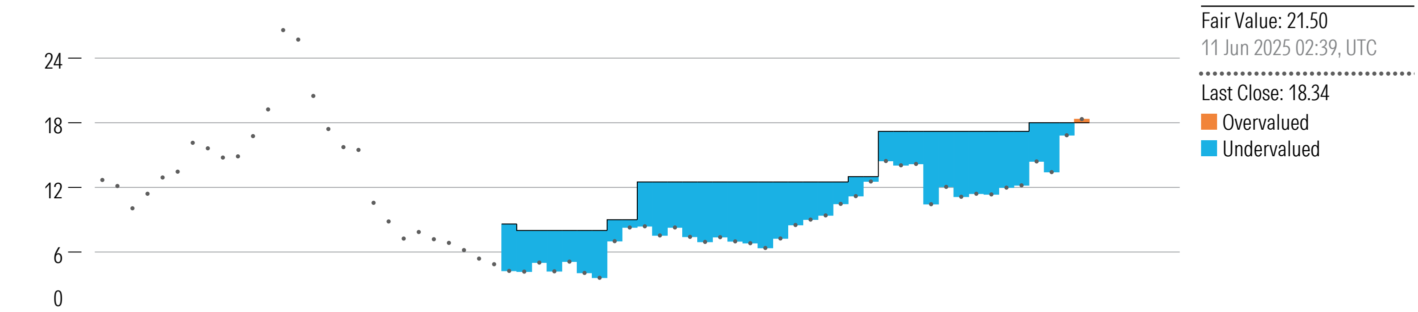
Morningstar Equity Analyst Report | Report as of 11 Jun 2025 02:46, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 1 of 23

Tencent Music Entertainment Group ADR TME ★★★ 11 Jun 2025 02:42, UTC

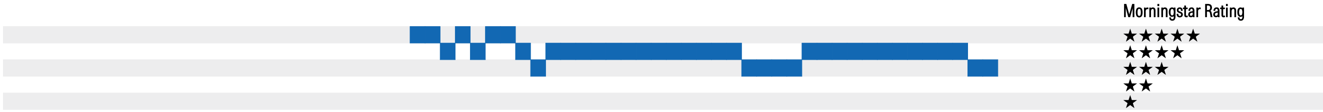
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
18.34 USD 10 Jun 2025	21.50 USD 11 Jun 2025 02:39, UTC	0.85	28.26 USD Bil 10 Jun 2025	Narrow	Large Blend	High	Standard	7 May 2025 05:00, UTC

Price vs. Fair Value



	2020	2021	2022	2023	2024	YTD
Price/Fair Value	—	—	0.92	0.72	0.66	0.85
Total Return %	63.88	-64.40	20.88	8.82	27.49	63.17

Morningstar Rating



Total Return % as of 10 Jun 2025. Last Close as of 10 Jun 2025. Fair Value as of 11 Jun 2025 02:39, UTC.

Contents

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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.

Tencent Music: Ximalaya Deal Accelerates Podcast Expansion; Lifting Valuation by 19% to USD 21.50

Analyst Note Ivan Su, Senior Equity Analyst, 11 Jun 2025

Tencent Music has announced plans to acquire Ximalaya, China's largest online audio and podcast platform, which holds a 25% market share. The transaction, to be funded through cash and equity, values Ximalaya at around USD 2.7 billion, or 3.1 times 2023 revenue.

Why it matters: Strategically, this deal meaningfully expands Tencent Music's presence beyond music streaming into the rapidly growing podcast segment. We view the transaction as value-accretive.

- Ximalaya generated revenue of CNY 6.2 billion (USD 870 million) in 2023, roughly 20% of Tencent Music's. Its operating margin was just above breakeven (around 1.5%), which is typical for businesses at this stage of scale and maturity.
- We anticipate significant cost synergies after the acquisition, primarily driven by reduced operating expenses. Ximalaya can leverage Tencent Music's research and development capabilities to boost efficiency and tap its 550 million user network to substantially lower customer acquisition costs.

The bottom line: We raise narrow-moat Tencent Music's fair value estimate by 19% to USD 21.50 (HKD 84) following the incorporation of the Ximalaya acquisition, assuming the transaction closes by year-end 2025. Shares of Tencent Music are undervalued currently.

- We forecast Ximalaya's revenue grows at an 11% CAGR during 2025-29. While notably above its 2% growth in 2023, it is achievable given Tencent Music's ability to distribute podcasts across its listener

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Sector
Communication Services

Industry
Internet Content & Information

Business Description

Tencent Music is the largest online music streaming platform in China, established in 2016 through the merger of QQ Music, Kuwo Music, and Kugou Music. Tencent, its largest shareholder, holds over 50% of the shares and more than 90% of the voting rights. Beyond streaming services, Tencent Music generates revenue through a diverse range of offerings, including podcasts, livestreaming, concerts, and karaoke.

base and potentially through parent Tencent's broader 1.3 billion user network.

