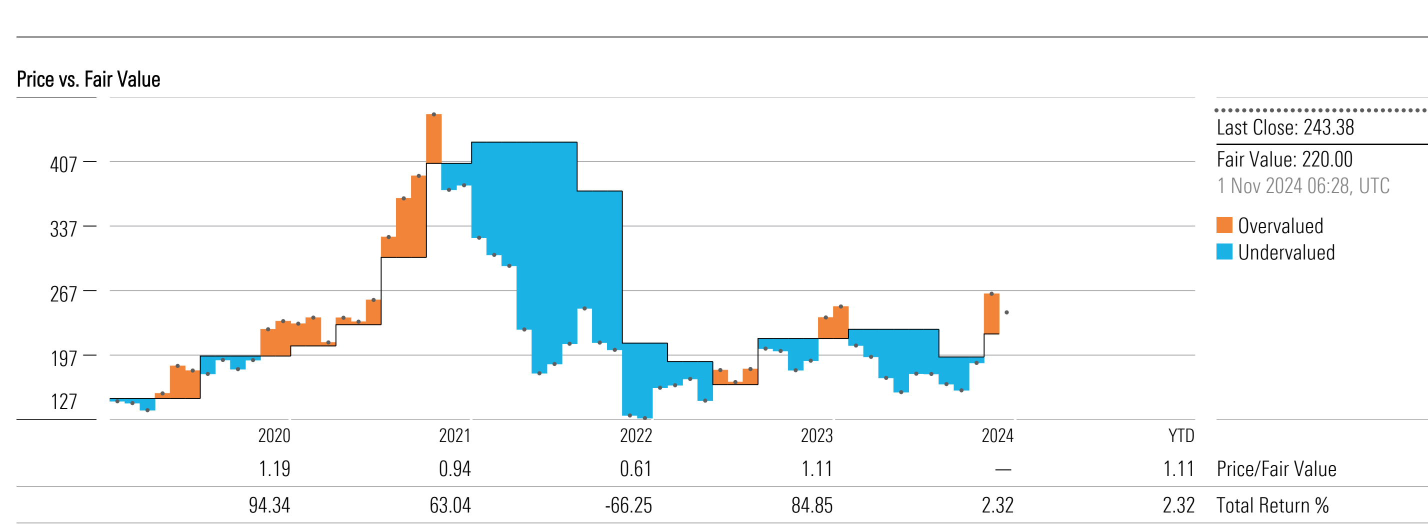
# Atlassian Corp A TEAM ★★★ 31 Dec 2024 22:48, UTC

| Last Price | Fair Value Estimate | Price/FVE | Market Cap | Economic Moat™ | Equity Style Box | Uncertainty | Capital Allocation | ESG Risk Rating Assessment[1] |
|---|---|---|---|---|---|---|---|---|
| 243.38 USD<br>31 Dec 2024 | 220.00 USD<br>1 Nov 2024 06:28, UTC | 1.11 | 63.38 USD Bil<br>31 Dec 2024 | Narrow | Large Growth | High | Standard | 4 Dec 2024 06:00, UTC |

## Price vs. Fair Value




| | 2020 | 2021 | 2022 | 2023 | 2024 | YTD | |
|---|---|---|---|---|---|---|---|
| | 1.19 | 0.94 | 0.61 | 1.11 | — | 1.11 | Price/Fair Value |
| | 94.34 | 63.04 | -66.25 | 84.85 | 2.32 | 2.32 | Total Return % |

Morningstar Rating
★★★★★
★★★★
★★★
★★
★

Total Return % as of 31 Dec 2024. Last Close as of 31 Dec 2024. Fair Value as of 1 Nov 2024 06:28, 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.

# Cloud Transition Leaves Atlassian Better Positioned in the Long Term

**Business Strategy & Outlook** Dan Romanoff, CPA, Senior Equity Analyst, 2 Aug 2024

Atlassian endeavors to "unleash the potential of teams" through better planning, project management, and workflow software, and we think its strong momentum is likely to continue in the coming years as the transition to the cloud continues. Atlassian's original product, Jira, was designed as a workflow solution for software developers that has grown into a richly featured, easy-to-use, inexpensive, easy-to-buy application. The software is often bundled with Confluence, a collaboration tool. The firm has also gradually moved upmarket toward enterprise customers, even as it continues to serve customers of all sizes.

Atlassian employs a distinct go-to-market strategy that eschews the traditional enterprise salesforce in favor of a low-cost, low-touch online marketing effort and e-commerce transactions on the firm's website. Free versions further help drive a large funnel. This is done to simplify the purchasing and onboarding process. Because of the company's web-based sales model, its sales and marketing expenses are among the lowest among enterprise software peers, leading to solid non-GAAP margins. That said, since sales and marketing expenses are typically the largest cost for software companies, we believe margins can expand significantly as the company matures. In the meantime, management believes its best marketing is a great product that is easy to buy and use that drives viral adoption within an organization once adopted by the first team.

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| Sector | Industry |
|---|---|
| Technology | Software - Application |

**Business Description**

Atlassian produces software that helps teams work together more efficiently and effectively. The company provides project planning and management software, collaboration tools, and IT help desk solutions. The company operates in four segments: subscriptions (term licenses and cloud agreements), maintenance (annual maintenance contracts that provide support and periodic updates and are generally attached to perpetual license sales), perpetual license (upfront sale for indefinite usage of the software), and other (training, strategic consulting, and revenue from the Atlassian Marketplace app store). Atlassian was founded in 2002 and is headquartered in Sydney.

Atlassian has excelled at upselling customers with more seats, additional products, and new use cases, and is also moving clients from on-premises to the cloud. We expect these factors to combine to drive strong top-line growth over the next five years. Retention is strong and upsell is obvious. In our view, new use cases are critical in driving long-term growth, as the service desk solution is applicable throughout an enterprise, whereas the IT-centric products have a narrower market. To that end, after its 2013 introduction, Jira Service Desk is already the first Atlassian solution that nearly one fifth of customers land with, as use cases have expanded to human resources and compliance.

**Bulls Say** Dan Romanoff, CPA, Senior Equity Analyst, 1 Nov 2024

- Atlassian's growth has been strong and is expected to remain so, with robust new customer adds, client retention, upselling, and the introduction of new solutions.
- The company is disruptive to existing markets, especially to legacy software providers. Additionally, Jira Service Desk has dramatically expanded the addressable market beyond the IT function.
- Because Atlassian has a limited salesforce, its sales and marketing expenses are significantly lower than peers', driving already solid non-GAAP operating margins and allowing for material expansion over the next five years.

**Bears Say** Dan Romanoff, CPA, Senior Equity Analyst, 1 Nov 2024

- Atlassian has traded at lofty valuations at times, and while it might continue to generate strong growth, the company may fail to live up to the optimistic assumptions that are sometimes embedded in the share price.
- Despite generating billions of dollars in revenue, the company is still not generating positive GAAP operating margins, and is not expected to do so within the next several years.
- The cloud transition aspect makes analysis of the company more challenging.

