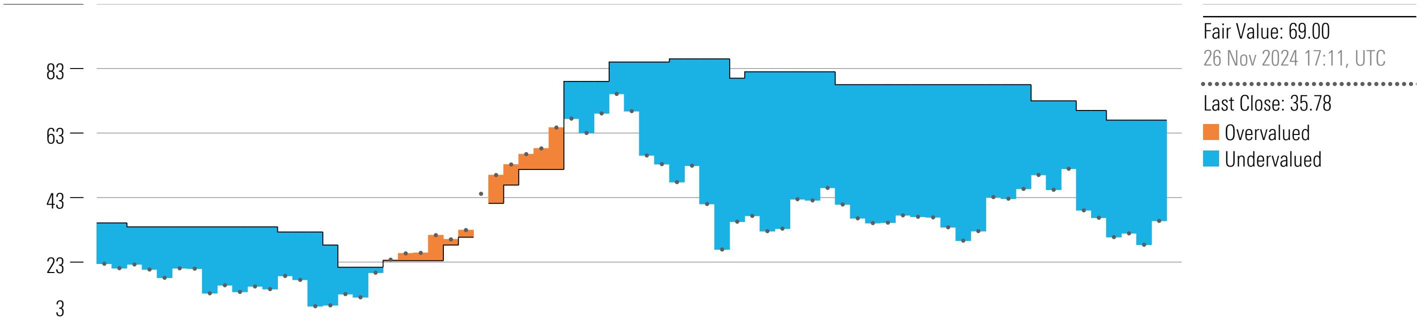
Morningstar Equity Analyst Report | Report as of 26 Nov 2024 17:17, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 1 of 23

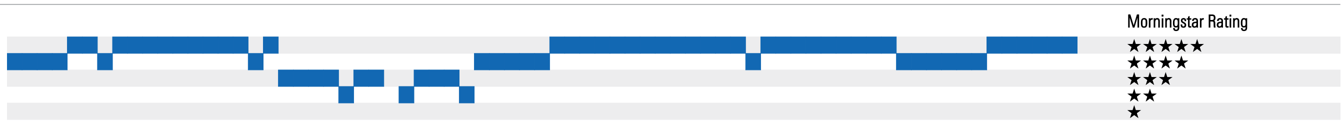
Bath & Body Works Inc BBWI ★★★★★ 26 Nov 2024 17:16, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
35.78 USD 25 Nov 2024	69.00 USD 26 Nov 2024 17:11, UTC	0.52	7.71 USD Bil 26 Nov 2024	Narrow	Small Value	High	Standard	6 Nov 2024 06:00, UTC

Price vs. Fair Value



	2019	2020	2021	2022	2023	YTD	
	0.43	1.06	0.82	0.51	0.55	0.52	Price/Fair Value
	-24.74	106.90	126.30	-38.47	4.32	-15.25	Total Return %



Total Return % as of 25 Nov 2024. Last Close as of 25 Nov 2024. Fair Value as of 26 Nov 2024 17:11, 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.

Bath & Body Works Earnings: Return to Growth in Sight as Demand Stabilizes; Shares Attractive

Analyst Note Jaime M. Katz, CFA, Senior Equity Analyst, 25 Nov 2024

Shares of narrow-moat Bath & Body Works popped 16% during Nov. 25 trading, as the business surfaced improving trends in its third-quarter results. Notably, a 3% increase in sales, to $1.6 billion, marked the first quarter of positive growth since the third quarter of 2021, a trend we believe will be restored in 2025. Positive store traffic and conversion as well as a normalization in candle demand supported low-single-digit growth across all three segments (body care, home fragrance, and soaps and sanitizers) in both the quarter and year-to-date period, signaling demand BBW may have finally bottomed out. Additionally, operating margin performance of 13.5% was slightly better than the 13% we had forecast, as some marketing expense shifted closer to the holidays. Although 2024's fourth quarter is set for a top-line decline, lapping a 14-week quarter last year, it appears the operating margin should remain flat, benefiting from pricing (AUR improvement and flat merchandise margin), buying and occupancy prowess, and supply chain improvements.

We are likely at the trough of operating margin performance in 2023 (17%), and we believe that a return to sales growth, along with efforts to expand the business, will contribute to restored profit expansion in 2025 and beyond. Newer brand extensions in men's, lip, laundry, and hair (10% of sales) have performed well and help elevate repeat business while reaching new customers. Such innovation is the linchpin of our long-term projection for 3% average sales growth over the next decade. Furthermore, BBW has held firm on its long-term targets for a gross margin of 45% and operating margin of 20%,

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Sector	Industry
Consumer Cyclical	Specialty Retail

Business Description

Bath & Body Works is a specialty home fragrance and fragrant body care retailer operating under the Bath & Body Works, C.O. Bigelow, and White Barn brands. The company generates most of its business in North America, with just 5% of sales from international markets in fiscal 2023. For fiscal 2023, 74% of sales stemmed from the brick-and-mortar network (which was composed of more than 1,800 retail stores), similar to 2022 levels, as consumer shopping patterns remained to normal. Future growth is expected from store reformatting, digital and international channels, as well as adjacent category expansions like hair and laundry.

numbers that are in line with our long-term projections. These factors will allow us to hold our $67 fair value estimate intact, and we still view shares as significantly undervalued. As an aside, BBW remains one of the best-positioned retailers, with 85% of its supply chain operating domestically, resulting in little tariff risk.

Business Strategy & Outlook Jaime M. Katz, CFA, Senior Equity Analyst, 26 Nov 2024

We believe Bath & Body Works has carved out a solid competitive edge in the sizable addressable markets in which it operates. The company’s strong brand intangible asset is supported by its leadership position across the bath and shower and candle air freshener industries in recent years, which has been bolstered by BBW’s quick response to consumer trends. Quantitatively, the narrow moat is reinforced by a 37% average return on invested capital excluding goodwill that we expect the business to generate over the next decade, well ahead of our 8% weighted average cost of capital estimate.

Outside of the $6 billion air care and $12 billion bath, shower, and sanitizer markets, we think the beauty industry and category adjacencies still offer a plethora of upside over time relative to BBW’s estimated 2024 sales of $7.3 billion. The firm has outlined a compelling pipeline of opportunities to reach new consumers and stimulate sales conversion ahead. For example, not only can BBW add expansion products like shaving and facial care, but it can also expand its penetration in categories like haircare, men's care (most recently with grooming), lip, and laundry.

This robust pipeline of opportunities should support average sales growth of 2% over fiscal 2024-28 (including a 2% decline in 2024). We forecast sales of $8.3 billion in 2028, which is contingent on average sales growth of 3% from North American stores, 3% from the digital channel, and 8% from international opportunities starting in 2025. This should be supported by elevated engagement with the brand, as there is more than 80% brand awareness among women 18-59 years old (and 60% of men in the same cohort). Longer term, operating margins should return to the low 20s (from a 17% estimate in 2024) as the firm's is able to leverage costs again on rising sales. Furthermore, while postpandemic consumer spending could continue to center around categories like travel, BBW should see solid demand trends ahead, with our forecast for organic growth slightly below the roughly 4% growth projection (Euromonitor) for the North American beauty and personal care industry during 2024-28. Growth could be faster with new line extensions.