- We expect Ximalaya's operating margin to improve from 1.5% in 2023 to 34% by 2029, driven mainly by a reduction in selling, general, and administrative expenses to 26% of revenue from 56%. Our midcycle margin assumption for Ximalaya is consistent with our outlook for Tencent Music.

Big picture: Tencent Music's 123 million subscribers surpass Ximalaya's 15 million by over eightfold. Even modest cross-selling could drive substantial podcast revenue growth.

Business Strategy & Outlook Ivan Su, Senior Equity Analyst, 5 May 2025

The music streaming industry in China is still in its early stages of development, and Tencent Music has established itself as the largest player in the market, with around 600 million monthly active users. While it is often compared with Spotify, Tencent Music enjoys a more favorable competitive position in China due to its unique integration within the broader Tencent ecosystem, the absence of YouTube as a competitor, a wider range of service offerings, and a stronger focus on in-house content development.

Tencent Music's subscriber/user ratio, currently at 20% versus Spotify's 40%, presents a significant revenue opportunity. By gradually placing more content behind paywalls, the company can convert free users into paying subscribers. Music subscription prices in China remain lower than global norms due to a history of rampant piracy, which reduces consumers' willingness to pay. However, with piracy largely addressed and a duopolistic market structure in place, subscription price should rise over time, providing another driver for growth.

Unlike typical streaming platforms with gross margins of about 30%, Tencent Music's gross margin is significantly higher, at 45%. This stems from a large portion of its content being produced in-house. Additionally, the fragmented structure of China's music licensing market—where only 20% is dominated by top labels—gives streaming platforms like Tencent Music stronger bargaining power in negotiations with content owners, further supporting its profitability.

China's antitrust laws in 2021 ended Tencent Music's exclusive music copyright agreements, allowing competitors like Cloud Music to access previously unavailable content. While competitors are gradually narrowing the content gap, Tencent Music's access to listening data from 600 million users and its ability to deliver highly personalized content play a critical role in reducing user churn. Over time, Tencent Music's lead in content may diminish, but the competition is unlikely to devolve into a race to the bottom.

Bulls Say Ivan Su, Senior Equity Analyst, 11 Jun 2025

- Compared with Spotify, Tencent Music has significant potential for subscriber growth, driven by its strategy of moving more music content behind a paywall.

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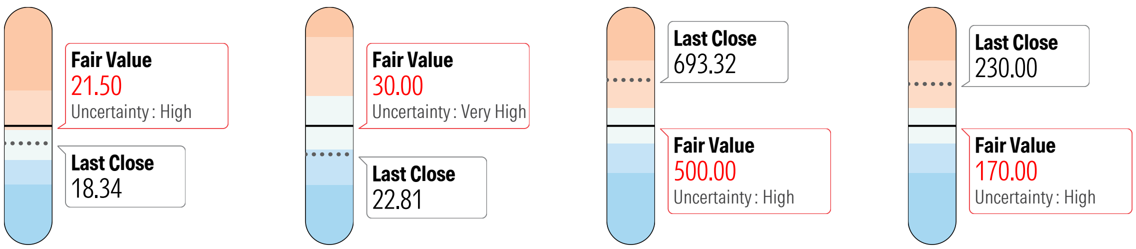
Competitors



	Tencent Music ...ment Group ADR TME	Sirius XM Holdings Inc SIRI	Spotify Technology SA SPOT	NetEase Cloud Music Inc 09899
Economic Moat	Narrow	None	Narrow	None
Currency	USD	USD	USD	HKD
Fair Value	21.50 11 Jun 2025 02:39, UTC	30.00 17 Oct 2024 14:39, UTC	500.00 29 Apr 2025 18:41, UTC	170.00 24 Feb 2025 09:07, UTC
1-Star Price	33.33	52.50	775.00	263.50
5-Star Price	12.90	15.00	300.00	102.00
Assessment	Fairly Valued 10 Jun 2025	Undervalued 10 Jun 2025	Overvalued 10 Jun 2025	Overvalued 10 Jun 2025
Morningstar Rating	★★★11 Jun 2025 02:42, UTC	★★★★10 Jun 2025 21:38, UTC	★★10 Jun 2025 22:03, UTC	★★10 Jun 2025 16:54, UTC
Analyst	Ivan Su, Senior Equity Analyst	Matthew Dolgin, Senior Equity Analyst	Matthew Dolgin, Senior Equity Analyst	Ivan Su, Senior Equity Analyst
Capital Allocation	Standard	Standard	Exemplary	Standard
Price/Fair Value	0.85	0.76	1.39	1.35
Price/Sales	6.97	0.87	8.53	5.34
Price/Book	2.72	0.66	21.60	4.37
Price/Earning	25.69	20.34	95.29	25.03
Dividend Yield	1.00%	4.89%	0.00%	0.00%
Market Cap	28.26 Bil	7.71 Bil	142.17 Bil	48.19 Bil
52-Week Range	9.41—19.40	18.69—41.60	288.07—717.87	87.85—231.40
Investment Style	Large Blend	Small Value	Large Growth	Large Blend

- Tencent Music leverages Tencent's extensive user network of over a billion people, enabling it to retain users more effectively while attracting new ones.
- Investing in independent artists and long-form audio could help Tencent Music better control content costs in the long run.