**Economic Moat** Dan Romanoff, CPA, Senior Equity Analyst, 2 Aug 2024

We assign a narrow moat rating to Atlassian based on switching costs. The company generates revenue from software sales and other services. We believe Atlassian's software-related revenue has a narrow moat, while services and other revenue has no moat. In our view, switching costs have historically enabled the company to generate returns on invested capital in excess of its cost of capital, and will more likely than not drive continued excess returns over the next 10 years.

Switching costs for software are often driven by several factors in our view. The more critical the function and the more touch points across an organization a software vendor has, the higher the switching costs. There is also the direct time and expense of implementing a new software package for the customer while maintaining the existing platform and retraining employees on a new system. Additionally, there is operational risk of changing software vendors, including business process reengineering, loss of data during the changeover, and overall project execution. A major

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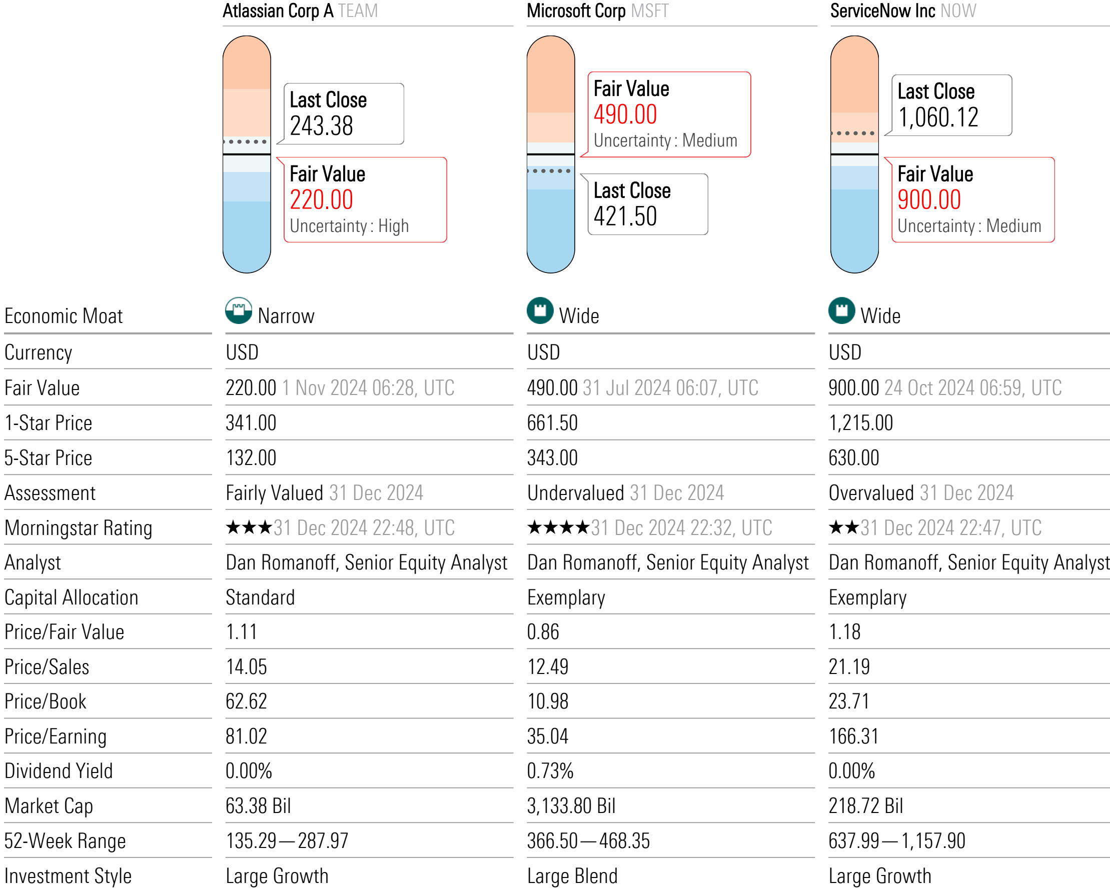
## Competitors




| | Atlassian Corp A TEAM | Microsoft Corp MSFT | ServiceNow Inc NOW |
|---|---|---|---|
| Economic Moat | Narrow | Wide | Wide |
| Currency | USD | USD | USD |
| Fair Value | 220.00 1 Nov 2024 06:28, UTC | 490.00 31 Jul 2024 06:07, UTC | 900.00 24 Oct 2024 06:59, UTC |
| 1-Star Price | 341.00 | 661.50 | 1,215.00 |
| 5-Star Price | 132.00 | 343.00 | 630.00 |
| Assessment | Fairly Valued 31 Dec 2024 | Undervalued 31 Dec 2024 | Overvalued 31 Dec 2024 |
| Morningstar Rating | ★★★31 Dec 2024 22:48, UTC | ★★★★31 Dec 2024 22:32, UTC | ★★31 Dec 2024 22:47, UTC |
| Analyst | Dan Romanoff, Senior Equity Analyst | Dan Romanoff, Senior Equity Analyst | Dan Romanoff, Senior Equity Analyst |
| Capital Allocation | Standard | Exemplary | Exemplary |
| Price/Fair Value | 1.11 | 0.86 | 1.18 |
| Price/Sales | 14.05 | 12.49 | 21.19 |
| Price/Book | 62.62 | 10.98 | 23.71 |
| Price/Earning | 81.02 | 35.04 | 166.31 |
| Dividend Yield | 0.00% | 0.73% | 0.00% |
| Market Cap | 63.38 Bil | 3,133.80 Bil | 218.72 Bil |
| 52-Week Range | 135.29—287.97 | 366.50—468.35 | 637.99—1,157.90 |
| Investment Style | Large Growth | Large Blend | Large Growth |

implementation is likely to involve a system integrator and can take in excess of a year in bad cases. Lastly, lost productivity is likely to be an issue as customers move up a learning curve on the new system along with the distraction of users involved in the function where the change is occurring.

Retention metrics typically help inform investors on both the presence and the durability of a moat. These come in two flavors, gross, which describes what percentage of the customer base remains customers after a given period, and net, which highlights what percentage of the customer spending is retained by the software provider after a given period. Atlassian has noted throughout its model transition over a multiyear period that its net revenue retention has been in excess of 130%, which is excellent. Despite a healthy mix of small and medium-size business, or SMB, revenue in the overall mix, we still estimate that customer retention is north of 90%, which is solid, as SMB customers tend to have higher churn.