Bulls Say Jaime M. Katz, CFA, Senior Equity Analyst, 26 Nov 2024

- BBW is set to renegotiate leases over time. Favorably updated rent agreements, new off-mall locations, and productivity gains from updated format conversions could help boost profits.
- The firm has rolled out a new customer loyalty app nationally; at last disclosure, it has attracted 38 million active members that comprise 80% of US sales. This should support repeat customer sales growth.

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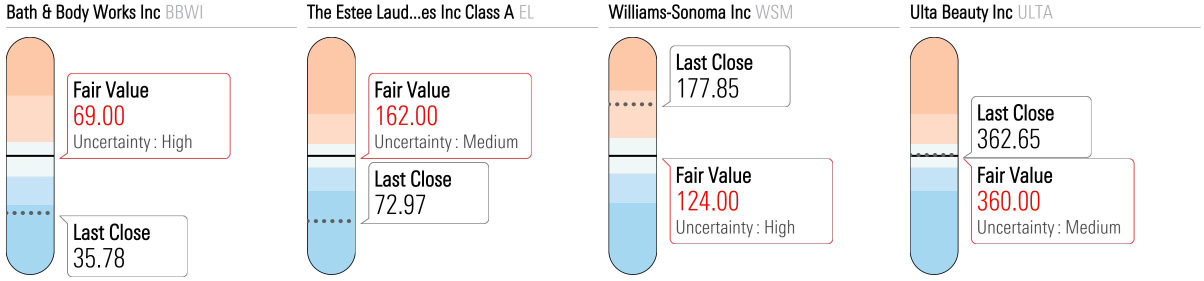
Competitors



	Bath & Body Works Inc BBWI	The Estee Laud...es Inc Class A EL	Williams-Sonoma Inc WSM	Ulta Beauty Inc ULTA
Economic Moat	Narrow	Wide	None	Narrow
Currency	USD	USD	USD	USD
Fair Value	69.00 26 Nov 2024 17:11, UTC	162.00 1 Nov 2024 06:47, UTC	124.00 21 Nov 2024 12:43, UTC	360.00 17 Oct 2024 21:21, UTC
1-Star Price	106.95	218.70	192.20	486.00
5-Star Price	41.40	113.40	74.40	252.00
Assessment	Undervalued 25 Nov 2024	Undervalued 25 Nov 2024	Overvalued 25 Nov 2024	Fairly Valued 25 Nov 2024
Morningstar Rating	★★★★★26 Nov 2024 17:16, UTC	★★★★★25 Nov 2024 22:42, UTC	★★25 Nov 2024 22:43, UTC	★★★25 Nov 2024 22:44, UTC
Analyst	Jaime M Katz, Senior Equity Analyst	Dan Su, Equity Analyst	Jaime M Katz, Senior Equity Analyst	David Swartz, Senior Equity Analyst
Capital Allocation	Standard	Standard	Standard	Exemplary
Price/Fair Value	0.52	0.45	1.43	1.01
Price/Sales	1.08	1.70	3.06	1.55
Price/Book	—	5.15	11.56	7.37
Price/Earning	8.54	27.85	21.03	14.43
Dividend Yield	2.24%	3.62%	1.21%	0.00%
Market Cap	7.84 Bil	26.19 Bil	22.03 Bil	17.09 Bil
52-Week Range	26.21—52.99	62.29—159.75	90.87—181.42	318.17—574.76
Investment Style	Small Value	Mid Blend	Mid Blend	Mid Blend

- Growth opportunities exist in white-space categories including the clean, natural organic space, skincare, haircare, laundry, and men's products.

Bears Say Jaime M. Katz, CFA, Senior Equity Analyst, 26 Nov 2024

- A downshift in demand around mall retailing could further slow footfall, tempering demand. Mall locations still represented about 55% of the fleet in November 2024 (versus 61% in 2016).
- Consumer trends can change rapidly, leading to a mismatch in customer assortment and demand. This could take time to remedy and temporarily hinder profits if BBW has to discount to clear inventory.
- As covid risks remain minimal, consumers could further shift discretionary spending from soaps and sanitizers to other categories, ceding additional volume benefits to the operating margin.

Economic Moat Jaime M. Katz, CFA, Senior Equity Analyst, 26 Nov 2024

Bath & Body Works is the number-one specialty home fragrance (40% of sales), body care and fragrance

(40%), and hand soap and hand sanitizer (15%) vendor in America, with brand visibility supported by its nearly 1,900 owned locations. With these three market-leading categories constituting around 95% of BBW's total sales, we believe it signals the product offerings' strong resonance with the firm's consumer base. According to Euromonitor, BBW holds the second spot in the $12 billion North American mass bath and shower business (behind wide-moat Unilever), with share of 13% in 2023 (most recently available), and more than double the share of number-three player Dial (owned by narrow-moat Henkel). In the $2.3 billion candle air freshener category, BBW held an impressive 32% share in 2023, second only to Yankee Candle (38%, a Newell brand) and around triple the next competitor's (Glade, owned by S.C. Johnson) market share. In skincare, BBW has realized slow gains in awareness, as it held more than 3% share in 2023. Given the intense competition and fragmented nature of the skincare industry, we view this steadfast position as evidencing the company's solid brand intangible asset; BBW holds the fourth-largest market share after CeraVe (6.7%, owned by wide-moat L'Oreal), Neutrogena (4.2%, a wide-moat Kenvue brand), and Olay (owned by wide-moat Procter & Gamble). Overall, Bath & Body Works has demonstrated its ability to maintain or gain market standing independent of external conditions (particularly in the bath and shower and candle businesses), which indicates a brand intangible asset exists.

The perpetual introduction of unique product offerings, with floor sets rotating every four to six weeks on average, has also helped BBW post consistent financial performance over the last decade, and we contend this has led to these solid market share positions. For example, sales grew to $7.4 billion in 2023 from $2.6 billion in 2010, while the net store base growth was up just 11% in locations over the same time frame. But beyond the nearly 300% increase in sales over this time frame, such robust demand has allowed for the continued extraction of operating gains from the model, evidenced by an operating margin of 17% in 2023. We believe consistency in historical margins (above 20%, but which have recently been temporarily eroded by inflation and expense deleverage on normalizing postpandemic sales) stems from the pricing power of the business, which generated 42% average gross margins in 2019-23, ahead of the mid-30s that narrow-moat beauty retailer Ulta and high 30%-rate no-moat specialty retailer Williams-Sonoma were able to capture over the same time frame. As evidence, while BBW shower gel prices around $13.50 (and above) per 10-ounce bottle, Dove clocks in around $7.50 for 20 ounces and Dial at less than $6.49 for 16 ounces. Even with a buy one/get one free promotion, BBW is handily outpacing its peers on a price/ounce basis. All in, we believe such factors demonstrate the consumer resonance of the offering, and as such, we believe BBW warrants a narrow economic moat rating.

