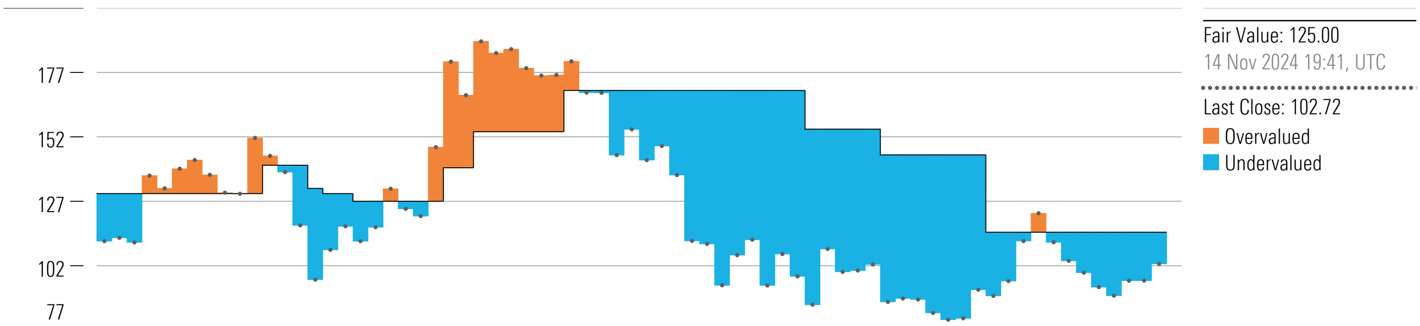
Morningstar Equity Analyst Report | Report as of 14 Nov 2024 19:48, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 1 of 23

The Walt Disney Co DIS ★★★ 14 Nov 2024 19:46, UTC

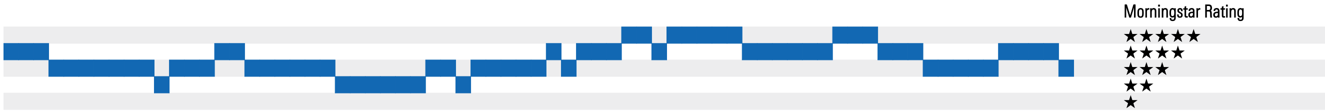
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
102.72 USD 13 Nov 2024	125.00 USD 14 Nov 2024 19:41, UTC	0.82	197.84 USD Bil 14 Nov 2024	Wide	Large Value	High	Standard	6 Nov 2024 06:00, UTC

Price vs. Fair Value



	2019	2020	2021	2022	2023	YTD	
	1.03	1.29	0.91	0.56	0.79	0.82	Price/Fair Value
	33.51	25.27	-14.51	-43.91	4.27	14.27	Total Return %

Morningstar Rating



Total Return % as of 13 Nov 2024. Last Close as of 13 Nov 2024. Fair Value as of 14 Nov 2024 19:41, 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.

Disney Earnings: Streaming Strength and Outlook Underpin Greater Enthusiasm

Analyst Note Matthew Dolgin, CFA, Senior Equity Analyst, 14 Nov 2024

Disney reported an excellent end to fiscal 2024, with very encouraging results and commentary surrounding the streaming and experiences businesses, both of which are critical to a healthy future. The strong performance of sports content allowed the legacy television business to hold up better than we expected in 2024, and the impact of legacy television in Disney's overall results is becoming less critical. We have growing confidence that Disney, with the help of a wide moat, has successfully evolved for the modern era, and we are raising our fair value estimate to $125 from $115.

For the full fiscal year, Disney's revenue was up 3%, but its operating profit jumped 21%, mostly because the streaming business is no longer the huge drag that it was through last year. Even better, the firm's long-term outlook implies the ramp in profits will continue. The firm expects high-single-digit growth in earnings per share and operating cash flow in 2025 and an acceleration to double digits the following year. We believe forthcoming revenue associated with recent investments in streaming and experiences will drive this result.

Most importantly, Disney seems to have turned a corner toward robust streaming profitability while also maintaining healthy growth. Total direct-to-consumer operating income hit $321 million in the fourth quarter after reaching profitability for the first time last quarter, with $47 million in operating income. The firm kept DTC quarterly expenses mostly flat year over year while revenue grew 14%. Between

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Sector	Industry
Communication Services	Entertainment

Business Description

Disney operates in three global business segments: entertainment, sports, and experiences. Entertainment and experiences both benefit from franchises and characters the firm has created over the course of a century. Entertainment includes the ABC broadcast network, several cable television networks, and the Disney+ and Hulu streaming services. Within the segment, Disney also engages in movie and television production and distribution, with content licensed to movie theaters, other content providers, or, increasingly, kept in-house for use on Disney's own streaming platform and television networks. The sports segment houses ESPN and the ESPN+ streaming service. Experiences contains Disney's theme parks and vacation destinations, and also benefits from merchandise licensing.

Disney+ and Hulu, Disney added more than 5 million subscribers during the quarter, including about 2 million in the US. We expect the launch of the flagship ESPN streaming service in late fiscal 2025 to further bolster streaming results, though we expect some additional initial costs. However, excluding sports streaming, management expects DTC operating income to exceed $1 billion in fiscal 2025, up from $143 million in 2024.

Business Strategy & Outlook Matthew Dolgin, CFA, Senior Equity Analyst, 8 Feb 2024

Disney is managing the evolution of the media industry, most notably the shift from linear television viewing to on-demand, direct-to-consumer, or DTC, streaming services. Disney was perfectly positioned to take advantage of the traditional model, with its ownership of a national broadcast network, in ABC; the top sports network, in ESPN; and a leading children's network, in the Disney Channel. These remain very valuable assets that give Disney advantages as the industry evolves, but challenges exist, and we don't think the new media landscape will be as profitable as the prior one.

Disney's linear networks businesses have been under pressure over the past few years as pay-TV subscriptions continue to decline. Disney is addressing this issue through its nascent DTC offerings. As the DTC offerings mature, we expect the recent rockiness—declining linear revenue and cash burn in the DTC businesses—to stabilize. A wealth of content and the financial capacity to continue creating more should keep Disney+ and Hulu among the more attractive streaming services for consumers. ESPN programming is moving to streaming platforms in 2024 and 2025. The availability of nearly all linear content on DTC apps will require Disney to manage its contracts with the pay-TV distributors that historically provided the bulk of the firm's television revenue, but with content that's in demand, we expect Disney to successfully manage this evolution. We believe Disney will maintain viewership and therefore monetization as DTC matures and the video entertainment industry becomes less bifurcated between linear and streaming subscriptions.