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Atlassian provides project planning and management software, collaboration tools, and service desk solutions. Key products include Jira Software, Jira Work Management, Confluence, Jira Service Management, Trello, Jira Align, and Bitbucket. The company's first product, Jira Software, helps software developers plan and manage coding projects. Jira Software is frequently used in conjunction with Confluence, the company's main collaboration solution. Over the years, the company's workflow software has been adapted to teams and processes outside of software development. Atlassian recognized this and in 2013 formally launched Jira Service Desk, a workflow solution that applies a ticketing and automation logic. The main uses for Jira Service Desk have been IT help desks, HR, and compliance, but the use cases are broader still. Once these software products are adopted, we believe they become integral to the workflow of software developers, or within the IT function, which we believe establishes switching costs as a moat source for Atlassian.

Atlassian's customer gathering effort differs from most enterprise software companies. Whereas the vast majority of enterprise software providers push larger deals through a direct salesforce in a lengthy qualification, product-proving, and relationship-building process, Atlassian sells its software over the internet without a direct salesforce. In fact, the vast majority of transactions occur on the company's website, further reinforcing the notion that the customer base skews more toward small and medium-size businesses. This dynamic is on display in the company's income statement, which shows sales and marketing expenses are the lowest as a percentage of revenues within our coverage. Further, Atlassian offers free versions with limited functionality to attract new users and encourage adoption.

Atlassian offers its solutions under software-as-a-service subscriptions and perpetual license agreements, with transparent pricing—all available on the company's website 24/7. While some niche competitors may offer free versions of project management software, these solutions tend to be stripped down. In order to have access to all features, the customer must pay for the freemium conversion. The Jira Software SaaS version is priced at $10 per user per month for up to 10 users, while 11-100 users is $5 per month—and customers do not have to sign up for annual contracts. So for a maximum of a few hundred dollars a year, a small software development company could base its entire production process around Jira. Conversely, a small team of 20 members within a larger organization can purchase Jira quickly and without a lengthy approval process—again for just a few hundred dollars per year. This is generally in line with peers. On the Service Desk side, however, Jira shines, as this solution is inexpensive compared with other leading peers, including ServiceNow, BMC (Remedy), and HP Enterprise. The flip side of this is twofold in that we consider ServiceNow, for example, more robust, and to use Jira Service Desk, Jira Core must be installed first.

Our general view is that enterprise software companies compete on features and functionality rather than price. In this case, our assessment is that Atlassian competes on both vectors, and has purposefully elected to do so. Attacking the market in this manner makes sense to us. On the pricing

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front, the company can simultaneously offer competitive (or better) pricing and buying than legacy competitors, while offering competitive features. This approach to selling software made it quick, cheap, and frictionless to try or buy Jira. From the company's perspective, it believes the opportunity in front of it is enormous and freely admits to being in land-grab mode, noting that there will be time to optimize for price in the future. Along those lines, management defined the market as $35 billion in its registration statement—a figure it hasn't recently updated.

While Jira's low price, particularly on the Service Desk solution, is part of Atlassian's strategy, its solutions are not low end. Indeed, most industry observers would consider Atlassian a good option that should be considered for service desk and agile planning use cases. Our assessment is that Service Desk is a good product and continues to garner recognition and traction and that the software development tools are a popular option as well. While the company's sales and marketing expense line might be on the low end compared with peers, its research and development expense is at the high end of the spectrum among peers. Competitors on the software development tools side include Microsoft, Oracle, Amazon, Google, Broadcom, while competitors on the service desk side include ServiceNow, BMC, IBM, Micro Focus, and Ivanti.

**Fair Value and Profit Drivers** Dan Romanoff, CPA, Senior Equity Analyst, 1 Nov 2024
Our fair value estimate for Atlassian is $220 per share, which implies a fiscal 2025 enterprise value/sales multiple of 11 times and adjusted price/earnings multiple of 66 times.

Our forecast includes a defined shift to subscriptions from maintenance and perpetual license over the next three and half years. We assume there will be some near-term variability to results. Given Atlassian’s appeal to small teams at organizations of all sizes and the web-driven sales model for perpetual licenses and maintenance, our base assumption is that this is a long-tailed transition. We model a 20% CAGR over the next five years for total revenue, with subscriptions driving growth.

We model non-GAAP operating margins as approximately flat from 23% in fiscal 2024 (actual) through fiscal 2028. We see this as driven by some pressure in the near-term from the cloud transition offset by strong execution, and later driven by scale across all operating expenses, mainly research and development, as the transition matures. The company does not offer long-term operating targets. However, we anticipate that Atlassian should eventually have margins near the upper end of the peer group given the low-touch sales and marketing approach.

Atlassian estimates the market size in terms of potential users, including 800 million knowledge workers at the highest level, drilling down to 100 million technical team members, and 23 million software developers. Management believes the addressable market in total is $125 billion. Our research indicates a market size for IT operations management of $60 billion, plus the significant opportunity for service desk workflow use cases outside the IT function, so while Atlassian and ServiceNow (for example) do

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not serve the exact same market in the exact same manner, the long-term opportunities are similar.

**Risk and Uncertainty** Dan Romanoff, CPA, Senior Equity Analyst, 2 Aug 2024

We assign Atlassian a High Fair Value Uncertainty rating. The company generally trades at high multiples relative to peers. While it is expected to produce revenue growth at the high end of peers and the premium may be justified, higher absolute valuation levels offer less room for missteps and therefore carry greater inherent risks, in our opinion.

Atlassian caters to companies of all sizes, which means there is revenue concentration among the largest customers. On the flip side, smaller customers typically have higher churn. We think this could be exacerbated in Atlassian's case, as nearly all sales are monthly rather than annually, although this is changing as the company moves to a cloud model.

Atlassian has not reached profitability on a GAAP basis, and we are not contemplating positive GAAP operating profits in our model for several years.

Atlassian faces strong competition from Microsoft on the software planning side and from ServiceNow on the help desk and general workflow side. There are also other legacy providers in both markets. We believe the legacy providers are the most at risk for market share loss. Microsoft is strong generally in the planning tools market, and has seen a further uptick as Azure has caught fire over the last couple of years. Similarly, ServiceNow has been displacing service desk software providers for years now.

While the company's frictionless sales model is appealing, we think at some point the company will need a roster of sale representatives to deal with larger and more complex customer needs. With no sales presence, the company has no relationship to fall back on in the case of an unsatisfied customer.

While we do not see significant environmental, social, and governance risks, we note Atlassian faces strong competition for software engineers on the hiring front and also faces risks arising from a potential data breach within its data centers.

**Capital Allocation** Dan Romanoff, CPA, Senior Equity Analyst, 2 Aug 2024

We assign Atlassian a Standard Capital Allocation Rating. The rating reflects our assessments of a sound balance sheet, fair investments, and appropriate shareholder distributions. We think investments back into the business are most likely to be the key driver of total shareholder returns and are therefore appropriately prioritized over other capital returns such as dividends and buybacks.