Part of BBW's productivity gains can be quantified via improving average sales per square foot—a particular bright point, given the struggles other mall retailers have faced in recent years in stimulating foot traffic. Sales per square foot clocked in at around $1,100 in 2023, handily outperforming numerous retailers with similar geographic exposure. For reference, most other department store-type retailers

(Kohl's, Macy's, JC Penney) have historically generated around $200 per square foot, metrics which have become difficult to parse as omnichannel sales have become pervasive. Those consumer retailers that have aligned with or surpassed BBW's sales per square foot have generally been significant market leaders (wide-moat Apple), those that have a particularly small footprint (Warby Parker), or firms that are considered luxury brands (Tiffany, narrow-moat Lululemon).

Additionally, we contend that part of BBW's robust productivity metrics are a result of the company's ability to perpetually adjust its retail footprint to incorporate higher-performing locations into the mix. While around one quarter of the store fleet is in Class A or -B malls, around 55% of locations are now in specialty, strip malls, and other types of real estate, where conversion is often higher. When consumers visit an off-mall location, it tends to be with purpose and intent, rather than to just peruse (like those walking through a mall might do). Given the higher productivity of these locations, we expect BBW to accelerate its focus on off-mall boxes. The brand had around one quarter of its boxes in weaker demographic Class C and -D malls. With Class D units seeing shorter average lease terms (two to three years), BBW should be able to continue to adjust the footprint of its fleet in order to maximize four-wall productivity. Furthermore, we think flat shipping costs and in-store-only offerings should entice consumers to shop BBW's physical boxes, supporting traffic and ticket growth while bounding the shift to e-commerce relative to other retailers (e-commerce represented 21% of 2023 sales).

With a proven blueprint to follow and continued spending on product innovation, BBW's sales should be able to pace near market growth ahead (beyond the 2% dip we forecast for 2024), supporting continued brand equity. Euromonitor projects below 4% average beauty and personal care growth domestically between 2024-28. Our sales forecast over the same time frame for BBW averages 2%, including the 2% decline in 2024. However, over the remainder of our forecast, BBW's sales growth should still trend in line with the industry considering its existing business lines, with 3% growth at stores, 4% growth from digital, and 8% growth from the international segment incorporated (driving a more than 3% average top-line opportunity).

Quantitatively, robust ROIC forecasts also support our narrow moat rating. Over the next decade, BBW should be able to generate ROICs including goodwill that average 37%, well above numerous other consumer companies, thanks to the low working capital base and the fast cash-conversion cycle (four to five weeks). For reference, even luxury companies like wide-moat Richemont (which have low capital intensity) are set to generate average ROICs including goodwill around 21% through 2028. On the luxury beauty/personal care side, wide-moat Estee Lauder is set to generate ROICs excluding goodwill that average 12% over the next five years, a level we believe the BBW business should surpass, offering us further evidence that BBW has a brand intangible asset edge.

Fair Value and Profit Drivers Jaime M. Katz, CFA, Senior Equity Analyst, 26 Nov 2024

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We are increasing our fair value estimate per share to $69 from $67 for narrow-moat Bath & Body Works after incorporating solid third-quarter results and refining our fiscal 2024 outlook. The firm's third-quarter results surfaced improving trends, starting with a 3% increase in sales, marking the first quarter of positive growth since the third quarter of 2021. Positive store traffic and conversion as well as a normalization in candle demand supported low-single-digit growth across all three segments (body care, home fragrance, and soaps and sanitizers) in both the quarter and year-to-date period, signaling demand BBW may have finally bottomed out. Additionally, operating margin performance of 13.5% was slightly better than the 13% we had forecast, as some marketing expense shifted closer to the holidays. Although 2024's fourth quarter is set for a top-line decline, lapping a 14-week quarter last year, it appears the operating margin should remain flat, benefiting from pricing (AUR improvement and flat merchandise margin), buying and occupancy prowess, and supply chain improvements.

Additionally, the firm nudged its full-year sales outlook to include a 1.7%-2.5% decline from a 2%-4% decline, while refining its EPS forecast to $3.15-$3.28 (from $3.06-$3.26). We have maintained our forecast for a 2% decline in sales and adjusted earnings per share up by eight cents, to $3.23.

Our long-term projected sales growth remains promising and is still predicated on three channels of growth. First, 3% average growth from the store channel (74% of 2023 sales), in line with BBW’s outlook for low- to mid-single-digit comp growth in the channel. Second, 4% average digital growth, a bit below the high-single-digit to low-double-digit growth BBW is seeking to achieve. This is bound by the robust digital growth BBW has already captured in recent periods (with digital representing 21% of sales in 2023) and the likelihood that digital as a percentage of the total sales mix should normalize at 31% over the next decade. Third, we forecast international could rise at 8% over the next decade as global franchise partnerships expand.

Such efforts will help BBW move toward its goal of $10 billion in sales; our model predicts just under $10 billion in sales in 2033. The scope of opportunities gives us confidence in our forecast, with the firm seeking to capitalize on new store formats (continued omnichannel expansion), an updated loyalty program, and new categories (like skincare and hair), among others. As covid threats remain depressed, consumers could continue to allocate spending to discretionary categories they had held back on (dining, travel), which is a key risk to our outlook. Even with more controlled growth ahead, we still forecast BBW will generate ROICs excluding goodwill that average 37% over the next decade.

Despite current challenges, we still view the shares as attractive, as we believe cost inflation and consumer apprehension will normalize over time, allowing BBW to return to its long-term profit algorithm. BBW stood firm on a 20% operating margin goal, and it is testing pricing mechanisms on products and pursuing a $200 million cost-saving plan that should help steer the business back to historical profit levels. However, we now contend that this goal is unlikely to be reached until 2028.

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Risk and Uncertainty Jaime M. Katz, CFA, Senior Equity Analyst, 26 Nov 2024

We assign a Morningstar Uncertainty Rating of High to Bath & Body Works based on the firm's fundamental exposure to the economy and economic cycles, and the range of return outcomes used by our star rating system.

In our opinion, Bath & Body Works faces the typical risks of consumer discretionary retailers, including unemployment levels, wage growth, increasing labor and freight costs, and low barriers to entry. Unfavorable changes to trade where portions of the supply chain are located could hurt top-line growth and margins (although 85% of inventory is produced domestically). Additionally, our forward estimates are based on continued investment in innovation and brand elevation as well as the ability to maintain the pricing structure even after the pandemic, and success is not guaranteed. There is a risk cost structure rises more than expected, improvement to the supply chain is more difficult to achieve than forecast, pricing power diminishes, or consumer spending is lower than expected and the model faces less leverage.

Brand positioning often leads to elevated expenditures (consumer acquisition costs) to target a wider demographic, yielding risk that some consumers could continue to trade down in a weakening economic environment, similar to what has manifested in prior recessions. Despite its unique offerings, the business still faces competition from lower-price peers like Dial and Dove. Some risks are offset by the pricing power achieved through brand awareness and exposure to the more resilient bath and beauty categories.