Other critical parts of Disney should continue to thrive. Although we don't expect attendance at movie theaters to be as high as it once was, the firm's franchises and top production studios should ensure that the content Disney produces and licenses will be in demand. More important, we expect continuing strength in the experiences business, which consists primarily of Disney's many theme parks. The ability to marry iconic franchises with vacation destinations gives the firm unique properties that have enduring popularity.

Bulls Say Matthew Dolgin, CFA, Senior Equity Analyst, 14 Nov 2024

- No peer can match the depth of Disney's iconic characters, franchises, or content library, which will keep the firm's streaming services in high demand and give the firm a leg up in creating new movies and television shows.
- The decline in linear television will slow, so the value in the assets associated with it will start to shine.

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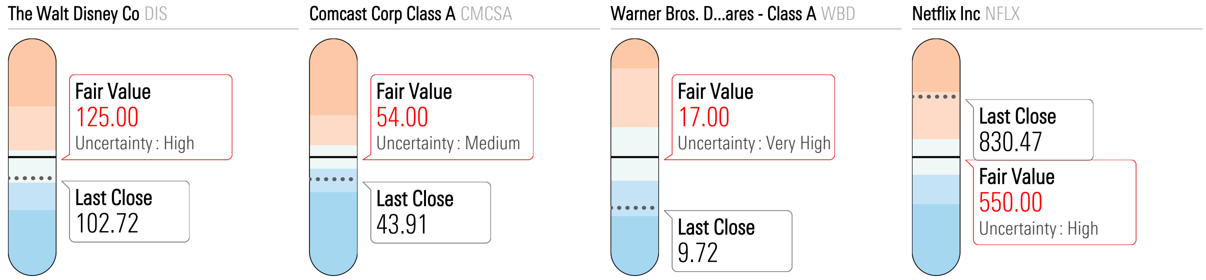
Competitors



	The Walt Disney Co DIS	Comcast Corp Class A CMCSA	Warner Bros. D...ares - Class A WBD	Netflix Inc NFLX
Economic Moat	Wide	Narrow	None	Narrow
Currency	USD	USD	USD	USD
Fair Value	125.00 14 Nov 2024 19:41, UTC	54.00 23 Jul 2024 18:10, UTC	17.00 8 Aug 2024 05:41, UTC	550.00 18 Oct 2024 03:37, UTC
1-Star Price	193.75	72.90	29.75	852.50
5-Star Price	75.00	37.80	8.50	330.00
Assessment	Fairly Valued 13 Nov 2024	Undervalued 13 Nov 2024	Undervalued 13 Nov 2024	Overvalued 13 Nov 2024
Morningstar Rating	★★★14 Nov 2024 19:46, UTC	★★★★13 Nov 2024 22:36, UTC	★★★★13 Nov 2024 22:35, UTC	★★13 Nov 2024 22:34, UTC
Analyst	Matthew Dolgin, Senior Equity Analyst	Michael Hodel, Director	Matthew Dolgin, Senior Equity Analyst	Matthew Dolgin, Senior Equity Analyst
Capital Allocation	Standard	Standard	Standard	Exemplary
Price/Fair Value	0.82	0.81	0.57	1.51
Price/Sales	2.09	1.41	0.60	9.74
Price/Book	1.85	1.96	0.68	15.62
Price/Earning	26.11	11.74	—	46.95
Dividend Yield	0.73%	2.78%	0.00%	0.00%
Market Cap	186.29 Bil	170.04 Bil	23.83 Bil	356.41 Bil
52-Week Range	83.91—123.74	36.43—45.82	6.64—12.70	445.64—836.99
Investment Style	Large Value	Large Value	Mid Value	Large Growth

ESPN remains the premier brand in sports—bringing it directly to the consumer through a streaming service will open it up to a new set of consumers.

- The allure of Disney's parks business is unmatched and will be a continuing profit engine.

Bears Say Matthew Dolgin, CFA, Senior Equity Analyst, 14 Nov 2024

- Linear television will continue to decline. Even if successful, newer revenue sources like direct-to-consumer streaming will never equal the profitability Disney once enjoyed.
- Disney now competes with tech companies for major sports rights, who may have incentive to continue driving up prices. Sports remains material to Disney's future, and being forced to pay up for the critical content will depress profits.
- Too many streaming platforms now exist, and it's questionable whether consumers will be willing to pay high prices or stick with individual services month in and month out.

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Economic Moat Matthew Dolgin, CFA, Senior Equity Analyst, 7 Feb 2024

We are maintaining our wide moat on Disney. Ultimately, we believe the firm's ownership of timeless characters and franchises and its ability to continue creating and attracting top-tier content outweigh the near-term challenges it faces related to an evolving media industry. Although we think it's likely that a media industry not built upon the traditional cable television bundle will keep Disney from returning to the level of economic profitability it routinely achieved in years past, we still expect the firm's returns on invested capital to comfortably exceed its cost of capital over the next 20 years.

Recent struggles at Disney are related to the shift from the linear television model—where nearly all U.S. households subscribed to a pay-TV service offered by distributors like the cable and satellite providers—to the direct-to-consumer, or DTC, streaming model. The attraction of Disney's top-tier networks, led by ESPN, ABC, and The Disney Channel,resulted in this package of Disney channels being included in nearly all subscriptions at industry-leading rates. Relatively high levels of television viewership also boosted advertising revenue. Cord-cutting and a decline in linear viewership has dampened both of those revenue streams.

Disney is still in the transition period of moving to the DTC model. Like all DTC platforms, the initial buildup of the service has come with operating losses, and Disney has not yet included all of its content on its streaming platforms, as doing so would hasten the decline of its linear business. We see these challenges as a temporary part of the transition. There are various ways this evolution can play out, with two likely possibilities, including lower fees paid by pay-TV distributors or the inclusion of streaming access as part of a pay-TV bundle. But the most important feature, in our view, is that Disney continues to hold premier content and has the highest likelihood among all competitors of maintaining a pipeline of the highest-quality programming. Over the long term, the ability to generate or attract the best content makes economic profitability highly likely.