As of June 2024, the balance sheet is sound with a net cash position, including $2.3 billion in cash and short-term investments, and approximately $1 billion in debt in the form of a term loan. Gross leverage is distorted given that the company is losing money on a GAAP basis. as a result of financial pressure arising from its model transition to cloud subscriptions. We view this pressure as transitory and thus

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expect the balance sheet to remain sound, as the company has typically maintained a conservative approach to leverage and generates more than enough free cash flow to fund growth and execute its acquisition strategy.

Atlassian does not pay a dividend, nor would we expect a company of this size or growth trajectory to do so. Further, the company has not repurchased stock, and we do not expect it to do so in the near term. Atlassian has been modestly acquisitive, with one or two tuck-in acquisitions annually. Our model contemplates $40 million-$50 million annually for technology feature-driven deals.

### Analyst Notes Archive

**Atlassian Earnings: Robust Results With a Growing AI Portfolio** Dan Romanoff, CPA, Senior Equity Analyst, 1 Nov 2024

Narrow-moat Atlassian delivered strong first-quarter results, exceeding our revenue and profitability expectations. We attribute the firm's upside to improvements in the macroeconomic environment, as well as the stabilization of small and medium customer spending. The company’s cloud segment continues to be a bright spot, and we believe the jump in the after-hours share price is related to management’s updated guidance of total revenue growth from 16% to now 16.75% at the midpoint along with a compelling artificial intelligence portfolio, serving as a revenue expansion opportunity. Given growing outperformance and better-than-anticipated guidance, we increased our estimates, primarily for profitability, and accordingly are raising our fair value estimate to $220 per share from $195 previously. Despite this increase, we see shares as fairly valued, given the spike on results.

Total revenue for the first quarter grew 21% year over year to $1.188 billion, surpassing the upper end of guidance at $1.157 billion. The outperformance was driven by strong subscription revenue growth of 33% year over year, reaching $1.132 billion. Diving deeper, data center revenue grew at a robust 38% year over year to $335 million, benefitting from server migrations, high renewal rates, and price increases that resulted in strong average revenue per user, underscoring the mission-critical nature of its products. Cloud revenue rose 31% year over year to $792 million, supported by favorable macro, effective sales execution, cross-selling of additional products, and a healthy traction of emerging products like Loom. We are encouraged to see a 17% year-on-year uptick in customers with more than $10,000 in cloud annual recurring revenue, representing a healthy stream of recurring revenue. However, management expects seasonality and a tough comp (from the prior year’s Loom acquisition as well as server end-of-service-related migrations) to weigh on results for the second half of the year.

**Atlassian Earnings: Solid Period Coupled With Disappointing Guidance** Dan Romanoff, CPA, Senior Equity Analyst, 2 Aug 2024

Narrow-moat Atlassian reported solid fourth-quarter results, including an upside to our top and bottom-line expectations. While guidance fell short of our model for both the first quarter and the full year for

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fiscal 2025, the sharp selloff in the aftermarket indicates investors were similarly disappointed. As a result of guidance, we lowered our estimates, particularly for revenue growth, over the next five years. Therefore, we are lowering our fair value estimate to $195 from $225. While we see an upside to the stock from here, we struggle to reconcile the meaningful slowdown in guidance for revenue growth throughout this year, coupled with the acceleration required to hit the firm's 2027 goal.

It is hard not to interpret the soft market Atlassian has seen for small companies as starting to bleed into larger customers, too. Fourth-quarter revenue increased 20% year over year to $1.132 billion, surpassing the midpoint of guidance at $1.128 billion. Subscription revenue grew 34% year over year to $1.069 billion, which was shy of our model by $2 million. Some deals were re-signed with lower-than-expected seat counts and closed later in the quarter, while data center migrations were lower than anticipated. Management noted that selling these larger deals is more complex, underscoring the ongoing struggles within software more broadly. Data center growth slowed to 41% year over year, hitting $327 million for the quarter, which was in line with guidance. Cloud revenue increased 31% year over year to $738 million, driven by migrations, seat expansion, and upsell, but came in just shy of guidance, which is not a problem per se, but given weak guidance, suggests possible deterioration.

We remain impressed with the firm's ability to steer profitability higher, all while investing in its cloud, enterprise, and artificial intelligence products. Non-GAAP operating margin was 19.6% in the quarter, compared with 21.6% in the year-ago period and guidance of 18.0%.

**Atlassian: Shares Attractive as Investor Day Highlights Growth Vectors and New Financial Targets**

Dan Romanoff, CPA, Senior Equity Analyst, 2 May 2024

We maintain our narrow moat rating for Atlassian after it hosted its 2024 investor day where it focused on its medium-term financial targets, growth vectors, and its research and development efforts. We make no changes to our model and thus maintain our fair value estimate of $225 per share. We appreciate the granular disclosures by management and think they support a positive story around the firm. We see shares as undervalued, especially in light of management's new financial targets.

While we think there was a wide variety of interesting topics, the most critical area from our point of view involved Atlassian's financial objectives over the next three years. We find it helpful amid a model transition for a bigger view of the road map and we're encouraged by what we heard. Management is targeting a compound annual growth rate of at least 20% over the next three years, culminating in more than $10 billion in annual revenue in less than five years. Additionally, the firm targets a non-GAAP operating margin over 25% by fiscal 2027. Our revenue assumptions generally align with these guideposts for three years, but our model does not hit $10 billion in sales until 2029, and the profitability marker is several hundred basis points higher than our estimates.

From a revenue standpoint, the firm plans to increase its focus on cross-selling and upselling into

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enterprise customers, driving seat expansion and upgrading pricing tiers, and continue to push data centers to cloud migrations. Along those lines, in the March quarter, net expansion rates were 120% for the cloud and 130% for the data center segment, two data points not normally provided. We are impressed that the data center business continues to grow so well even as the customer base is migrating to cloud versions. It is even more impressive given the firm continues to call out small customers who have been hit more by macroconditions and are not undertaking the same level of seat expansion they historically have.

**Atlassian Earnings: Strong Quarter Led by Booming Data Center Revenue Growth** Dan Romanoff, CPA, Senior Equity Analyst, 26 Apr 2024

Narrow-moat Atlassian reported strong third-quarter results, including upside to both our top- and bottom-line expectations. Management also provided good guidance for the fourth quarter. That said, we are maintaining our fair value estimate of $225 per share as we await fiscal-2025 guidance with next quarter's results. In our view, Atlassian is performing well against its migration road map, and we are further encouraged with positive demand trends amid an improving environment. We acknowledge demand issues from smaller customers, though. We are unconcerned about the 6% drop in share price after-hours given the firm's strong fundamentals and view the stock as attractive.

On the call, it was announced co-founder and co-CEO Scott Farquhar will be stepping down from his role at the end of August and will assume an advisory role on Atlassian's board. Mike Cannon-Brookes, longtime co-CEO, will continue to lead the company as sole CEO, so we expect a seamless transition.