Bears Say Ivan Su, Senior Equity Analyst, 11 Jun 2025

- Tencent Music relies heavily on record labels, with no proprietary differentiation in its content.
- User engagement on Tencent Music's apps could decline, due to the growing popularity of short-form video platforms like Douyin.

- Existing livestreamers on Tencent Music's platforms are at risk of being poached by competitors offering lower take rates and more attractive sign-on bonuses.

Economic Moat Ivan Su, Senior Equity Analyst, 5 May 2025

We assign Tencent Music a narrow moat rating. The company is the biggest music streaming platform in China by far, and we have confidence that the company will generate excess returns on capital over the next 10 years, as it continues to benefit from intangible assets in the form of its Tencent-affiliation and possession of user data that helps curate recommendations, as well as network effect.

Tencent Music benefits from intangible assets in the form of its extensive user listening data, a result of its position as the largest streaming platform in China, with three times as many users as its closest competitor. This extensive data fuels its powerful recommendation algorithms, enabling the platform to deliver highly personalized playlists that closely align with individual listening preferences. As more users engage with and listen to music, the algorithms continuously improve, creating a self-reinforcing cycle where the platform becomes smarter and more tailored with every interaction. This not only helps Tencent Music to retain its existing users, but also attracts new subscribers to its paid services.

The effectiveness of Tencent Music's recommendation system is reflected in the growing share of recommendation-driven streams, which now account for 40% of all streams. By providing highly relevant and easy-to-discover content, the platform saves users time and effort, making them more reliant on its personalized offerings. This personalization creates a "data lock-in" effect, as the convenience and satisfaction users gain from tailored recommendations far outweigh the potential cost savings of switching to a cheaper alternative.

Another intangible asset enjoyed by Tencent Music is its role as a subsidiary of Tencent, enabling it to leverage the network effects of China's largest digital ecosystem with 1.3 billion users. Through its integration with WeChat, Tencent Music provides a seamless experience for music sharing. Unlike competing apps that redirect users out of WeChat to listen to shared tracks, Tencent Music allows users to play tracks directly within the WeChat app, offering a frictionless user experience. This ease of access, combined with other integrated features, strengthens user loyalty and positions the platform to increase subscription fees over time. Additionally, the rise of WeChat Video Accounts—a short video feature within WeChat—further amplifies Tencent Music's reach by allowing viewers to identify songs playing in videos and directly linking them to Tencent Music. This serves as a low-cost yet effective promotional tool, attracting new users and solidifying Tencent Music's position as the leading music streaming platform in China.

Tencent Music's network effects are particularly evident in its social entertainment segment, where it creates an attractive marketplace for both viewers and livestreamers. Livestreamers are drawn to

Tencent Music's platform by the opportunity to gain more fans and generate revenue through virtual gifts and sponsored advertising. As more streamers come to Tencent Music, more viewers are attracted to watch and interact with their favorite livestreamers, creating a virtuous cycle. On the music streaming side, Tencent Music's network effect is centered around its expansive content library, which is the largest in China, boasting over 260 million music and audio tracks. With around 70% market share and over 600 million monthly active users, Tencent Music has established itself as the go-to app for music, attracting both listeners and content producers. Listeners represent the demand side of this network, while content producers—such as artists, livestreamers, and labels—represent the supply side. As more listeners consume content, the platform becomes increasingly attractive to content producers, who in turn add more offerings to Tencent Music, further enriching its library and benefiting listeners with a wider array of content.

Fair Value and Profit Drivers Ivan Su, Senior Equity Analyst, 11 Jun 2025

Following Tencent Music's announced acquisition of Ximalaya, we raise our fair value estimate to USD 21.50 per share.

We now forecast Tencent Music will deliver a five-year revenue CAGR of 19%, alongside a net profit CAGR of 26%. Our updated assumptions incorporate steady margin expansion driven primarily by a favorable shift in revenue mix toward higher-margin, in-house content, as well as meaningful operating leverage. We discount future free cash flows using a weighted average cost of capital of 9.4%.

We continue to view subscription revenue from the company's music streaming segment as its central growth engine. We expect substantial subscriber growth, fueled by increased exclusive content placed behind paywalls. By 2029, we forecast that subscribers will represent 28% of monthly active users, equating to an average annual net addition of approximately 9 million subscribers. Additionally, we forecast the average revenue per paying user increasing from CNY 10.80 in 2024 to CNY 16.00 by 2029, reflecting a CAGR of 8%.

In contrast, after years of revenue decline, Tencent Music's social entertainment services segment now contributes roughly 20% of the company's total revenue. We anticipate this segment to stabilize at around CNY 55 billion in annual revenue, as declines in livestreaming revenue are offset by the introduction of new features.