The intangible assets that underpin Disney's moat include the intellectual property behind franchises and characters that have proved enduring across generations, ESPN's position in the sporting world, and the multiple television and movie production studios Disney has. The interaction among these assets benefits all of the firm's business lines and makes the whole stronger than the individual parts. Not only would new competitors find it nearly impossible to offer competing entertainment experiences, but we see few—if any—existing companies that can offer anything similar to what Disney can.

Apart from the ABC broadcast network, ESPN is Disney's premier programming network. It is a leader in sports content and reputation, giving it near-universal carriage in pay-TV bundles at industry-leading fees and making it an attractive outlet for premier talent and sports leagues. Although the exposure ESPN historically provided is less of a differentiator than it once was, Disney still has resources to secure major sports rights, and it remains second to none for the reach it can offer to on-air talent for general, all-day sports programming, as opposed to platforms where sports is not a focus. Disney has thus far resisted offering linear ESPN programming on a streaming service, but we expect that to change within the next couple of years. With a linear subscriber base down more than 25% since the 100 million peak in 2010, we see less and less value in preserving the bundle in its current form while forgoing opportunities with consumers who have cut the cord. ESPN remains synonymous with sports, and we expect it to continue to attract sports fans, whether through DTC or the bundle.

Our view is similar for Disney's entertainment segment. Linear TV networks, which include the ABC broadcast network and various cable channels, face headwinds from the decline in pay-TV subscribers and linear television viewership, but Disney still has multiple top film and TV production studios and enough unique content to drive successful DTC streaming services. Disney+ and Hulu trail only Netflix in streaming subscribers, and we think the existing size and content pipeline will begin to drive durable DTC profitability by 2025. In our view, a streaming service needs scale to give it the resources to operate in a virtuous cycle, where it can generate enough cash to continue securing a wide enough content library to retain large subscriber bases. We believe Disney has major building blocks already in place. All outlets within the segment also benefit from the strong franchises Disney has created, which give it a durable advantage in creating future movies and continuing to monetize content it has created. Finally, while broadcast networks aren't as vital to society as they once were, they remain unique properties that attract content and drive advertising, given their reach.

We believe Disney's experiences segment, which consists mostly of theme parks and other vacation-related revenue streams, has the most durable advantage. Disney characters have proven timeless, and we think it would be nearly impossible for new competitors to offer destinations that are as attractive. Securing and building the infrastructure is one challenge, but even if a competitor undertook that massive project, it wouldn't have the depth of attractive characters to drive interest at a national or global level. These characters and franchises also drive licensing revenue on consumer products, a high margin source of continuing revenue for Disney. In short, Disney can provide a type of experience that we expect will drive consistent demand, and its offering for that type of experience is unique and best in class.

Fair Value and Profit Drivers Matthew Dolgin, CFA, Senior Equity Analyst, 14 Nov 2024

We’re raising our fair value estimate for Disney to $125 from $115, implying a P/E multiple of 20 times our 2025 adjusted earnings estimate.

We project entertainment linear networks revenue to average a 3% revenue decline throughout our five-year forecast. We expect growth to be somewhat choppy from year to year, mostly due to advertising revenue. We project a slight annual decline in the affiliate fees Disney receives from pay-TV distributors due to a continuing decline in the number of subscribers to pay-TV services. However, we

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expect the pace of cord-cutting to slow, and the decline should be largely offset by growth in fees over time.

We are slightly more optimistic about sports linear networks, where we project revenue to grow 1%-2% annually. However, we project higher growth out of the broader sports segment, driven by subscriber growth on ESPN+, its sports streaming service, and growth in pay-per-view sales. We don't expect significant incremental revenue opportunities from ESPN linear programming becoming available on streaming, which should occur by the end of 2025. Broadly, we believe success driving subscribers and revenue to streaming ESPN will result in a greater decline of the linear ESPN revenue stream. We also think it's possible that the streaming services will highlight the value of pay-TV subscriptions, which could help diminish the linear television decline. Either way, we don't expect much incremental revenue for Disney, but rather similar revenue in one of multiple forms. We project the sports segment to grow 2%-3% annually.

With its other streaming services, including Disney+, Hulu, and international platforms, we project high-single-digit sales growth annually. We believe there is room to continue adding subscribers—we project 2 million-3 million annually to the domestic platforms and 7 million annually internationally—and we expect average revenue per user to trend up, through periodic price increases and higher advertising revenue. However, we expect a competitive market with multiple streaming services, and we believe Disney will remain sensible with pricing as it focuses on profitability, which is why we don't project even bigger subscriber gains. In the U.S., we project Disney+ and Hulu to each have around 65 million subscribers by 2028, well below leader Netflix.

We project mid-single-digit average annual growth in the experiences segment, driven by theme parks and the related hospitality services as well as new cruise ships that are due to arrive in 2025 and 2026. However, the recovery in attendance after the pandemic shut down some theme parks into 2022 is now virtually complete, so we don't expect the double-digit growth of the past few years.

We project margins to expand and free cash flow to rise significantly, both as a result of the cost-cutting measures Disney initiated in 2022 as well as a rationalization in content spending. We project the firm's segments operating margin to rise from about 15% in fiscal 2023 to 22% by 2029, returning to a level not seen since 2019. We project content spending to grow to $24 billion in 2025, and we expect further growth each year, as we believe the firm must continue spending to offer attractive programming and retain sports rights. However, cost efficiencies and leverage we expect the firm to get from the growth of its DTC platforms result in free cash flow rising from our projected $8 billion in 2025 to nearly $13 billion by 2029.

Risk and Uncertainty Matthew Dolgin, CFA, Senior Equity Analyst, 7 Feb 2024

Our Morningstar Uncertainty Rating for Disney is High. The evolution of the media industry that is currently taking place is the main factor behind our assessment.

Outside of its parks and experiences business, Disney historically had three main sources of revenue: fees that it received from pay-TV distributors to carry the Disney bundle of channels, television advertising, and licensing fees for movies and television programming distributed by third parties. Each of these revenue sources are now under pressure. Cord-cutting and diminished linear television viewership have depressed carriage fees and advertising revenue. Shorter runs in movie theaters and an industry shift toward DTC streaming services have depressed licensing revenue.