We continue to see softness in the smaller customer market but expect an uptick in paid seat expansions as macro conditions improve. Enterprise demand has remained more resilient, which is consistent with the rest of our enterprise software coverage. Third-quarter revenue increased 30% year over year to $1.189 billion, surpassing the high end of guidance. Subscription revenue grew 41% year over year to $1.071 billion, exceeding our expectations. Data center revenue continued to soar, growing 64% year over year to $364 million, driven by migrations from Server, as well as expansion within existing customers. Cloud revenue increased 31% year over year to $703 million, driven by paid seat expansion from enterprise customers.

We are impressed with the firm's ability to expand its bottom line, all while investing in its cloud, enterprise, and artificial intelligence products. Non-generally accepted accounting principles operating margin was 26.6% in the quarter, compared with 22.7% in the year-ago period.

**Atlassian Earnings: Selloff After Strong Quarter Contrasts Our Belief in a Quality Growth Company** Dan Romanoff, CPA, Senior Equity Analyst, 2 Feb 2024

We are raising our fair value estimate to $225 per share, from $215 previously, for narrow-moat

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# Atlassian Corp A TEAM ★★★ 31 Dec 2024 22:48, UTC

| Last Price | Fair Value Estimate | Price/FVE | Market Cap | Economic Moat™ | Equity Style Box | Uncertainty | Capital Allocation | ESG Risk Rating Assessment[1] |
|---|---|---|---|---|---|---|---|---|
| 243.38 USD<br>31 Dec 2024 | 220.00 USD<br>1 Nov 2024 06:28, UTC | 1.11 | 63.38 USD Bil<br>31 Dec 2024 | Narrow | Large Growth | High | Standard | 4 Dec 2024 06:00, UTC |

Atlassian after it reported good results for its fiscal second quarter that surpassed our expectations. Additionally, it raised its full-year outlook for both cloud and data center revenue, as well as adjusted operating margin. We are unconcerned about an after-hours selloff, given the strong run shares have had over the last 13 months, but we now see the stock as fairly valued. We believe the firm is executing well on its migration objective, are encouraged by indicators of an improving macroeconomic environment, and we think the free-to-paid model has developed a large funnel to convert over the next several years.

We see demand trends as favorable based on commentary from Atlassian and progress on its transition to the cloud. Total revenue for the quarter grew 21% year over year, to $1.06 billion, compared with the high end of guidance of $1.03 billion. Subscription revenue grew 31% year over year to $932 million, exceeding our aggressive expectations. Data center revenue continued to grow at a rampant pace to the tune of 41% growth year over year to $275 million as 60% of migrations in the quarter came from data center customers. Paid seat expansion improved at enterprise customers based on strong execution from the salesforce, while smaller customers remain more subdued, which is consistent with recent results.

Profitability remains strong, with non-GAAP operating margin coming in at 23.6%, growing 360 basis points year over year. Management expects operating expense growth rates to increase in the second half of the fiscal year due to heightened product investments such as cloud, enterprise, and artificial intelligence. Also affecting operating expense growth is that during the second half of the year, the firm will lap last year's benefit from restructuring and lower bonus expenses. We are not convinced investments will fully materialize at an accelerated pace.

**Atlassian Earnings: Selloff After Solid Quarter Offers a Buying Opportunity** Dan Romanoff, CPA, Senior Equity Analyst, 3 Nov 2023

We are maintaining our fair value estimate of $215 per share for narrow-moat Atlassian after the company reported good results for its fiscal first quarter coupled with solid guidance for the second quarter. With shares selling off after hours we see a buying opportunity. Our model changes are minor and we struggle to uncover a supportable rationale for the selloff. Demand trends remain healthy overall and are showing signs of improvement as the company reported better-than-expected revenue and much-better-than-expected profitability. Guidance calls for solid revenue growth and good operating margins. Overall, results support our long-term thesis on a quality growth company.

Total revenue for the quarter grew 21% year over year, to $978 million, compared with the high end of guidance of $970 million. Subscription revenue grew 31% year over year to $852 million, which was in line with our aggressive assumptions. Management said the company continues to gain traction in premium and enterprise accounts. Cloud migrations are on track, per management, but there is a good size pool of customers who still have not migrated, and may not migrate by the end of support deadline

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in February 2024.

Customer additions have been volatile over the last year even as deal sizes are picking up. Atlassian added several thousand new customers in the quarter overall, and 1,377 customers in the cloud that generate $10,000 or more of annually recurring revenue, or ARR. Top of funnel demand remains positive, so overall demand is not problematic, in our opinion, even as conversions of free users remains depressed against historical norms.

Profitability remains a bright spot for Atlassian, as it has for much of our coverage, which supports our long-term profitability assumptions. Non-GAAP operating margin came in at 23.0%, compared with 18.3% a year ago and guidance of 19.5%. Spending discipline, better revenue, and benefits from lower headcount drove margin strength.

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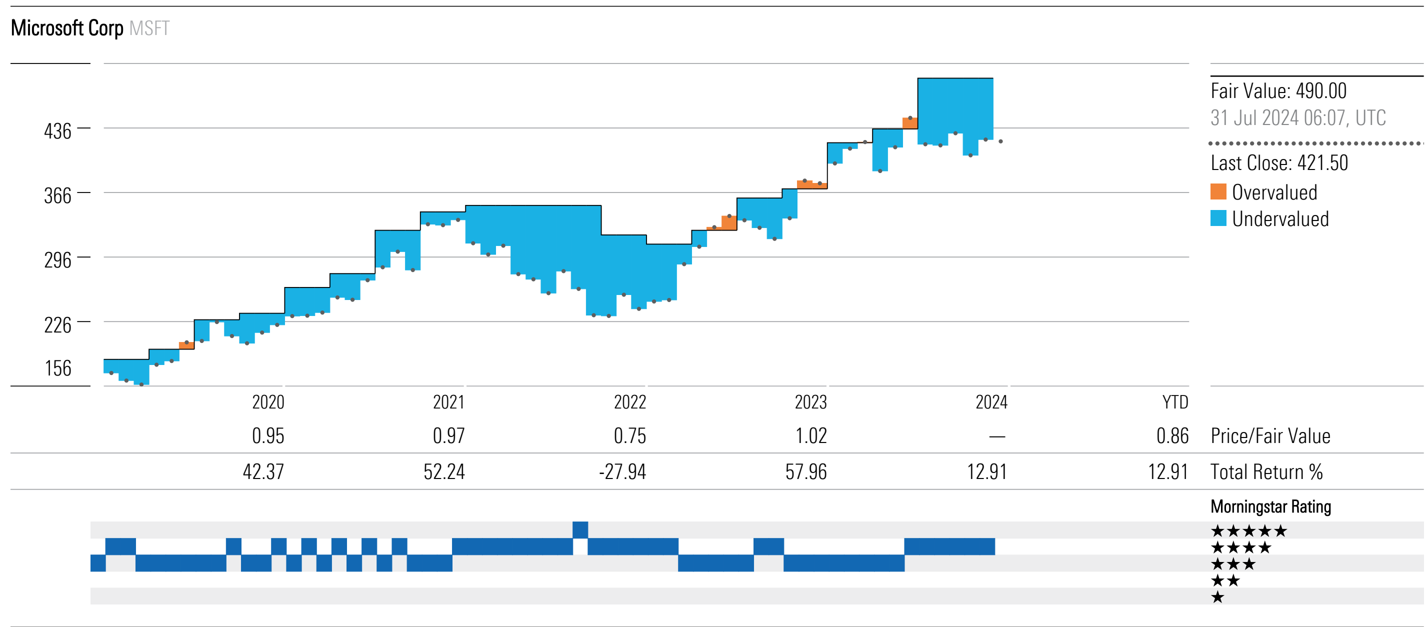
# Atlassian Corp A TEAM ★★★ 31 Dec 2024 22:48, UTC