We see the biggest environmental, social, and governance issue BBW faces stemming from consumer choice, as buyers focus on more natural products and not mass-produced products. We don't think this risk is imminently material, however, and as such, it fails to affect our valuation.

Capital Allocation Jaime M. Katz, CFA, Senior Equity Analyst, 26 Nov 2024

Our Morningstar Capital Allocation Rating for Bath & Body Works is Standard. Forecast adjusted returns on invested capital excluding goodwill (32% on average over the next five years) are set to exceed our weighted cost of capital estimate of 8% over our entire outlook, and the balance sheet remains sound, given the company's medium revenue cyclicality and operating leverage (low fixed costs). With little debt coming due over the near term and net debt/EBITDA that should average below 2 times over our forecast, we think the firm possesses financial flexibility on the balance sheet.

We view management's investment strategy as fair and believe BBW is investing properly to defend its competitive position. With BBW liberated from Victoria's Secret, we have a better sight line to how investments could bolster returns (product innovation, packaging, new category expansion). Gina Boswell took the helm as CEO as of Dec. 1, 2022, bringing extensive leadership and business development experience from her career at high-profile consumer-focused firms including Avon, no-moat Ford, and wide-moat Estee Lauder, most recently rising through the ranks at wide-moat Unilever after its acquisition of Alberto Culver Company. Throughout her years at Unilever, she was named executive vice president of personal care (North America), head of Unilever U.K. and Ireland, and president of customer development, Unilever U.S.A, most recently. We believe Boswell's experience in categories like deodorant, skin cleansing and care, and hair care should prove particularly relevant, as BBW attempts expansion across these categories and products. CFO Wendy Arlin had been with the brand since before the BBW carve out, but Eva Boratto filled the finance leadership slot in August 2023, bringing financial chops from significant public company experience.

We deem cash distributions as appropriate, with the management team returning capital to shareholders when optimal. As such, it suspended the dividend early in the pandemic cycle and stopped repurchasing shares, in an effort to preserve cash. The firm already reinstated its dividend in June 2021, now at $0.80 per share annually, and has reinstated share buybacks, with the board of directors approving $500 million to be allocated for repurchases February 2024.

On Feb. 22, 2023, Third Point (which took an initial 6% stake in the business in December 2022 and still holds ownership as of its latest 13-f filing), articulated its intent to nominate candidates to BBW's board of directors. Since the activist's initial engagement, BBW has added two new directors to its board with significant consumer experience and is beginning to capitalize on the knowledge base that CEO Gina Boswell has brought to the organization. We believe the company is working cooperatively with Third Point and investing prudently to protect the competitive edge that stems from its brand intangible asset, although we can appreciate investor frustration regarding share repurchases in 2021 and early 2022 at much higher prices. We are concerned that activist noise could intermittently create a distraction that takes momentum away from operational efforts at the organization as the board and leadership team attempts to defend its strategic direction and the compensation structure that is in place. Ultimately, however, we believe it should ensure that the stewards of the business act appropriately to support improving long-term returns.

Analyst Notes Archive

Bath & Body Works Earnings: Pressed Customer Washes Out Near-Term Growth, but Brand Relevance Holds Jaime M. Katz, CFA, Senior Equity Analyst, 28 Aug 2024

As consumers experience higher prices and global macroeconomic and geopolitical concerns, most discretionary companies are reporting drag from the recent uncertainty. Narrow-moat Bath & Body Works was no exception, nudging its full-year sales outlook to include a 2%-4% decline from flat to down 2.5%, while refining its EPS forecast to $3.06-$3.26 (from $3.05-$3.35). These metrics are still in line with our forecast for a 2% decline in sales and earnings per share of $3.16. Unfortunately, this implies a back half that fails to return to sales growth, with the fourth quarter facing a 500-basis-point headwind lapping last year's inclusion of a 53rd week. Although the near term could prove spotty for consumer demand, we don't think current trends are indicative of long-term fundamentals for this business. As such, we don't expect any material change to our $70 fair value estimate, rendering shares very undervalued.

Bath & Body Works' second-quarter results displayed the ambivalence of its constituents, with sales down 2% to $1.5 billion, in line with our projection. The gross margin of 41% was 100 basis points better than our forecast, as 130 basis points of merchandise margin gains exhibited Bath & Body Works' pricing power. The selling, general, and administrative ratio was 120 basis points higher than last year (29%, in line with our model) as more marketing was required to motivate customers. This generated another depressed operating margin metric at 12%. A continuance of this performance sets up the firm for a sub-17% operating margin for 2024, which isn't terrible considering this will be the third consecutive year with languishing sales. It also remains well below the 20%-plus range the firm was able to deliver on average in the past decade. Fortunately, we think a significant operating leverage is embedded in the business, and that when sales turn positive margin expansion should easily resume, marching back up to that 20% range within the next five years.

Bath & Body Works Earnings: Near-Term Operating Margin Expansion Stalls Without Sales Leverage

Jaime M. Katz, CFA, Senior Equity Analyst, 4 Jun 2024

We don't plan any material change to our $73 per share fair value estimate for narrow-moat Bath & Body Works, or BBW, after considering its first-quarter results and a modest upward nudge to its full-year outlook. We view shares as undervalued after a post-print double-digit drop and believe the market is focusing on near-term profit pressure, with higher marketing costs in the second quarter expected to lead to year-over-year operating margin contraction. Moreover, with the full-year outlook largely unchanged, we think investors are concerned that second-half operating margins could be flat versus last year (around 20.5%), indicating stalled progress back to the 20%-plus full-year metrics the firm historically achieved. BBW lifted the low end of its prior 2024 outlook, now calling for a sales decline of 2.5% to flat and EPS of $3.05-$3.35 (up a nickel), in line with our preprint forecast that included a sales decline of 1.9% and EPS of $3.16. As such, we don't surmise much change to our near-term outlook.

With sales down a mere 1% in the first quarter and operating margin expansion of 60 basis points (to 13.5%), we think the business is holding up well in an environment where consumers are more tactically allocating their spending. Pricing held firm as evidenced by a 110-basis-point improvement in both the gross margin (43.8%) and merchandise margin rate, benefiting from previous efforts to improve the cost of goods sold (including transportation, sourcing, and distribution). Unfortunately, as we lap the initiation of such efforts that began in 2023, expense improvement becomes more incremental. Much of the longer-term potential for margin improvement hinges on the cost leverage that occurs with a return to top-line growth, which we are unlikely to see until 2025. But we have no reason to believe sales

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growth is permanently stalled, given ongoing efforts in innovation, adjacent category expansion, and engagement (loyalty, personalization).

