narrow	Large Growth	High	Standard	2 Oct 2024 05:00, UTC

ESG Risk Rating Breakdown

Exposure		
Company Exposure[1]	37.7	
– Manageable Risk	35.0	
Unmanageable Risk[2]	**2.7**	
Management		
Manageable Risk	35.0	
– Managed Risk[3]	15.8	
Management Gap[4]	**19.1**	
Overall Unmanaged Risk	**21.8**	

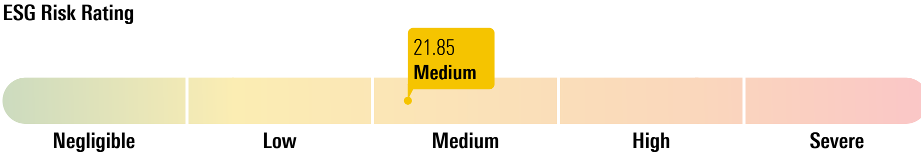




- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

- 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 45.2% 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: Internet Software and Services. 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		
Trip.com Group Ltd	37.7 | Medium	0	55+	45.2 | Average	100	0	21.8 | Medium	0	40+
Booking Holdings Inc	33.6 | Low	0	55+	52.2 | Strong	100	0	17.2 | Low	0	40+
Tripadvisor Inc	42.1 | Medium	0	55+	37.2 | Average	100	0	27.5 | Medium	0	40+
Meituan	36.3 | Medium	0	55+	42.0 | Average	100	0	22.1 | Medium	0	40+
Tongcheng Travel Holdings Ltd	36.9 | Medium	0	55+	45.9 | Average	100	0	21.1 | Medium	0	40+

Morningstar Equity Analyst Report | Report as of 24 Oct 2024 00:03, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

Appendix
Historical Morningstar Rating

Trip.com Group Ltd ADR TCOM 23 Oct 2024 21:30, 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
★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★★	★★★★

Booking Holdings Inc BKNG 23 Oct 2024 21:29, 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
★★★	★★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★

Tripadvisor Inc TRIP 23 Oct 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
—	—	★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
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
★★★★★	★★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★

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
—	—	—	—	—	—	—	—	—	—	—	—

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.

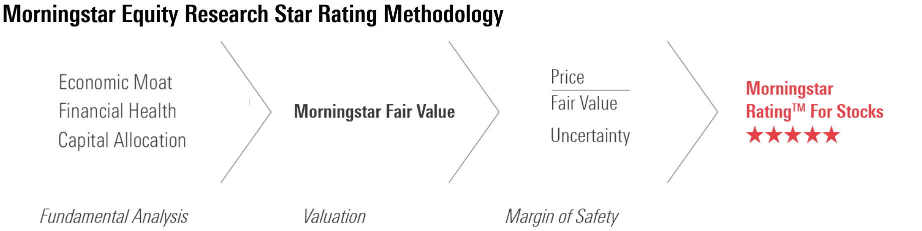
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return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

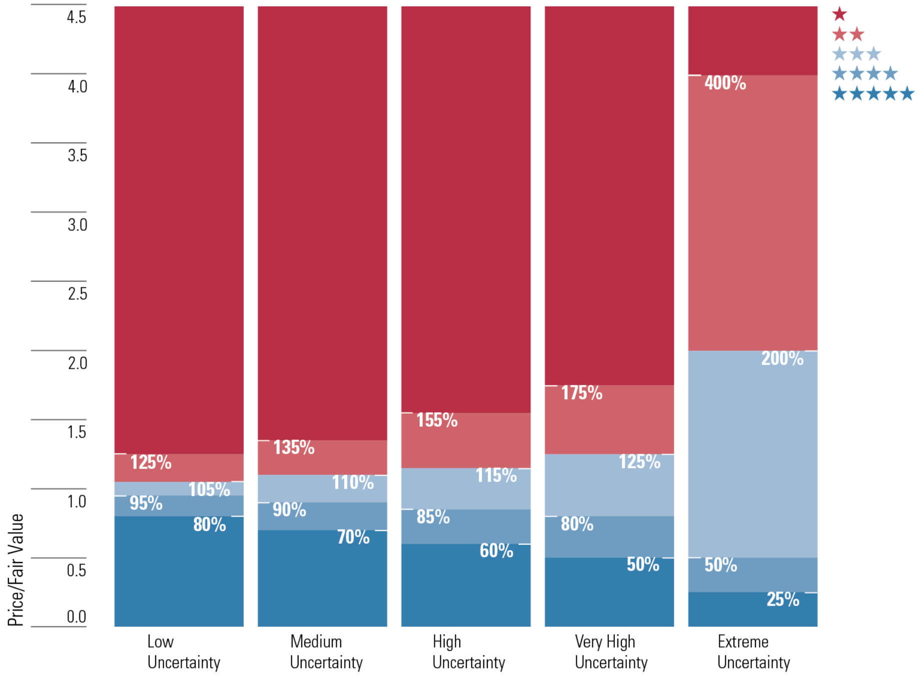
4. Market Price

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.

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-

Research Methodology for Valuing Companies

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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