A successful evolution for Disney would entail its DTC business more than offsetting the declines associated with its traditional business model. Considering the moat Disney has thanks to the value of its content assets, we think this is possible. However, this shift is still in the early stages and the transition has not been smooth—and there remains a real possibility that Disney's business in this new era will never be as good as it once was.

From an environmental, social, and governance perspective, we believe potential social issues carry the greatest risk. The entertainment industry in general has a history of bad behavior regarding issues like sexual assault and harassment and racial and gender discrimination. Disney has not been immune from lawsuits in the past, and there's always a risk of additional ones. We doubt any individual one could create a material financial impact, but harm to the firm's image could bring consequences with consumers and employees that ultimately dent Disney's business.

Capital Allocation Matthew Dolgin, CFA, Senior Equity Analyst, 1 Dec 2023

We assign Disney a Standard Morningstar Capital Allocation Rating. Our rating is based primarily on our assessment of Disney's business investment decisions but also considers the firm's balance sheet health, and decisions surrounding capital return to shareholders.

Over the course of its history, Disney's decisions have been exceptional. The characters it created, savvy acquisitions, such as Marvel, and the foresight to create its parks business have made Disney an iconic brand and premier company with a wide economic moat. However, investment decisions over the past decade have been more mixed. The firm spent roughly $70 billion, ultimately with a mixture of cash and stock, to buy 21st Century Fox in 2019. We believe Disney acquired some valuable assets in the deal, but we question whether Disney will receive proper value. Disney acquired many linear television networks, which we think are declining in value, and an additional stake in Hulu, paving the way for the firm's commitment to buy all of the streaming platform. Disney undoubtedly needed to adjust its vision for the company's future as the linear television model that had been so successful began to look like a relic. However, we question whether this was the best way to preserve value, and we think focus and capital investment likely would've been better suited elsewhere.

Apart from the debatable decision about buying 21st Century Fox and taking on debt to do it, we think

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Disney has managed its balance sheet well and made the right decisions regarding return of capital to shareholders. Disney found itself in an unthinkable position when the pandemic struck and its parks business shut down almost completely. The firm was in a good enough financial position to survive the shock and come out of it without a balance sheet that impaired the company. Management wisely, in our view, cut the dividend while the firm brought down leverage and invested aggressively in its direct-to-consumer business, which is crucial to the firm’s future. With leverage now back to levels not seen since before the 21st Century Fox acquisition, the firm is beginning to return capital to shareholders again.

Analyst Notes Archive

Disney Earnings: Experiences Softness Weighs on Results, but Much of Business Has Turned Up

Matthew Dolgin, CFA, Senior Equity Analyst, 7 Aug 2024

Strength in experiences has been Disney's salvation over the past couple of years as the traditional media business has struggled with secular challenges. The script largely flipped during Disney's third quarter, as the streaming business continues to gain momentum; a return of box office success drove sizable licensing profits; and strength at ESPN blunted struggles throughout the rest of the linear television business. In experiences, waning demand and high costs stood out, but we see this as a cyclical bump rather than a structural crisis. We're maintaining our $115 fair value estimate, and we are more comfortable with Disney's business now than in recent years. We believe the stock is undervalued.

Experiences revenue grew only 2% year over year, as a slowdown in attendance and guest spending internationally has now joined the domestic trend that has persisted over the past year, following rapid growth coming out of the pandemic. Moreover, experiences segment operating income fell by 3% on 150 basis points of margin contraction. Management expects these tepid results to persist for the next several quarters, as it has seen a dropoff in consumer demand. It cited several factors that led to higher expenses, but startup costs associated with new projects in the works will also require higher spending. However, we expect demand to be cyclical, and with new cruise ships and park extensions set to open over the next couple of years, we still expect plenty of room for long-term growth.

The firm finally reached streaming profitability across ESPN+ and its other entertainment streaming services while also seeing an acceleration in revenue growth, to 15.5% year over year. Between Hulu and Disney+, the firm added over 1.5 million subscribers, all in North America. Average revenue per user for Disney+ was down 5% year over year, which we attribute largely to the full-quarter effect of the Charter cable subscribers who began receiving access earlier this year.

Disney Earnings: Improved Streaming Results Come at the Expense of Continued Linear Weakness

Matthew Dolgin, CFA, Senior Equity Analyst, 7 May 2024

Disney continued to make good progress on cost reductions and building a path to streaming profitability during its fiscal second quarter. However, promising streaming metrics coincided with a traditional television business that continues to struggle, and the firm provided a muted fiscal third-quarter outlook, especially for its experiences segment. Our concern remains with the bigger picture. Until Disney can show more progress on the collective streaming and linear television trend, we expect overall performance to remain muted. We're maintaining our $115 fair value estimate.

Entertainment streaming revenue, which excludes ESPN+, grew 13% year over year and reached operating profitability for the first time, but we see streaming as inextricably linked to linear television networks (excluding ESPN), where revenue declined 8% and operating income dropped by more than 20%. There are inklings of progress on the collective business, but we need to see a longer trend and more details than the company has provided so far. Combined, entertainment streaming and linear revenue grew 5% year over year, while the operating margin doubled to nearly 10%.

Unsurprisingly, domestic Disney+ subscribers jumped significantly in the quarter, by 8 million, as many Charter cable subscribers began receiving access through their existing pay-TV packages in January. We were pleasantly surprised that Disney+ domestic average revenue per user still grew 14% year over year and declined only modestly sequentially. We expected a bigger weight from the Charter subscribers. It doesn't seem this positive surprise was the result of a shift in revenue allocation from the linear networks, as the 8% decline in linear networks revenue marked the best rate of decline in the past four quarters. While we suspect a lower rate of advertising revenue decline caused the improvement, we think it's unlikely the affiliate revenue decline could be much worse given the overall improvement.