On the profitability side, we have conviction that Tencent Music will enjoy better margins in the years to come. While a typical streaming-only platform might see a gross margin of around 30%, the company's strategy of producing content in-house—as a record label would—significantly boosts its margin capabilities. We estimate that Tencent Music achieves a 75% gross margin on its in-house content. We expect increased traction for the company's in-house content as it utilizes its extensive streaming data to analyze user preferences. This drives our forecast for 51% gross margin by 2029, up from 42% in

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2024. Coupled with operating leverage on selling, general, and administrative expenses, our model calls for an earnings CAGR of 26% over the next five years.

Lastly, Tencent Music's investments in Spotify and Warner Music Group contribute around 8% of our fair value estimate.

Risk and Uncertainty Ivan Su, Senior Equity Analyst, 5 May 2025

Our Morningstar Uncertainty Rating for Tencent Music is High.

The biggest risk lies in Tencent Music's dependency on record labels, as the company's service lacks proprietary differentiation. Over the long term, record labels may find ways to claim a larger share of the industry's profits, potentially squeezing Tencent Music's margins. Competition is another potential concern, with Cloud Music emerging as a strong competitor, particularly among younger Chinese audiences who prefer its community-driven experience. If future generations increasingly value this sense of community, Tencent Music could cede streaming market share.

While unlikely, catastrophic risks, such as the emergence of disruptive technologies, could fundamentally change how music is consumed. Although no clear alternative to streaming has emerged, the history of music consumption—from physical products to downloads to streaming—indicates that disruption remains a possibility.

Like many other listed Chinese internet firms, Tencent Music has adopted the variable interest entity, or VIE, structure, which is specifically designed to let firms bypass Chinese legal restrictions on foreign ownership in certain sectors. Tencent Music's investors essentially hold shares of the firm's VIEs domiciled in the Cayman Islands. We don't expect repudiation of VIEs by the Chinese government, but if VIEs are found to violate laws or regulations, Chinese regulatory authorities might take action against the VIEs—including revoking the operating licenses of Tencent Music's subsidiaries, or discontinuing, restricting, or restructuring their operations.

Finally, environmental, social, and governance, or ESG, risks include data privacy concerns and regulatory uncertainty. The 2021 enactment of China's Personal Information Protection Law imposes stricter limits on data usage, which could undermine the effectiveness of its targeted advertising. This may lead to lower ad prices, reduced inventory, and a negative impact on revenue.

Capital Allocation Ivan Su, Senior Equity Analyst, 15 May 2025

Our Morningstar Capital Allocation Rating for Tencent Music is Standard. Our rating reflects Tencent Music's sound balance sheet, fair investment track record, and appropriate shareholder distribution.

Investments into content and R&D have been key to its strategy, but we expect future returns on investments to be lower than historical ones now that the government has put an end to its exclusive licensing deals. The firm has also made investments in long-form audio (podcasts and audiobooks), but the low visibility on whether these investments will pay off will increase business and financial risks.

The company's balance sheet remains sound, with a net cash position and only modest levels of debt. Tencent Music has generated positive free cash flow (cash from operations minus capital expenditures) since its IPO in 2018, and we expect it to do so for the foreseeable future. Given the business' strong balance sheet position, we believe that Tencent Music can finance future investments acquisitions mainly through self-retained cash, aided by a moderate level of debt for large deals.

Tencent Music has made a series of investments in the past, including the acquisition of Lazy Audio for CNY 2.7 billion in 2021. Also, it expanded its global presence through acquiring a Japanese online karaoke platform in early 2022, and plans to invest in more firms with synergies to its core businesses. Given its strong financial position, we expect the firm to make more acquisitions and strategic investments, with the goal of providing more content to listeners.

We think Tencent Music's track record of shareholder distribution is appropriate. The company initiated a share repurchase program in 2020 and has consistently maintained these buybacks in subsequent years. To date, Tencent Music has repurchased over USD 500 million worth of shares at an average price of USD 11 per share. Considering that this average repurchase price falls below our fair value estimate, we view these buybacks as accretive to the company's overall valuation. Additionally, the company announced its inaugural dividend in 2024 and set the annual payout ratio at 30%, further demonstrating its commitment to returning value to shareholders.

Analyst Notes Archive

Tencent Music Earnings: Hitting the Right Notes With Strong Results and a Deeper Economic Moat

Ivan Su,Senior Equity Analyst,19 Mar 2025

Tencent Music reported strong fourth-quarter earnings, with revenue up 8% and operating profit surging 51%. Management's 2025 guidance points to accelerated growth and further margin expansion, along with plans to boost capital returns through renewed share buybacks.Why it matters: We've long argued that the market's concerns about Tencent Music's ability to grow were unjustified. The latest earnings and strong guidance serve as a testament to the music streaming platform's economic moat, which enables it to lock in listeners while implementing price increases. As revenue continues to grow, margin expansion should follow. The firm now expects to reach its medium-term gross margin target of 45% by 2025—well ahead of its previous expectation. This progress is fueled by better content cost leverage and a rising share of low-cost in-house content. The latest announcement of a new share repurchase program of up to USD 1 billion over the next two years marks a significant increase in shareholder returns, amounting to around 75% of net profit expected to be distributed to shareholders in 2025. The bottom line: We raise our fair value estimate for narrow-moat Tencent Music by 5% to USD 18. While our long-term revenue assumptions are largely unchanged, we nudge up our profitability