Bath & Body Works: Lowering Uncertainty Rating to High From Very High Jaime M. Katz, CFA, Senior Equity Analyst, 5 Mar 2024

We are lowering our Uncertainty Rating for narrow-moat Bath & Body Works to High from Very High, consistent with our quantitative methodology. A lower Uncertainty Rating signals that a narrower margin of safety is generally required for shares to appear attractive. While the rating is primarily driven by the volatility in the share price, it also considers the firm's fundamental exposure to the economy and economic cycles. We believe Bath & Body Works faces similar risks to most other consumer discretionary retailers, including the impact of inflationary pressures, employment levels, wage growth, and low barriers to entry. Additionally, on the input side, less favorable changes to trade where portions of the supply chain are located could hurt top-line growth and margins (although most inventory is produced in its Beauty Park facilities in the US). Favorably, our current risk assessment incorporates the mitigation of share erosion based on continued investment in innovation and brand elevation, which should help maintain a solid pricing structure across categories. The change in the Uncertainty Rating doesn’t sway our $73 fair value estimate, which is predicated on long-term sales growth of 3% and a return to 20%-plus operating margin performance.

Bath & Body Works Earnings: Investments Crimp Margins but Position Brand for Long-Term Success Jaime M. Katz, CFA, Senior Equity Analyst, 29 Feb 2024

Narrow-moat Bath & Body Works (BBW) delivered a strong fourth quarter, with sales and EPS ahead of our forecast. Fourth-quarter sales rose 1%, to $2.9 billion, a touch above our $2.8 billion estimate and more than 30% over 2019, despite the ongoing normalization of demand in certain categories. EPS of $2.06 exceeded our $1.76 projection, aided by a gross margin of 45.9% (versus our 44% estimate) that benefited from a 290-basis-point uptick in merchandise margin stemming from higher average unit retail and cost deflation. However, the initial sales and EPS outlook for 2024 sent shares lower by a mid-single-digit rate. With 2024 facing a 100-basis-point headwind from lapping an extra week in 2023, like-for-like sales are set to be down 2% to up 1%, which will still represent above-40% growth over a 5-year period. In our opinion, a stalled operating margin at 17% was the real surprise, as it was well below our 19% forecast.

We plan to lower our $78 fair value estimate by a mid-single-digit rate to account for the near-term sales and profit headwinds that are higher than we originally anticipated, but still view shares as attractive. We didn't expect BBW would return to an above-20% operating margin range until 2027, and we don't think near-term pressure will derail this trajectory. In fact, we contend the higher costs stem from activities that stand to bolster the brand and further engage consumers, which should lead to gross margin benefits over time. Particularly, heightened spending on elevating the loyalty program, with 37 million active members (up 30% and comprising 80% of US sales), will facilitate conversion with some of its stickiest customers. And higher marketing to support the further rollout of categories like haircare, men's, lip, and laundry stands to engage a wider total addressable market, supporting long-term sales growth. We believe spending on such efforts offers BBW a path back to 3%-4% sales growth and 20%-plus operating margins over time.

Bath & Body Works Earnings: Merchandising Prowess Lifts Profits as Products Resonate With Consumers Jaime M. Katz, CFA, Senior Equity Analyst, 16 Nov 2023

Although narrow-moat Bath & Body Works delivered third-quarter sales that were in line with the firm's prior guidance—at $1.6 billion, down 3%—the profitability of the enterprise impressed. The firm delivered an operating margin of 14%, up 150 basis points over last year and well ahead of the sub-12% prognosis from consensus (FactSet). Importantly, this lift was largely attributable to the gross margin rise to 43.7%, practically in line with prepandemic third-quarter marks, buoyed by improving merchandise margins (200 basis points) as a result of successful product launches that continue to cater to customer trends. While BBW nudged the full-year outlook lower to include a sales decline of 2.5%-4% (from 1.5%-3.5% prior) and raised its EPS outlook to $2.90-$3.10 (from $2.85-$3.15), metrics are largely in line with our 2% sales decline and $3.07 EPS preprint estimates. As such, we don't plan any material change to our $78 fair value estimate and view shares as extremely attractive.

Unfortunately, shares have struggled in 2023, down more than 20%, significantly underperforming the broad market indexes, which we believe reflects the firm's temporarily pressured operating margins and investor hesitancy to invest in discretionary goods given macroeconomic uncertainty. However, we contend the affordable luxury that BBW offers provides some resilience to a soft consumer given that the firm stands to benefit from the holiday gifting season and product replenishment demand. Management is already calling for a top-line return to growth in the back half of 2024, and sales are still on track to be 46% higher than 2019 in 2023. As the revenue cadence normalizes in 2024, we don't see any reason BBW cannot return to a 20%-plus operating margin over the long term on mid-single-digit sales growth. Such growth should be easily achievable given continued category extensions as we've recently seen in men's, laundry, and lip care.

Bath & Body Works Earnings: Operating Margin Stabilization Near, With Potential Expansion in View Jaime M. Katz, CFA, Senior Equity Analyst, 23 Aug 2023

Narrow-moat Bath & Body Works, or BBW, felt the pain of spending normalization in the second quarter. While sales of $1.56 billion kept up with the firm’s forecast for a low- to mid-single-digit decline, the downtick led to cost deleverage, resulting in a 12% operating margin (down nearly 300 basis points). Although sales were 40% higher than the same period in 2019, selling, general, and administrative costs provided a stall in profitability. However, the biggest expense headwind stemmed from technology costs, some of which should prove transitory given that this spending was necessitated a result of BBW's split from Victoria's Secret. Thankfully, the gross margin held up well, at 40% thanks to increased average unit revenue and improved merchandise margin, which experienced its first uptick in over two years. In our opinion, this implies the brand intangible asset is holding firm, indicated by consumer willingness to forgo discounting despite widespread concern around discretionary spending.

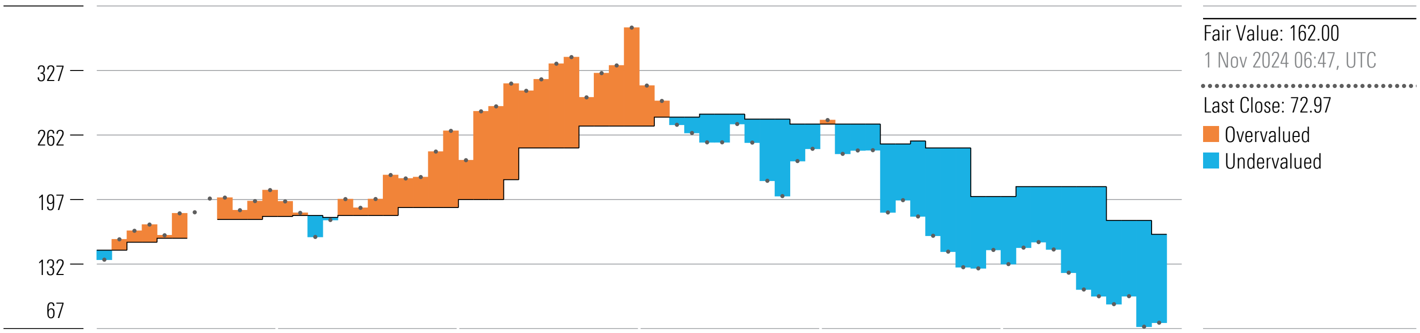
Management signaled confidence in the back half of the year, offering a modestly improved outlook that includes a 1.5%-3.5% decline in revenue (versus flat to down midsingle digits prior) and $2.80-$3.10 in adjusted EPS ($2.70-$3.10). Given that our preprint projection for 2023 called for a 2.5% sales decline and $2.80 in EPS, we don't foresee any change to our near-term outlook. As such, we don't plan to materially alter our $78 fair value estimate and view shares as significantly undervalued. BBW shares have wildly underperformed the broader markets, down 17% year to date as we believe concern around discretionary spending and persistent inflation have weighed on consumer sentiment. However, we still believe BBW can buck the trend through rich product innovation (with laundry set for launch this fall on the heels of a men's grooming platform), which will bolster product interest and aid the firm's return to 20% operating margin metrics that we forecast in 2026.