Disney: Changes Are on the Way Despite the Proxy Fight Victory Matthew Dolgin, CFA, Senior Equity Analyst, 3 Apr 2024

Walt Disney has won its proxy battle with Trian and other activist investors, as shareholders elected Disney's entire recommended slate of directors. Trian and the two nominees it submitted were the biggest threat to Disney's slate, but since Trian released its very detailed presentation last month, we've maintained that the outcome wasn't nearly as consequential as suggested by the publicity that the contest generated. We're maintaining our $115 fair value estimate and believe the stock's recent appreciation now reflects forthcoming improvement, which we expect will occur regardless of which side had won.

We think Trian has some good ideas, but few were revolutionary or revealed issues that Disney wasn't already aware of and working on, and we don't think two Trian directors would've had an overwhelming impact. The most important thing for Disney is that the battle is now behind it, and it can return its focus to addressing the issues that need to improve.

Most notably, Disney needs to figure out how to best preserve pay-TV revenue as viewership shifts to streaming services. Trian identified the struggle Disney has had in growing a profitable streaming business, but it offered few tangible solutions. We agree with Trian's suggestion that a key is bundling the service with other media firms, but Disney is already on that track: Disney, Warner Bros. Discovery, and Fox intend to create a joint-venture streaming service in 2024, and Disney+ is now included as part of the bundle for Charter's pay-TV subscribers. We are skeptical that the sports joint venture will ultimately be the best manifestation of a bundled product due to the difficult balance between offering a compelling price point and not accelerating the cannibalization of pay-TV subscriptions, but we believe that continuing to evolve these types of initiatives is key to finding a solution that balances revenue and audience reach against consumer demand for more flexible offerings.

Disney: India Exit a Wise Move; Our $115 Fair Value Estimate Unchanged Matthew Dolgin, CFA, Senior Equity Analyst, 28 Feb 2024

Walt Disney intends to spin Star India into a joint venture that will include Viacom 18, a local competitor. Disney's contribution to the JV, in which it will have a 37% stake, will consist of the Star India assets and some Disney content rights and licenses, for which we expect Disney will earn licensing revenue. While Disney will receive no immediate cash compensation as it would have for selling the operations outright, we think the most important aspect is that it is exiting India and should be better able to focus attention and resources on its core businesses. The Indian operations contributed minimally to our forecast, and we are maintaining our $115 fair value estimate and wide moat rating.

Star India primarily consists of a streaming service and linear television networks. Its results recently have been very challenging, and we think it has a much better chance at success when combined with Viacom 18. Disney does not break out the general entertainment networks, but the sports networks have consistently been generating operating losses the past couple of years while revenue has been very volatile. The Disney+ Hotstar streaming service lost nearly 24 million subscribers in fiscal 2023—close to 40% of the subscriber base—and also saw a material decline in average revenue per subscriber after not renewing streaming cricket rights in 2022. This deal will reduce some of Disney's obligations for content spending—which notably include linear cricket rights for nearly $1 billion annually—and instead allocate that capital to areas we think will be more beneficial.

Considering the deterioration of Star India, the resulting control of these assets by a local company, and the court-approved scheme of arrangement that this joint venture is structured through, we suspect the transaction will receive regulatory approval, but we can't be certain of this, given the combination of major competitors. Disney anticipates the deal closing in the first half of fiscal 2025.

Disney Earnings: Lots of Good, Especially for the Flashy Metrics, but Underlying Issues Remain

Matthew Dolgin, CFA, Senior Equity Analyst, 8 Feb 2024

In a fiscal first-quarter report overflowing with news, Disney showed significant progress in several important business lines and offered reasons to be excited. The most unequivocally positive result, in our view, was significant margin expansion. But from a top-line perspective, some of the news, particularly surrounding live sports making its way to streaming and encouraging Disney+ trends, is merely consistent with the ongoing evolution of Disney's business. As an offset to grand streaming plans, the results in Disney's linear and licensing businesses were lukewarm to poor. We believe the quarter validates the strength of Disney's assets and the firm's ability to survive the evolution of the media industry. However, we don't think the story has changed. We're maintaining our $115 fair value estimate and now believe the stock is only modestly undervalued.

Disney is now all-in on streaming live sports. In addition to the planned joint venture with Fox and Warner to put the firms' linear sports programming on a streaming platform in 2024, Disney announced it will also offer all linear ESPN programming on a standalone platform with ESPN+ by the fall of 2025. We believe these alternatives are critical as pay-TV subscriber bases continue to decline. Still, we don't expect a huge incremental revenue stream, as we expect much of the streaming revenue gains to be offset by accelerating linear losses. We expect pay-TV distributors to demand lower affiliate fee payments and/or require streaming access be included for their pay-TV subscribers, similar to the recent agreement renewal between Charter and Disney. Further, if these services are priced too low, they will likely expedite the demise of the pay-TV bundle, and if they're priced too high—so that they look more similar to a pay-TV bundle—we question how much demand they'll generate.

Disney, Warner Bros. Discovery, and Fox: Coming Together With a Sports Streaming Platform

Matthew Dolgin, CFA, Senior Equity Analyst, 7 Feb 2024

Disney, Warner Bros. Discovery, and Fox announced a joint venture to create a streaming platform that will include all of the linear sports content that the firms broadcast. The platform should launch in the fall of 2024 and will include programming from 14 linear networks and a variety of sports leagues. The move doesn't change our fair value estimates—$115 for Disney, $20 for Warner Bros. Discovery, and $43 for Fox. We've expected a streaming bundle and linear sports programming moving increasingly to streaming, and we don't believe this move changes the total monetization pie for sports content.

Few specifics about the sports streaming platform have been disclosed apart from the programming that it will include, but generally we believe greater streaming success will lead to more linear television pressure, and vice versa. In comments on its earnings call, Fox's management stressed that this streaming platform is targeted to the half of U.S. households that do not have pay-TV subscriptions rather than as an alternative to those that do. Whether that proves true, in our view depends on the service's price point, and we think the content contributors will have to thread a needle to triangulate between price points of pay-TV subscriptions and standalone streaming platforms. Pricing too low will more likely lead to a swifter decline of pay-TV subscribers and significantly reduce the fees pay-TV

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Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
102.72 USD 13 Nov 2024	125.00 USD 14 Nov 2024 19:41, UTC	0.82	197.84 USD Bil 14 Nov 2024	Wide	Large Value	High	Standard	6 Nov 2024 06:00, UTC

distributors are willing to pay. Pricing on the higher end to avoid that fate, which we think is likely, would moderate uptake while still leading to some concessions to pay-TV distributors due to the lack of exclusivity.