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assumptions, resulting in a 5% average increase in earnings forecasts over the next five years. We continue to view Tencent Music as undervalued, currently trading at a 20% discount to our fair value estimate and at a 21 times 2025 earnings multiple. Long view: Despite rapid growth over the years, Tencent Music's subscriber/user ratio stood at only 22% at the end of 2024, significantly lower than Spotify's 40%. Additionally, its average monthly subscription price of CNY 11 (USD 1.50) remains less than a third of global benchmarks. Bulls say: Tencent Music's growing share of recommendation-driven streams (now 40%-plus) reinforces the platform's switching cost and improves its pricing power.

Chinese Music Streaming: Undervalued Leaders Well Positioned for Accelerating Growth in 2025
Ivan Su,Senior Equity Analyst,7 Jan 2025

2024 was a strong year for the Chinese music streaming industry, with share prices for both Tencent Music and Cloud Music rising by more than 20%. This performance was fueled by increasing subscribers, higher subscription prices, and improving profitability.Why it matters: Despite ongoing economic uncertainties in China, we anticipate revenue growth acceleration for both companies in 2025, with Tencent Music projected to grow by 8% and Cloud Music by 7%. Music streaming services are low-cost forms of entertainment, and the habitual nature of these subscriptions makes them resilient to economic pressures. Consumers are unlikely to cancel such subscriptions, even in tougher times. While revenue from social entertainment services will continue to decline as consumers reduce spending on livestreaming tips, the absolute size of this revenue pool has shrunk from more than 50% to less than a third of top lines. As a result, the drag on overall growth will be limited.The bottom line: We have fine-tuned our forecasts but maintain our fair value estimates of USD 17.20 per ADR for Tencent Music and HKD 153 per share for Cloud Music. Both companies still appear undervalued, trading at about 30% discount to our fair value estimates and approximately 15 times 2025 earnings.Long view: Both firms currently have subscriber/user ratios in the 20% range, significantly lower than Spotify's 40%. Additionally, average subscription prices for Chinese music streaming services remain less than half of global benchmarks. We view this stark disparity as compelling evidence of significant room for long-term revenue growth through further subscription price increases and subscriber expansion.(Jan. 7, 2025): A previous version referred to increasing dividend payout ratios instead of increasing subscribers.

Tencent Music Earnings: Long Runway for Subscription Price Hikes; Shares Undervalued Ivan Su,Senior Equity Analyst,13 Nov 2024

Narrow-moat Tencent Music's third-quarter results were broadly in line with our expectations, and management's 2025 guidance, particularly the stable outlook for livestreaming and rising profitability, reinforces our midteens earnings per share growth forecast. We are maintaining our USD 17.20/HKD 67 fair value estimate and continue to view the shares, which currently trade more than 30% below our valuation, as undervalued. We believe the market underestimates the size of Tencent Music's long-term subscriber base and the opportunity to lift subscription prices further.This is the first quarter following the company's strategy shift toward driving growth through higher average pricing, and the results indicate that such pivot is likely to be gradual, so the market need not be concerned about a drastic slowdown in subscriber growth. Revenue from music subscriptions grew 20% year over year, driven by a 16% increase in subscribers and a 4% increase in average subscription price.Super VIP subscribers, a key driver of long-term growth in average subscription price, reached 10 million during the quarter, representing 8% of the company's total subscriber base. By incorporating additional features such as access to long-form audio and enhanced sound quality, management is on track to convert more regular VIP subscribers to the higher-priced SVIP tier.Our confidence in Tencent Music's ability to implement price increases is supported by its average subscription price of CNY 10.80 in the third quarter, which is markedly lower than Spotify's CNY 37. This significant pricing disparity provides clear evidence of substantial opportunities for revenue enhancement through strategic member tiering and thoughtful price adjustments.Total revenue for the company grew 7% year on year, partially offset by a 24% drop in social entertainment revenue.