Morningstar Equity Analyst Report | Report as of 26 Nov 2024 17:17, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 13 of 23

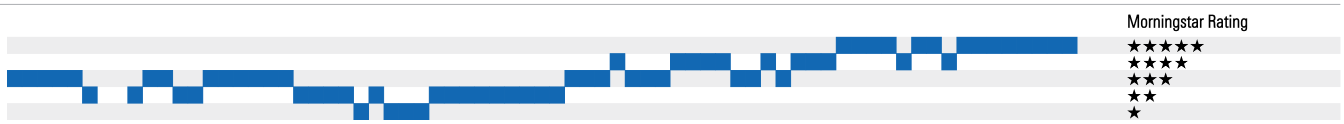
Bath & Body Works Inc BBWI ★★★★★ 26 Nov 2024 17:16, UTC

Competitors Price vs. Fair Value

The Estee Lauder Companies Inc Class A EL

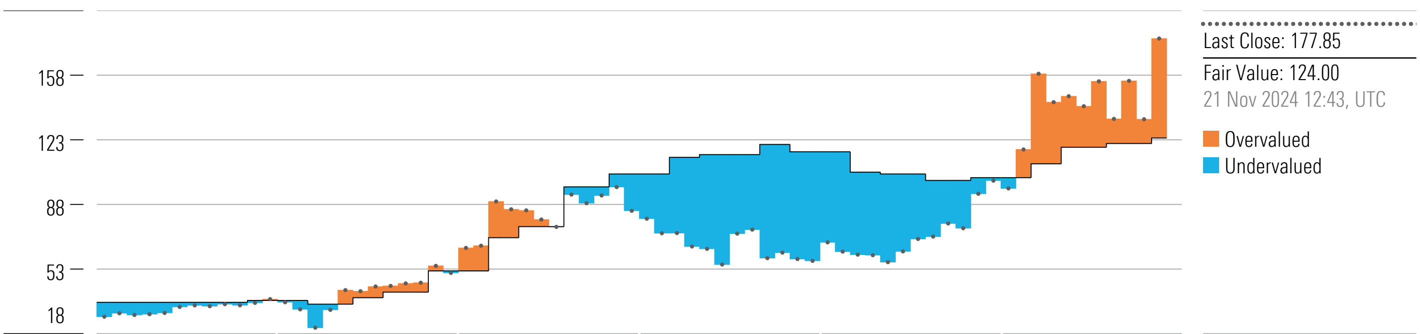


	2019	2020	2021	2022	2023	YTD	
	1.15	1.41	1.37	0.91	0.73	0.45	Price/Fair Value
	60.12	29.60	39.90	-32.31	-39.99	-48.75	Total Return %

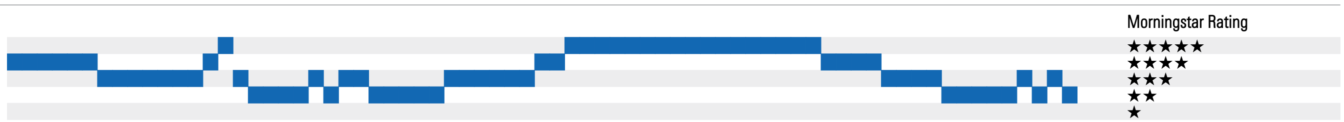


Total Return % as of 25 Nov 2024. Last Close as of 25 Nov 2024. Fair Value as of 1 Nov 2024 06:47, UTC.

Williams-Sonoma Inc WSM



	2019	2020	2021	2022	2023	YTD	
	1.02	0.98	0.81	0.49	0.98	1.43	Price/Fair Value
	49.28	41.35	68.45	-30.25	78.61	78.42	Total Return %



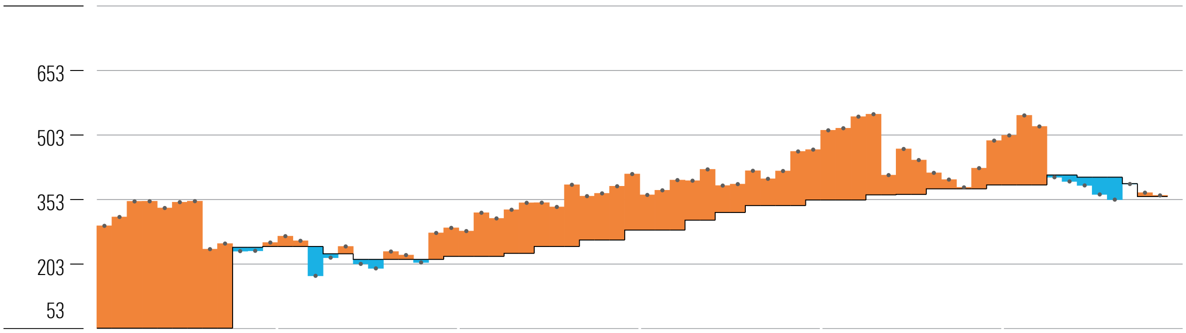
Total Return % as of 25 Nov 2024. Last Close as of 25 Nov 2024. Fair Value as of 21 Nov 2024 12:43, UTC.

Morningstar Equity Analyst Report | Report as of 26 Nov 2024 17:17, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 14 of 23

Bath & Body Works Inc BBWI ★★★★★ 26 Nov 2024 17:16, UTC

Competitors Price vs. Fair Value

Ulta Beauty Inc ULTA

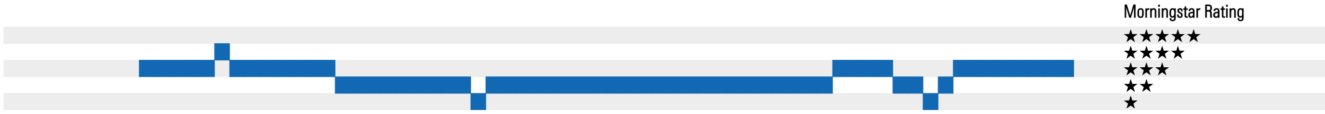


Last Close: 362.65

Fair Value: 360.00
17 Oct 2024 21:21, UTC

	2019	2020	2021	2022	2023	YTD
Price/Fair Value	1.04	1.30	1.46	1.33	1.27	1.01
Total Return %	3.39	13.44	43.59	13.76	4.46	-25.99

Morningstar Rating



Total Return % as of 25 Nov 2024. Last Close as of 25 Nov 2024. Fair Value as of 17 Oct 2024 21:21, UTC.