We also don't yet know the incremental costs each firm will need to undertake to build and market the platform, but because the platform shouldn't require additional content costs, as other nascent streaming services have, we don't expect them to be overly significant. Fox's management said it expected for the platform to be accretive pretty quickly.

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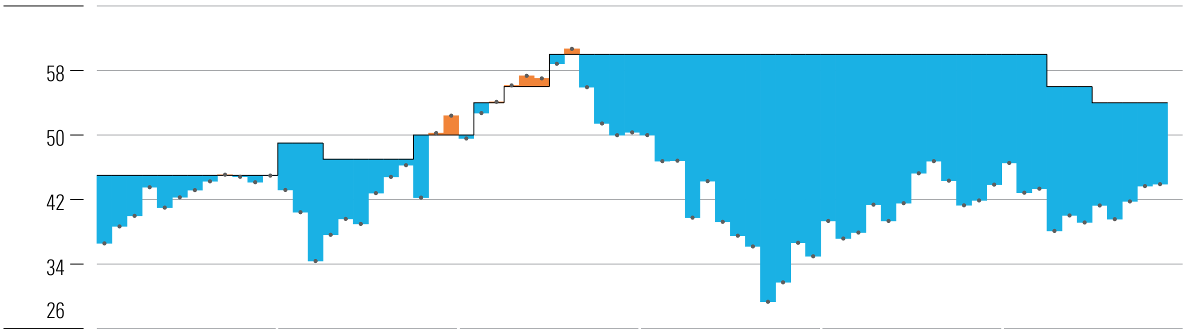
The Walt Disney Co DIS ★★★ 14 Nov 2024 19:46, UTC

Competitors Price vs. Fair Value

Comcast Corp Class A CMCSA



Fair Value: 54.00
23 Jul 2024 18:10, UTC

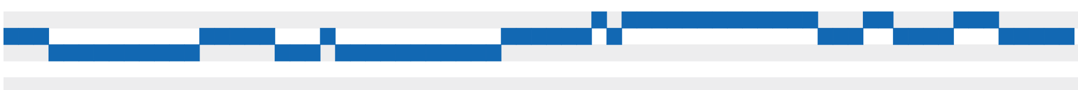
Last Close: 43.91

Overvalued

Undervalued

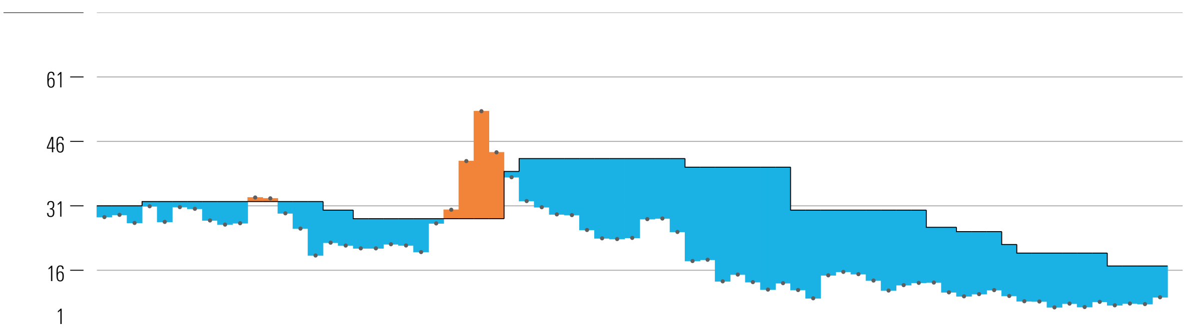
	2019	2020	2021	2022	2023	YTD	
	1.00	1.05	0.84	0.58	0.73	0.81	Price/Fair Value
	33.92	18.52	-2.08	-28.41	28.65	2.92	Total Return %

Morningstar Rating



Total Return % as of 13 Nov 2024. Last Close as of 13 Nov 2024. Fair Value as of 23 Jul 2024 18:10, UTC.

Warner Bros. Discovery Inc Ordinary Shares - Class A WBD



Fair Value: 17.00
8 Aug 2024 05:41, UTC

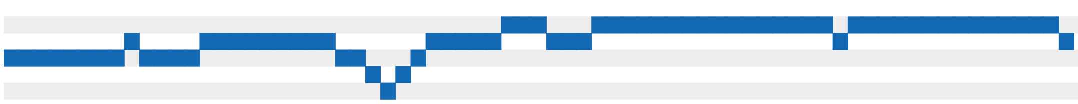
Last Close: 9.72

Overvalued

Undervalued

	2019	2020	2021	2022	2023	YTD	
	1.02	1.07	0.56	0.32	0.46	0.57	Price/Fair Value
	32.34	-8.09	-21.77	-59.73	20.04	-14.59	Total Return %

Morningstar Rating



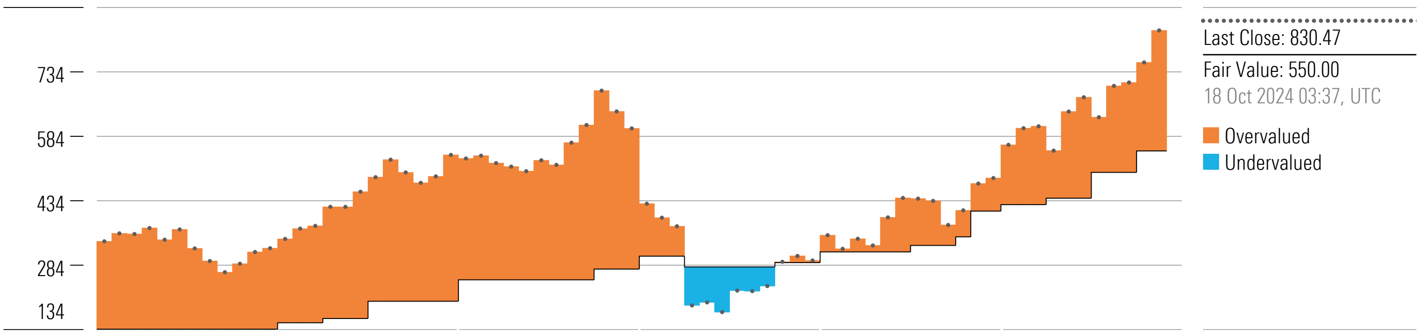
Total Return % as of 13 Nov 2024. Last Close as of 13 Nov 2024. Fair Value as of 8 Aug 2024 05:41, UTC.