## Competitors Price vs. Fair Value

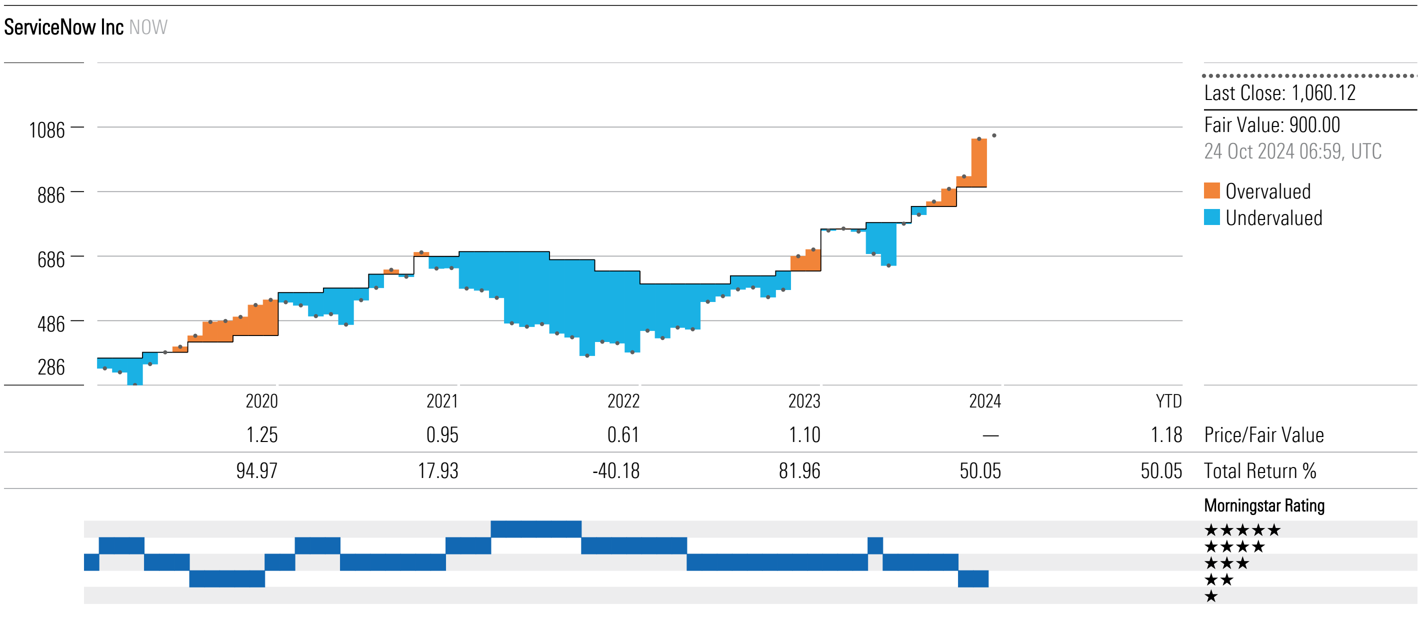
### Microsoft Corp MSFT




| | 2020 | 2021 | 2022 | 2023 | 2024 | YTD |
|---|---|---|---|---|---|---|
| Price/Fair Value | 0.95 | 0.97 | 0.75 | 1.02 | — | 0.86 |
| Total Return % | 42.37 | 52.24 | -27.94 | 57.96 | 12.91 | 12.91 |

Total Return % as of 31 Dec 2024. Last Close as of 31 Dec 2024. Fair Value as of 31 Jul 2024 06:07, UTC.

### ServiceNow Inc NOW




| | 2020 | 2021 | 2022 | 2023 | 2024 | YTD |
|---|---|---|---|---|---|---|
| Price/Fair Value | 1.25 | 0.95 | 0.61 | 1.10 | — | 1.18 |
| Total Return % | 94.97 | 17.93 | -40.18 | 81.96 | 50.05 | 50.05 |

Total Return % as of 31 Dec 2024. Last Close as of 31 Dec 2024. Fair Value as of 24 Oct 2024 06:59, UTC.

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# Atlassian Corp A TEAM ★★★ 31 Dec 2024 22:48, UTC

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|---|---|---|---|---|---|---|---|---|
| 243.38 USD<br>31 Dec 2024 | 220.00 USD<br>1 Nov 2024 06:28, UTC | 1.11 | 63.38 USD Bil<br>31 Dec 2024 | Narrow | Large Growth | High | Standard | 4 Dec 2024 06:00, UTC |

## Morningstar Historical Summary

**Financials** as of 30 Sep 2024

| **Fiscal Year,** ends 30 Jun | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | YTD | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenue (USD Mil) | 320 | 457 | 627 | 881 | 1,210 | 1,614 | 2,089 | 2,803 | 3,535 | 4,359 | 1,188 | 4,569 |
| Revenue Growth % | 48.5 | 43.0 | 37.1 | 40.6 | 37.4 | 33.4 | 29.4 | 34.2 | 26.1 | 23.3 | 21.5 | 23.3 |
| EBITDA (USD Mil) | 14.84 | 17.09 | 9.22 | 28.11 | -495.07 | -199.20 | -365.88 | -377.73 | -220.07 | 27.41 | -0.02 | 14.28 |
| EBITDA Margin % | 4.6 | 3.7 | 1.5 | 3.2 | -40.9 | -12.3 | -17.5 | -13.5 | -6.2 | 0.6 | 0.0 | 0.3 |
| Operating Income (USD Mil) | 1.71 | -5.88 | -55.83 | -46.05 | -63.36 | 14.09 | 141.41 | 70.08 | -345.22 | -117.08 | -31.98 | -130.19 |
| Operating Margin % | 0.5 | -1.3 | -8.9 | -5.2 | -5.2 | 0.9 | 6.8 | 2.5 | -9.8 | -2.7 | -2.7 | -2.9 |
| Net Income (USD Mil) | 6.78 | 4.37 | -37.45 | -113.43 | -637.62 | -350.65 | -578.98 | -519.51 | -486.76 | -300.52 | -123.77 | -392.41 |
| Net Margin % | 2.1 | 1.0 | -6.0 | -12.9 | -52.7 | -21.7 | -27.7 | -18.5 | -13.8 | -6.9 | -10.4 | -8.6 |
| Diluted Shares Outstanding (Mil) | 209 | 193 | 222 | 231 | 239 | 245 | 250 | 253 | 256 | 259 | 260 | 260 |
| Diluted Earnings Per Share (USD) | 0.03 | 0.02 | -0.17 | -0.49 | -2.67 | -1.43 | -2.32 | -2.05 | -1.90 | -1.16 | -0.48 | -1.52 |
| Dividends Per Share (USD) | — | — | — | — | — | — | — | — | — | — | — | — |