Morningstar Equity Analyst Report | Report as of 26 Nov 2024 17:17, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 15 of 23

Bath & Body Works Inc BBWI ★★★★★ 26 Nov 2024 17:16, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
35.78 USD 25 Nov 2024	69.00 USD 26 Nov 2024 17:11, UTC	0.52	7.71 USD Bil 26 Nov 2024	Narrow	Small Value	High	Standard	6 Nov 2024 06:00, UTC

Morningstar Historical Summary

Financials as of 31 Jul 2024

Fiscal Year, ends 31 Jan	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
Revenue (USD Bil)	10.77	11.45	12.15	12.57	12.63	13.24	5.41	6.43	7.88	7.56	2.91	7.38
Revenue Growth %	3.0	6.3	6.1	3.5	0.5	4.8	-59.2	19.0	22.5	-4.1	-1.5	-0.9
EBITDA (USD Mil)	2,167	2,398	2,725	2,608	2,289	1,832	1,566	2,075	2,174	1,614	573	1,665
EBITDA Margin %	20.1	20.9	22.4	20.7	18.1	13.8	29.0	32.3	27.6	21.3	19.7	22.6
Operating Income (USD Mil)	1,743	1,953	2,192	2,003	1,728	1,336	1,040	1,604	2,009	1,376	370	1,286
Operating Margin %	16.2	17.1	18.0	15.9	13.7	10.1	19.2	24.9	25.5	18.2	12.7	17.4
Net Income (USD Mil)	903	1,042	1,253	1,158	983	644	-366	844	1,333	800	239	937
Net Margin %	8.4	9.1	10.3	9.2	7.8	4.9	-6.8	13.1	16.9	10.6	8.2	12.7
Diluted Shares Outstanding (Mil)	296	298	297	291	287	279	278	281	273	233	225	227
Diluted Earnings Per Share (USD)	3.05	3.50	4.22	3.98	3.42	2.31	-1.33	3.00	4.88	3.43	1.06	4.12
Dividends Per Share (USD)	1.20	1.36	2.00	2.40	2.40	2.40	1.20	0.30	0.45	0.80	0.40	0.80

Valuation as of 31 Oct 2024

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Price/Sales	2.3	2.4	1.5	1.4	0.5	0.4	0.9	1.5	1.3	1.3	1.0	0.9
Price/Earnings	26.6	24.1	16.7	18.3	9.6	13.8	-49.0	19.2	11.2	13.7	7.7	6.9
Price/Cash Flow	15.6	17.0	10.0	10.8	5.6	3.9	5.1	10.9	9.1	8.9	8.0	7.1
Dividend Yield %	1.57	2.09	3.65	3.99	9.35	6.62	1.61	0.64	1.9	1.85	2.51	2.82
Price/Book	-58.5	-42.2	-15.8	-15.2	-5.4	-4.0	-6.6	-10.7	-3.7	-4.6	-4.1	-3.6
EV/EBITDA	13.6	13.4	8.8	8.5	5.5	7.5	11.1	10.9	7.1	9.3	0.0	0.0

Operating Performance / Profitability as of 31 Jul 2024

Fiscal Year, ends 31 Jan	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
ROA %	13.7	14.2	15.7	13.9	12.0	7.9	-4.0	7.8	15.2	13.9	4.6	18.5
ROE %	—	—	—	—	—	—	—	—	—	—	—	—
ROIC %	—	—	—	—	—	—	—	—	—	—	—	—
Asset Turnover	1.6	1.6	1.5	1.5	1.5	1.6	0.6	0.6	0.9	1.3	0.6	1.5

Financial Leverage

Fiscal Year, ends 31 Jan	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Debt/Capital %	—	99.6	—	—	—	—	—	—	—	—	—	—
Equity/Assets %	—	0.2	—	—	—	—	—	—	—	—	—	—
Total Debt/EBITDA	—	2.0	—	—	—	—	—	—	—	—	—	—
EBITDA/Interest Expense	6.9	7.4	8.2	6.6	5.6	4.8	4.2	4.8	5.6	4.6	3.6	5.1

Morningstar Analyst Historical/Forecast Summary as of 28 Aug 2024

Financials

Fiscal Year, ends 31 Dec 2023	2022	2023	Estimates 2024	2025	2026
Revenue (USD Mil)	7,561	7,429	7,301	7,507	7,750
Revenue Growth %	-4.1	-1.7	-1.7	2.8	3.2
EBITDA (USD Mil)	1,598	1,555	1,472	1,539	1,589
EBITDA Margin %	21.1	20.9	20.2	20.5	20.5
Operating Income (USD Mil)	1,377	1,286	1,253	1,314	1,356
Operating Margin %	18.2	17.3	17.2	17.5	17.5
Net Income (USD Mil)	794	747	714	785	823
Net Margin %	10.5	10.1	9.8	10.5	10.6
Diluted Shares Outstanding (Mil)	233	229	221	216	211
Diluted Earnings Per Share(USD)	3.41	3.27	3.23	3.63	3.90
Dividends Per Share(USD)	0.80	0.80	0.80	0.96	1.15

Forward Valuation

	2022	2023	Estimates 2024	2025	2026
Price/Sales	1.4	1.3	1.1	1.0	1.0
Price/Earnings	12.4	13.2	11.1	9.9	9.2
Price/Cash Flow	—	—	—	—	—
Dividend Yield %	1.9	1.8	2.2	2.7	3.2
Price/Book	-4.5	-6.1	-5.4	-7.1	-10.6
EV/EBITDA	10.2	9.6	8.8	8.4	8.2

Morningstar Equity Analyst Report | Report as of 26 Nov 2024 17:17, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 16 of 23

Bath & Body Works Inc BBWI ★★★★★ 26 Nov 2024 17:16, UTC

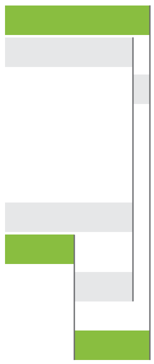
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
35.78 USD 25 Nov 2024	69.00 USD 26 Nov 2024 17:11, UTC	0.52	7.71 USD Bil 26 Nov 2024	Narrow	Small Value	High	Standard	3 of 5 globes 6 Nov 2024 06:00, UTC

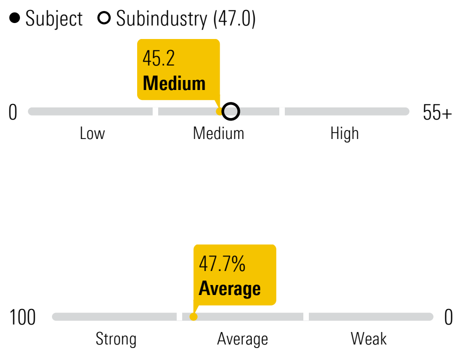
ESG Risk Rating Breakdown

Exposure	
Company Exposure[1]	45.2
– Manageable Risk	39.9
Unmanageable Risk[2]	**5.3**