Morningstar Equity Analyst Report | Report as of 14 Nov 2024 19:48, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 14 of 23

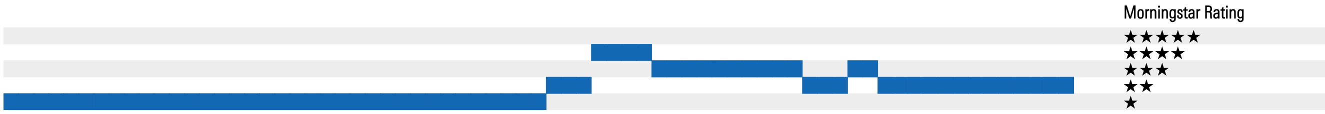
The Walt Disney Co DIS ★★★ 14 Nov 2024 19:46, UTC

Competitors Price vs. Fair Value

Netflix Inc NFLX



	2019	2020	2021	2022	2023	YTD
Price/Fair Value	2.40	2.70	2.19	1.02	1.19	1.51
Total Return %	20.89	67.11	11.41	-51.05	65.11	70.57



Total Return % as of 13 Nov 2024. Last Close as of 13 Nov 2024. Fair Value as of 18 Oct 2024 03:37, UTC.

Morningstar Equity Analyst Report | Report as of 14 Nov 2024 19:48, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 15 of 23

The Walt Disney Co DIS ★★★ 14 Nov 2024 19:46, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
102.72 USD 13 Nov 2024	125.00 USD 14 Nov 2024 19:41, UTC	0.82	197.84 USD Bil 14 Nov 2024	Wide	Large Value	High	Standard	6 Nov 2024 06:00, UTC

Morningstar Historical Summary

Financials as of 30 Sep 2024

Fiscal Year, ends 30 Sep	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
Revenue (USD Bil)	49	52	56	55	59	70	65	67	83	89	91	91
Revenue Growth %	8.4	7.5	6.0	-0.9	7.8	17.1	-6.1	3.1	22.7	7.5	2.8	2.8
EBITDA (USD Bil)	14.83	16.49	17.75	17.08	18.31	19.07	5.09	9.08	12.00	12.11	14.63	14.63
EBITDA Margin %	30.4	31.4	31.9	31.0	30.8	27.4	7.8	13.5	14.5	13.6	16.0	16.0
Operating Income (USD Bil)	11.54	13.22	14.36	13.87	14.84	11.83	3.79	3.66	6.77	8.99	11.91	11.91
Operating Margin %	23.6	25.2	25.8	25.2	25.0	17.0	5.8	5.4	8.2	10.1	13.0	13.0
Net Income (USD Bil)	7.50	8.38	9.39	8.98	12.60	11.05	-2.86	2.00	3.15	2.35	4.97	4.97
Net Margin %	15.4	16.0	16.9	16.3	21.2	15.9	-4.4	3.0	3.8	2.7	5.4	5.4
Diluted Shares Outstanding (Mil)	1,759	1,709	1,639	1,578	1,507	1,666	1,808	1,828	1,827	1,830	1,831	1,831
Diluted Earnings Per Share (USD)	4.26	4.90	5.73	5.69	8.36	6.64	-1.58	1.09	1.72	1.29	2.72	2.72
Dividends Per Share (USD)	0.86	1.81	1.42	1.56	1.68	1.76	0.88	0.00	0.00	0.00	0.75	0.75

Valuation as of 31 Oct 2024

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Price/Sales	3.4	3.4	3.1	3.1	2.8	3.5	5.0	4.2	1.9	1.9	2.0	2.0
Price/Earnings	22.1	21.5	18.2	18.9	13.1	23.0	-114.9	138.9	49.8	69.9	36.9	36.9
Price/Cash Flow	16.9	16.5	12.9	13.7	11.6	36.5	42.9	50.8	26.4	16.8	13.3	13.3
Dividend Yield %	1.22	1.3	1.43	1.51	1.57	1.22	0.49	—	—	0.33	0.78	0.78
Price/Book	3.6	3.9	3.9	3.9	3.4	2.9	3.9	3.2	1.6	1.7	1.7	1.7
EV/EBITDA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Operating Performance / Profitability as of 30 Sep 2024

Fiscal Year, ends 30 Sep	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
ROA %	9.1	9.7	10.4	9.6	13.0	7.6	-1.5	1.0	1.5	1.2	2.5	2.5
ROE %	16.6	18.7	21.4	21.2	28.0	16.1	-3.3	2.3	3.4	2.4	5.0	5.0
ROIC %	12.5	13.9	15.3	14.2	19.2	11.5	-1.3	2.3	2.8	2.3	4.2	4.2
Asset Turnover	0.6	0.6	0.6	0.6	0.6	0.5	0.3	0.3	0.4	0.4	0.5	0.5

Financial Leverage

Fiscal Year, ends 30 Sep	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Debt/Capital %	21.9	22.3	27.6	31.6	25.9	30.0	40.1	36.9	33.8	31.5	29.4	—
Equity/Assets %	53.4	50.5	47.0	43.1	49.5	45.8	41.5	43.5	46.7	48.3	51.3	—
Total Debt/EBITDA	1.0	1.1	1.1	1.5	1.1	2.5	12.1	6.3	4.3	4.1	3.3	—
EBITDA/Interest Expense	50.4	62.2	50.1	33.7	31.9	19.5	3.4	6.5	7.7	6.1	7.1	7.1

Morningstar Analyst Historical/Forecast Summary as of 14 Nov 2024

Financials

Fiscal Year, ends 30 Sep 2024	2023	2024	Estimates 2025	2026	2027
Revenue (USD Mil)	88,898	91,361	94,160	99,004	103,398
Revenue Growth %	7.5	2.8	3.1	5.1	4.4
EBITDA (USD Mil)	11,347	13,819	19,455	21,080	22,973
EBITDA Margin %	12.8	15.1	20.7	21.3	22.2
Operating Income (USD Mil)	8,992	11,914	13,648	15,574	17,366
Operating Margin %	10.1	13.0	14.5	15.7	16.8
Net Income (USD Mil)	6,923	9,195	9,812	10,825	12,345
Net Margin %	7.8	10.1	10.4	10.9	11.9
Diluted Shares Outstanding (Mil)	1,830	1,831	1,829	1,829	1,829
Diluted Earnings Per Share(USD)	3.77	4.96	5.36	5.92	6.75
Dividends Per Share(USD)	0.00	0.75	1.05	1.20	1.50