**Valuation** as of 31 Dec 2024

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Recent Qtr | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Price/Sales | 17.8 | 10.8 | 15.1 | 21.9 | 22.3 | 33.7 | 42.6 | 10.9 | 16.5 | 13.8 | 13.8 | 13.8 |
| Price/Earnings | 769.2 | -1,666.7 | -188.7 | -59.2 | -88.5 | -129.9 | -88.5 | -153.8 | -120.5 | -161.3 | -161.3 | -161.3 |
| Price/Cash Flow | 61.0 | 36.9 | 43.3 | 62.5 | 63.7 | 100.0 | 113.6 | 35.8 | 64.9 | 46.5 | 46.5 | 46.5 |
| Dividend Yield % | — | — | — | — | — | — | — | — | — | — | — | — |
| Price/Book | 29.9 | 6.9 | 11.4 | 29.9 | 42.6 | 84.7 | -3,333.3 | 68.5 | 79.4 | 61.7 | 61.7 | 61.7 |
| EV/EBITDA | 415.7 | 266.1 | 0.0 | 723.8 | -58.4 | -288.4 | -263.2 | -86.5 | -274.5 | 0.0 | -3.4 | 0.0 |

**Operating Performance / Profitability** as of 30 Sep 2024

| **Fiscal Year,** ends 30 Jun | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | YTD | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ROA % | 2.1 | 0.6 | -3.3 | -6.1 | -23.6 | -10.2 | -16.9 | -16.6 | -13.1 | -6.5 | -2.4 | -8.6 |
| ROE % | 4.4 | 1.0 | -4.6 | -12.6 | -86.6 | -61.5 | -133 | -167 | -99.1 | -35.6 | -12.0 | -43.5 |
| ROIC % | 4.3 | 0.7 | -5.0 | -6.7 | -40.2 | -21.3 | -39.3 | -38.4 | -28.1 | -16.6 | -6.2 | -20.6 |
| Asset Turnover | 1.0 | 0.7 | 0.6 | 0.5 | 0.4 | 0.5 | 0.6 | 0.9 | 1.0 | 0.9 | 0.2 | 1.0 |

**Financial Leverage**

| **Fiscal Year,** ends 30 Jun | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Recent Qtr | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Debt/Capital % | — | — | — | 47.5 | — | 28.5 | 42.1 | 79.6 | 64.7 | 53.8 | 53.8 | — |
| Equity/Assets % | 47.2 | 73.8 | 69.6 | 37.5 | 19.0 | 14.8 | 10.0 | 9.8 | 15.9 | 19.8 | 20.6 | — |
| Total Debt/EBITDA | 0.0 | 0.0 | 0.1 | 29.2 | -1.7 | -5.8 | -1.7 | -3.5 | -5.8 | 45.6 | -65,525.9 | — |
| EBITDA/Interest Expense | 201.5 | 240.3 | 122.8 | 4.1 | -12.3 | -4.0 | -4.0 | -9.1 | -7.3 | 0.8 | 0.0 | 0.4 |

## Morningstar Analyst Historical/Forecast Summary as of 31 Oct 2024

**Financials**

| **Fiscal Year,** ends 30 Jun 2024 | 2023 | 2024 | Estimates 2025 | 2026 | 2027 |
|---|---|---|---|---|---|
| Revenue (USD Mil) | 3,535 | 4,359 | 5,101 | 6,089 | 7,219 |
| Revenue Growth % | 26.1 | 23.3 | 17.0 | 19.4 | 18.6 |
| EBITDA (USD Mil) | -270 | -69 | -185 | -43 | 121 |
| EBITDA Margin % | -7.6 | -1.6 | -3.6 | -0.7 | 1.7 |
| Operating Income (USD Mil) | -345 | -117 | -253 | -116 | 18 |
| Operating Margin % | -9.8 | -2.7 | -5.0 | -1.9 | 0.3 |
| Net Income (USD Mil) | 492 | 760 | 869 | 1,083 | 1,223 |
| Net Margin % | 13.9 | 17.4 | 17.0 | 17.8 | 16.9 |
| Diluted Shares Outstanding (Mil) | 256 | 259 | 261 | 261 | 261 |
| Diluted Earnings Per Share(USD) | 1.92 | 2.93 | 3.33 | 4.15 | 4.69 |
| Dividends Per Share(USD) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

**Forward Valuation**

| | 2023 | 2024 | Estimates 2025 | 2026 | 2027 |
|---|---|---|---|---|---|
| Price/Sales | 12.2 | 10.6 | 12.4 | 10.4 | 8.8 |
| Price/Earnings | 87.4 | 60.4 | 73.1 | 58.6 | 51.9 |
| Price/Cash Flow | — | — | — | — | — |
| Dividend Yield % | — | — | — | — | — |
| Price/Book | 65.8 | 44.3 | 93.6 | 116.4 | 115.9 |
| EV/EBITDA | -157.6 | -652.3 | -337.2 | -1,464.4 | 514.6 |

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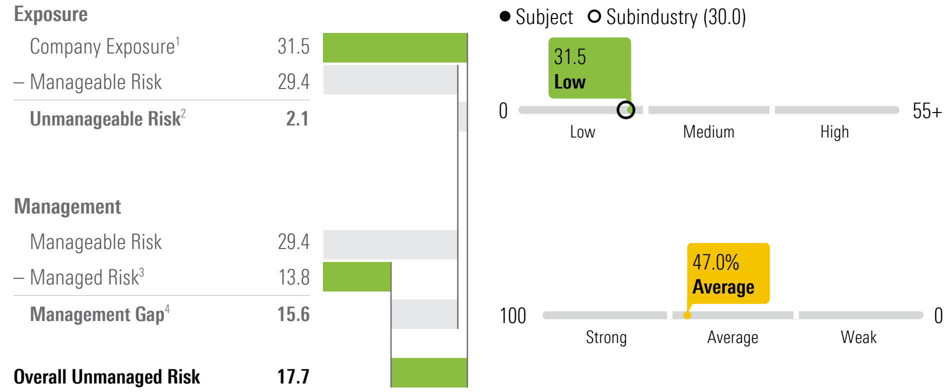
## ESG Risk Rating Breakdown