Tencent Music Earnings: Management Lifts 2024 Outlook, Announces New Pricing Strategy Ivan Su,Senior Equity Analyst,14 Aug 2024

Narrow-moat Tencent Music's second-quarter earnings mildly exceeded our expectations, but shares plummeted by more than 15% during US hours due to concerns over the company's emphasis on driving growth through higher subscription prices, potentially diminishing the contribution of subscriber growth to overall revenue. We believe the market is overreacting to this strategy shift. We fine-tuned our near-term forecasts, but the impact is immaterial to our fair value estimate of USD 17.20 per share. With its shares trading at around USD 11, we continue to view the firm as undervalued.Tencent Music's subscription revenue growth is driven by two factors—subscriber growth and subscription price increases. Historically, subscriber growth has been the primary driver, but there's substantial upside potential in raising prices. In the second quarter of 2024, Tencent Music's subscriber/user ratio is at 20%, half of Spotify's 40%, indicating more room for growth. More importantly, Tencent Music's average monthly subscription price is CNY 10.70, substantially lower than Spotify's CNY 37.30—a difference of over 300%. We view this stark pricing gap as clear evidence that there is significantly greater potential for revenue growth through price adjustments than through expanding subscriber numbers.The post-results share price decline ignored the fact that second-quarter earnings were better than expected, and management also lifted full-year guidance. In the second quarter, adjusted net profit grew 23% despite a 4% year-over-year decline in revenue. The decline in revenue should be largely expected by the market due to a 43% decline in livestreaming revenue as a result of weak macroeconomic conditions, partially offset by a 29% increase in streaming subscription revenue. Notably, profitability continued to be a highlight, with gross margin clocking in at 42%—marking the ninth consecutive quarter of sequential improvement.

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Tencent Music Earnings: A Melody of Margin Expansion and Shareholder Returns Ivan Su,Senior Equity Analyst,14 May 2024

We are raising Tencent Music Entertainment's fair value estimate by 32% to USD 17.20 (HKD 67 for H-shares) following its strong first-quarter earnings. A gross margin of 40.9% was comfortably ahead of our and PitchBook's consensus expectations. Management expects a continued expansion in margins as its high-margin original content continues to gain traction. Tencent Music's share price is reacting positively to the results and the first-ever dividend of USD 0.14 per share. Coupled with the remaining share buyback authorization of USD 265 million, the company is on track to return at least USD 475 million to shareholders this year. We remain buyers of Tencent Music despite the run-up in share price, as we believe the market has yet to fully appreciate the potential for significant growth in its subscriber base and the opportunities for margin expansion through operating leverage.In the first quarter of 2024, Tencent Music's revenue declined 3% year over year, but net profit increased 28%. The revenue weakness was due to the removal of gambling-related features in the second quarter of 2023 as a precautionary measure to mitigate regulatory risks. Still, the impact was partially offset by a whopping 39% growth in music subscription revenue. Profitability was the highlight, with gross margin improving 260 basis points quarter over quarter, again underlining the business' operating leverage and the positive mix shift toward music produced in-house by Tencent Music. Net profit margin reached 22.6%, up from 20.4% in the fourth quarter and 17.1% in the same period last year.

Tencent Music Earnings: Tuning Into Growth and Shareholder Returns; Shares Undervalued Ivan Su,Senior Equity Analyst,20 Mar 2024

Narrow-moat Tencent Music's fourth-quarter 2023 earnings were broadly in line with our expectations. We roll forward our model and modestly lift our fair value estimate to USD 13 per ADR (HKD 51 per share) from USD 12.50 (HKD 49.10). We also lower our Morningstar Uncertainty Rating to High from Very High, reflecting increased clarity in the competitive environment and the company's ongoing improvements in profitability.. We view the music streaming company's shares as undervalued, trading at a 13% discount to our fair value estimate. We believe the market continues to underestimate the size of Tencent's Music long-term subscriber base and the opportunity to lift subscription prices further.In the fourth quarter of 2023, Tencent Music's revenue declined 7% year over year. This was again due to a significant decline in social entertainment revenue (that is, livestreaming), but partially offset by a 45% growth in music subscription revenue. The decline in livestreaming revenue is within our expectations, following the shutdown of gambling-related features in the second quarter of 2023 as a precautionary measure to mitigate potential regulatory risks. Profitability continued to improve during the quarter, with gross margin clocking in at 38.3%, a 270-basis-point improvement from the previous quarter—again highlighting the operating leverage the business can deliver. Adjusted net profit margin was 22.8%, translating to an adjusted net profit growth of 9.5% as a result. Looking forward to 2024, management has offered guidance that surpasses market expectations, projecting low-single-digit revenue growth and a low-teens increase in adjusted net income. Our projections are slightly more optimistic than management's, as we anticipate the company will record decent growth in pricing, benefiting from the habitual nature of streaming subscriptions while maintaining strong cost discipline.

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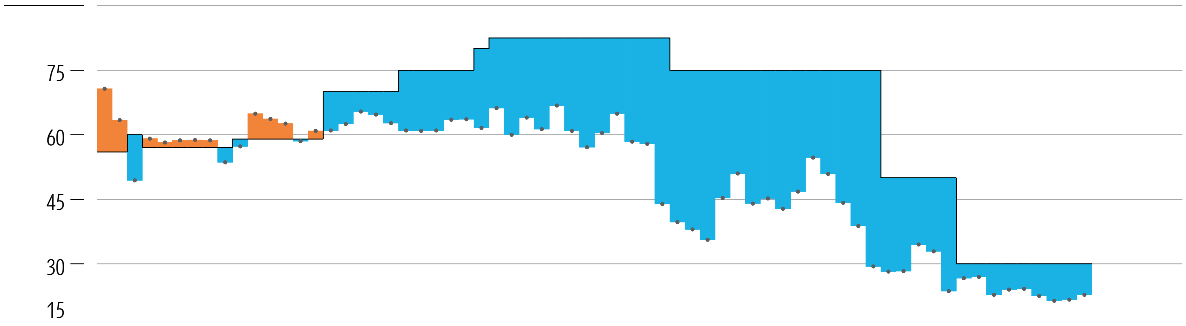
Competitors Price vs. Fair Value