Management	
Manageable Risk	39.9
– Managed Risk[3]	19.0
Management Gap[4]	**20.9**

Overall Unmanaged Risk	**26.2**

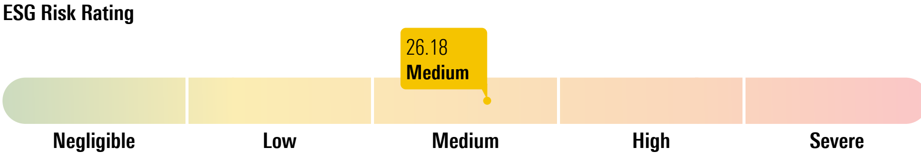




- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

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

ESG Risk Rating



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

1. A company's Exposure to material ESG issues 2. Unmanageable Risk refers to risks that are inherent to a particular business model that cannot be managed by programs or initiatives 3. Managed Risk = Manageable Risk multiplied by a Management score of 47.7% 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 Nov 06, 2024. Highest Controversy Level is as of Nov 08, 2024. Sustainalytics Subindustry: Personal Products. 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 06 Nov 2024

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

Company Name	Exposure	Range	Management	Range	ESG Risk Rating	Range
Bath & Body Works Inc	45.2 | Medium	0 – 55+	47.7 | Average	100 – 0	26.2 | Medium	0 – 40+
The Estee Lauder Companies Inc	48.5 | Medium	0 – 55+	57.0 | Strong	100 – 0	24.0 | Medium	0 – 40+
Williams-Sonoma Inc	26.4 | Low	0 – 55+	62.5 | Strong	100 – 0	11.4 | Low	0 – 40+
Ulta Beauty Inc	26.3 | Low	0 – 55+	50.7 | Strong	100 – 0	13.8 | Low	0 – 40+
Albertsons Companies Inc	46.4 | Medium	0 – 55+	33.7 | Average	100 – 0	31.9 | High	0 – 40+

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Appendix
Historical Morningstar Rating

Bath & Body Works Inc BBWI 25 Nov 2024 22:41, 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
★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★	★★★★

The Estee Lauder Companies Inc Class A EL 25 Nov 2024 22:42, 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
★★	★★★	★★★	★★	—	—	★★	★★★	★★★	★★★	★★★	★★★

Williams-Sonoma Inc WSM 25 Nov 2024 22:43, 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
★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★

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Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
—	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★	★	★★
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.

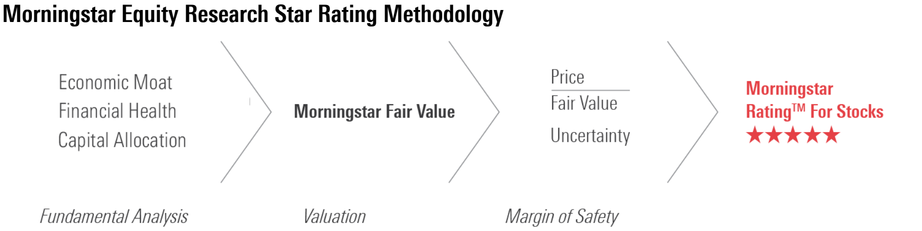
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return 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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thing that can affect our ability to accurately predict these outcomes. The rating begins with a suggested rating produced by a quantitative process based on the trailing 12-month standard deviation of daily stock returns. An analyst overlay is then applied, with analysts using the suggested rating, historical rating data, and their own knowledge of the company to inform them as they make the final Uncertainty Rating decision. Ultimately, the rating decision rests with the analyst. Analysts take into account many characteristics when making their final decision, including cyclical factors, operational and financial factors such as leverage, company-specific events, ESG risks, and anything else that might increase the potential dispersion of future outcomes and our ability to estimate those outcomes.

Our recommended margin of safety—the discount to fair value demanded before we'd recommend buying or selling the stock—widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the potential dispersion of outcomes, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the Uncertainty Rating provides guidance in portfolio construction based on risk tolerance.

Our Uncertainty Ratings are: Low, Medium, High, Very High, and Extreme.

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

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

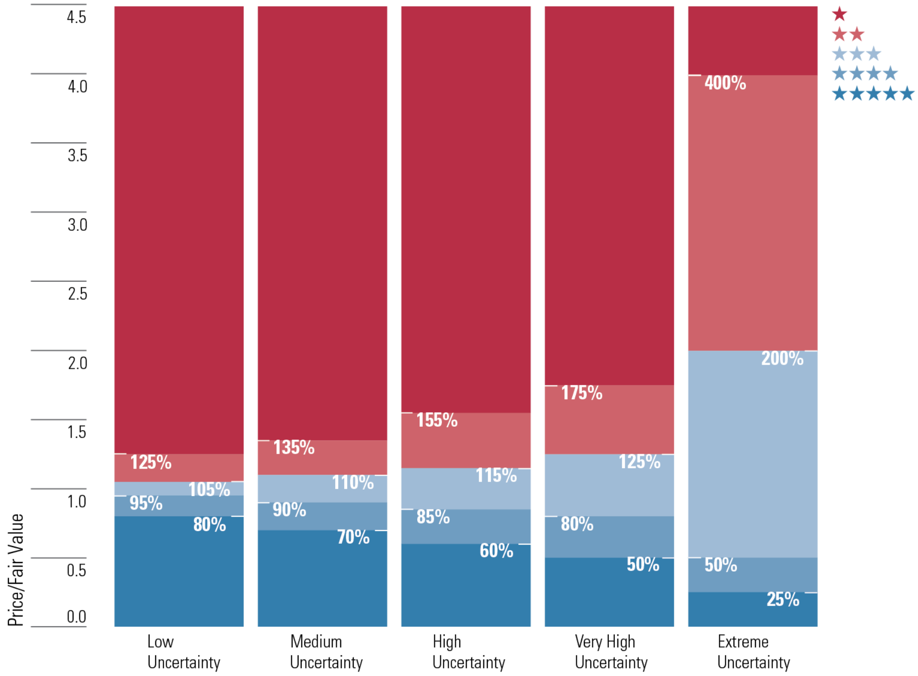
4. Market Price

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

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

Morningstar Star Rating for Stocks

Morningstar Equity Research Star Rating Methodology



Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions

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

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider compan-

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

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

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

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

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

Sustainalytics analyzes over 1,300 data points to assess a company's exposure to and management of ESG risks. In other words, ESG Risk Ratings measures a company's unmanaged ESG Risks represented as a quantitative score. Unmanaged Risk is measured on an open-ended scale starting at zero (no risk) with lower scores representing less unmanaged risk and, for 95% of cases, the unmanaged ESG Risk score is below 50.

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

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

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

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