Forward Valuation

	2023	2024	Estimates 2025	2026	2027
Price/Sales	1.7	2.0	2.0	1.9	1.8
Price/Earnings	25.5	20.7	19.2	17.4	15.2
Price/Cash Flow	—	—	—	—	—
Dividend Yield %	—	0.7	1.0	1.2	1.5
Price/Book	1.8	1.9	1.7	1.6	1.5
EV/EBITDA	16.2	16.5	11.7	10.8	9.9

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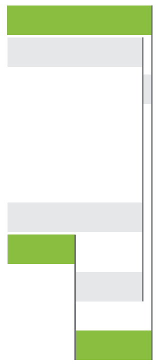
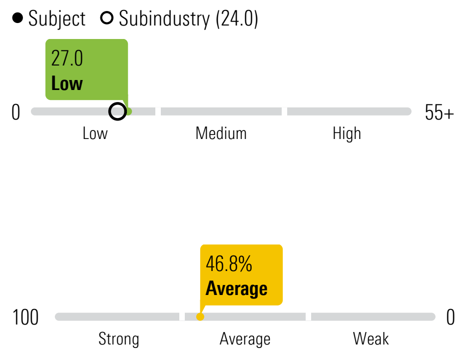
The Walt Disney Co DIS ★★★ 14 Nov 2024 19:46, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
102.72 USD 13 Nov 2024	125.00 USD 14 Nov 2024 19:41, UTC	0.82	197.84 USD Bil 14 Nov 2024	Wide	Large Value	High	Standard	6 Nov 2024 06:00, UTC

ESG Risk Rating Breakdown

Exposure	
Company Exposure[1]	27.0
– Manageable Risk	25.3
Unmanageable Risk[2]	**1.7**
Management	
Manageable Risk	25.3
– Managed Risk[3]	11.9
Management Gap[4]	**13.5**
Overall Unmanaged Risk	**15.1**





- 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 46.8% 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: Movies and Entertainment. 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	Management	ESG Risk Rating
The Walt Disney Co	27.0 | Low	46.8 | Average	15.1 | Low
Comcast Corp	42.0 | Medium	52.6 | Strong	22.1 | Medium
Warner Bros. Discovery Inc	26.0 | Low	31.7 | Average	18.1 | Low
Netflix Inc	23.5 | Low	35.9 | Average	15.5 | Low
Inmyshow Digital...y (Group) Co Ltd	25.5 | Low	14.5 | Weak	21.9 | Medium

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Appendix
Historical Morningstar Rating

The Walt Disney Co DIS 13 Nov 2024 22:33, 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
★★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★

Comcast Corp Class A CMCSA 13 Nov 2024 22:36, UTC

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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
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★

Warner Bros. Discovery Inc Ordinary Shares - Class A WBD 13 Nov 2024 22:35, 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.

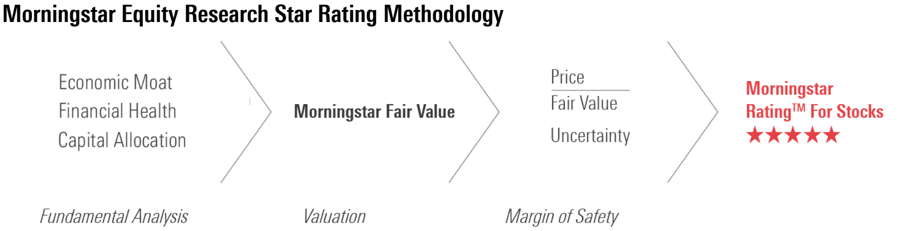
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return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

Qualitative Analysis Uncertainty Ratings	Margin of Safety ★★★★★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.

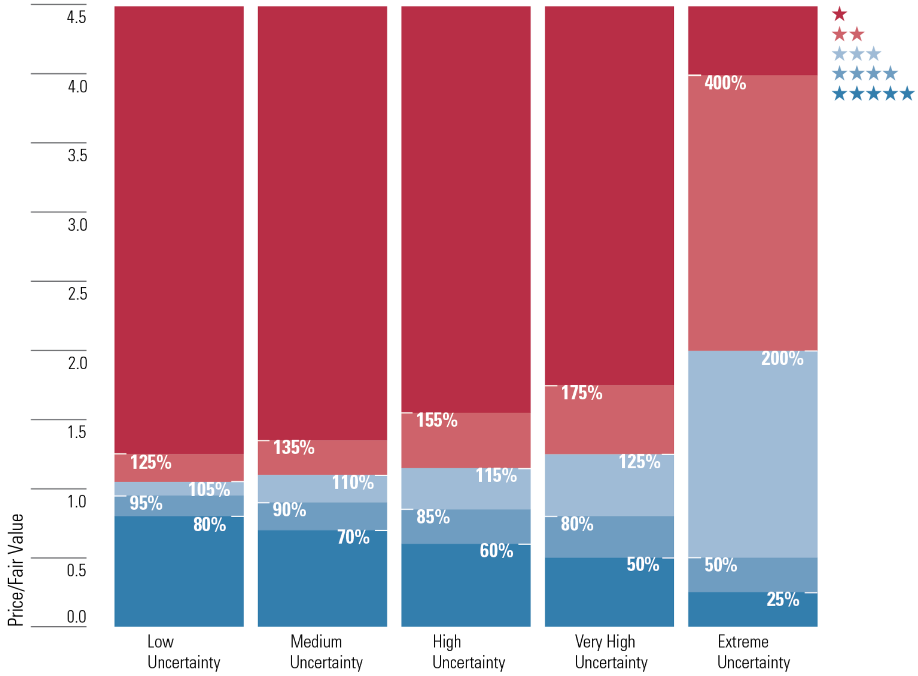
4. Market Price

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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