Sirius XM Holdings Inc SIRI



Fair Value: 30.00
17 Oct 2024 14:39, UTC

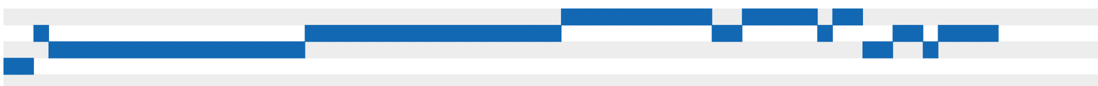
Last Close: 22.81

Overvalued

Undervalued

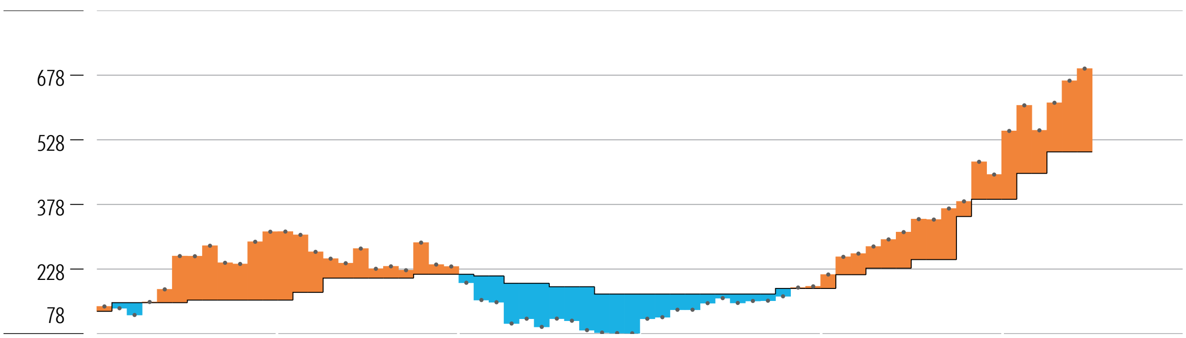
	2020	2021	2022	2023	2024	YTD	
	1.08	0.85	0.71	0.73	0.76	0.76	Price/Fair Value
	-10.15	0.72	-2.68	-4.64	-56.37	2.41	Total Return %

Morningstar Rating



Total Return % as of 10 Jun 2025. Last Close as of 10 Jun 2025. Fair Value as of 17 Oct 2024 14:39, UTC.

Spotify Technology SA SPOT



Last Close: 693.32

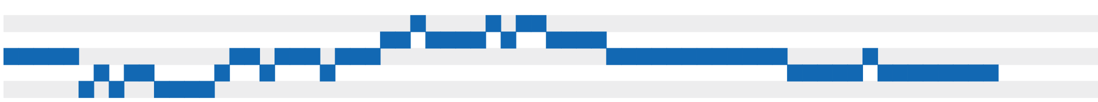
Fair Value: 500.00
29 Apr 2025 18:41, UTC

Overvalued

Undervalued

	2020	2021	2022	2023	2024	YTD	
	2.02	1.08	0.46	1.03	1.15	1.39	Price/Fair Value
	110.40	-25.62	-66.27	138.01	138.08	54.97	Total Return %

Morningstar Rating



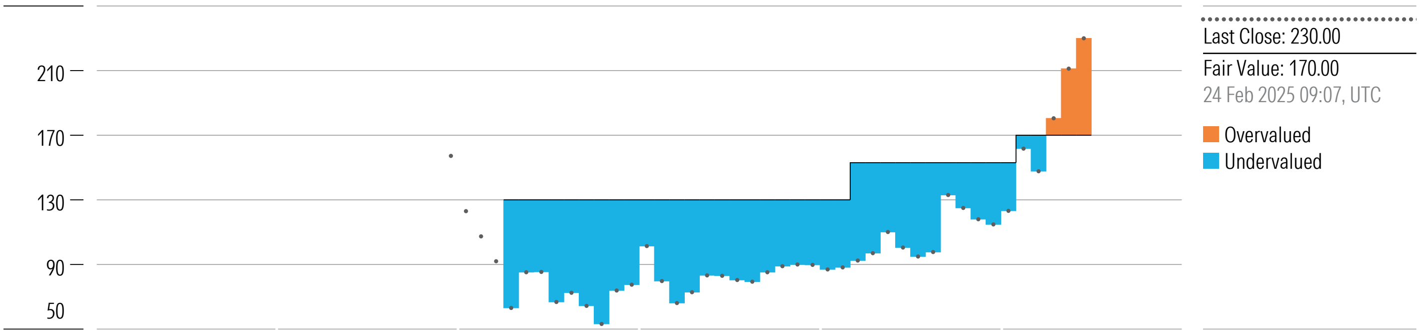
Total Return % as of 10 Jun 2025. Last Close as of 10 Jun 2025. Fair Value as of 29 Apr 2025 18:41, UTC.