- 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

17.68
**Low**

**Negligible** | **Low** | **Medium** | **High** | **Severe**

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 47.0% 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 Dec 04, 2024. Highest Controversy Level is as of Dec 08, 2024. Sustainalytics Subindustry: Enterprise and Infrastructure Software. 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 04 Dec 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 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Atlassian Corp** | 31.5 \| Low | 0 | | 55+ | 47.0 \| Average | 100 | | 0 | 17.7 \| Low | 0 | | 40+ |
| Microsoft Corp | 33.8 \| Low | 0 | | 55+ | 62.2 \| Strong | 100 | | 0 | 14.2 \| Low | 0 | | 40+ |
| Salesforce Inc | 33.6 \| Low | 0 | | 55+ | 58.9 \| Strong | 100 | | 0 | 15.2 \| Low | 0 | | 40+ |
| ServiceNow Inc | 35.1 \| Medium | 0 | | 55+ | 57.7 \| Strong | 100 | | 0 | 16.3 \| Low | 0 | | 40+ |
| Informatica Inc | 32.1 \| Low | 0 | | 55+ | 48.7 \| Average | 100 | | 0 | 17.5 \| Low | 0 | | 40+ |

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# Appendix
## Historical Morningstar Rating

**Atlassian Corp A** TEAM 31 Dec 2024 22:48, UTC

| Dec 2025 | Nov 2025 | Oct 2025 | Sep 2025 | Aug 2025 | Jul 2025 | Jun 2025 | May 2025 | Apr 2025 | Mar 2025 | Feb 2025 | Jan 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| — | — | — | — | — | — | — | — | — | — | — | — |
| 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 |
| ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ |

**Microsoft Corp** MSFT 31 Dec 2024 22:32, UTC

| Dec 2025 | Nov 2025 | Oct 2025 | Sep 2025 | Aug 2025 | Jul 2025 | Jun 2025 | May 2025 | Apr 2025 | Mar 2025 | Feb 2025 | Jan 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| — | — | — | — | — | — | — | — | — | — | — | — |
| 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 |
| ★★★ | ★★★ | ★★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★ | ★★★★ | ★★★★ | ★★★ |

**ServiceNow Inc** NOW 31 Dec 2024 22:47, UTC

| Dec 2025 | Nov 2025 | Oct 2025 | Sep 2025 | Aug 2025 | Jul 2025 | Jun 2025 | May 2025 | Apr 2025 | Mar 2025 | Feb 2025 | Jan 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| — | — | — | — | — | — | — | — | — | — | — | — |
| 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 |
| ★★ | ★★ | ★★ | ★★ | ★★ | ★★★ | ★★★ | ★★★ | ★★★★ | ★★★★ | ★★★★ | ★★★ |

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# Research Methodology for Valuing Companies

**Overview**

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our singlepoint star rating.

**1. Economic Moat**

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

**2. Estimated Fair Value**

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

**Stage I: Explicit Forecast**

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

**Stage II: Fade**

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

**Stage III: Perpetuity**

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

**3. Uncertainty Around That Fair Value Estimate**

Morningstar's Uncertainty Rating is designed to capture the range of potential outcomes for a company's intrinsic value. This rating is used to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating is aimed at identifying the confidence we should have in assigning a fair value estimate for a given stock.

Our Uncertainty Rating is meant to take into account anything that can increase the potential dispersion of future outcomes for the intrinsic value of a company, and any-

**Morningstar Equity Research Star Rating Methodology**

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# Research Methodology for Valuing Companies

thing that can affect our ability to accurately predict these outcomes. The rating begins with a suggested rating produced by a quantitative process based on the trailing 12-month standard deviation of daily stock returns. An analyst overlay is then applied, with analysts using the suggested rating, historical rating data, and their own knowledge of the company to inform them as they make the final Uncertainty Rating decision. Ultimately, the rating decision rests with the analyst. Analysts take into account many characteristics when making their final decision, including cyclical factors, operational and financial factors such as leverage, company-specific events, ESG risks, and anything else that might increase the potential dispersion of future outcomes and our ability to estimate those outcomes.

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

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

| 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.

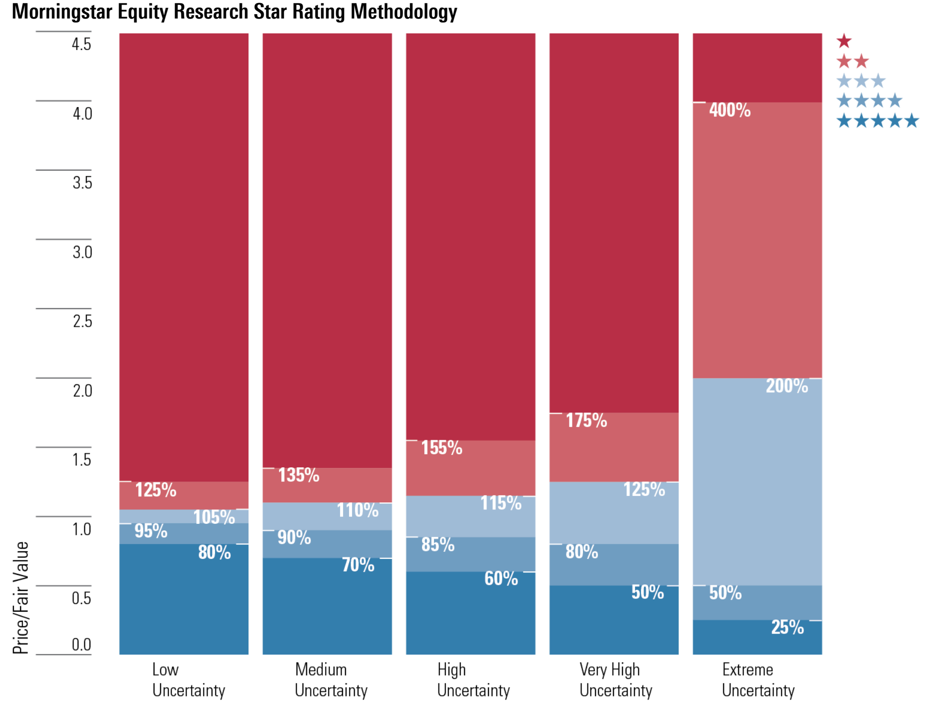
### 4. Market Price

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.

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.

**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.

**Risk Warning**

Please note that investments in securities are subject to market and other risks and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost. A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's Uncertainty Rating serves as a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

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