Morningstar Equity Analyst Report | Report as of 11 Jun 2025 02:46, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 13 of 23

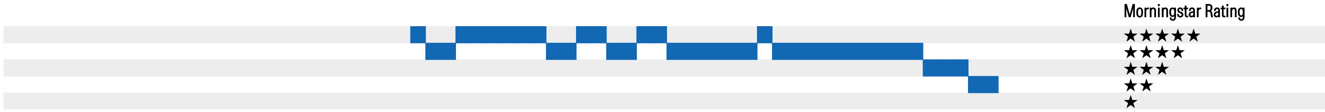
Tencent Music Entertainment Group ADR TME ★★★ 11 Jun 2025 02:42, UTC

Competitors Price vs. Fair Value

NetEase Cloud Music Inc 09899



	2020	2021	2022	2023	2024	YTD	
	—	—	0.60	0.69	0.75	1.35	Price/Fair Value
	—	—	-50.70	15.81	27.91	100.35	Total Return %



Total Return % as of 10 Jun 2025. Last Close as of 10 Jun 2025. Fair Value as of 24 Feb 2025 09:07, UTC.

Morningstar Equity Analyst Report | Report as of 11 Jun 2025 02:46, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 14 of 23

Tencent Music Entertainment Group ADR TME ★★★ 11 Jun 2025 02:42, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
18.34 USD 10 Jun 2025	21.50 USD 11 Jun 2025 02:39, UTC	0.85	28.26 USD Bil 10 Jun 2025	Narrow	Large Blend	High	Standard	7 May 2025 05:00, UTC

Morningstar Valuation Model Summary

Financials as of 11 Jun 2025	Actual			Forecast				
Fiscal Year, ends 31 Dec	2022	2023	2024	2025	2026	2027	2028	2029
Revenue (CNY Mil)	28,339	27,752	28,401	31,654	42,515	46,953	52,068	57,174
Operating Income (CNY Mil)	3,216	4,777	7,349	9,391	11,901	14,358	17,078	19,730
EBITDA (CNY Mil)	4,892	6,011	8,492	12,881	13,016	15,483	18,235	20,916
Adjusted EBITDA (CNY Mil)	4,892	6,011	8,492	12,881	13,016	15,483	18,235	20,916
Net Income (CNY Mil)	3,677	4,920	6,644	10,714	10,420	12,448	14,699	17,008
Adjusted Net Income (CNY Mil)	4,745	5,923	7,671	9,245	10,602	11,671	12,946	14,521
Free Cash Flow To The Firm (CNY Mil)	3,590	3,372	6,394	-13,917	9,240	11,049	13,258	15,528
Weighted Average Diluted Shares Outstanding (Mil)	3,233	3,168	3,131	3,194	3,160	3,127	3,094	3,060
Earnings Per Share (Diluted) (CNY)	1.14	1.55	2.12	3.35	3.30	3.98	4.75	5.56
Adjusted Earnings Per Share (Diluted) (CNY)	1.47	1.87	2.45	2.90	3.35	3.73	4.18	4.75
Dividends Per Share (CNY)	0.00	0.49	0.65	1.03	1.20	1.67	1.87	2.13

Margins & Returns as of 11 Jun 2025		Actual			Forecast					
	3 Year Avg	2022	2023	2024	2025	2026	2027	2028	2029	5 Year Avg
Operating Margin %	19.2	11.4	17.2	25.9	29.7	28.0	30.6	32.8	34.5	33.1
EBITDA Margin %	—	17.3	21.7	29.9	40.7	30.6	33.0	35.0	36.6	—
Adjusted EBITDA Margin %	—	17.3	21.7	29.9	40.7	30.6	33.0	35.0	36.6	35.2
Net Margin %	18.0	13.0	17.7	23.4	33.9	24.5	26.5	28.2	29.8	28.6
Adjusted Net Margin %	21.7	16.7	21.3	27.0	29.2	24.9	24.9	24.9	25.4	25.9
Free Cash Flow To The Firm Margin %	15.8	12.7	12.2	22.5	-44.0	21.7	23.5	25.5	27.2	10.8

Growth & Ratios as of 11 Jun 2025		Actual			Forecast					
	3 Year CAGR	2022	2023	2024	2025	2026	2027	2028	2029	5 Year CAGR
Revenue Growth %	-3.1	-9.3	-2.1	2.3	11.5	34.3	10.4	10.9	9.8	15.0
Operating Income Growth %	39.3	18.4	48.5	53.8	27.8	26.7	20.7	18.9	15.5	21.8
EBITDA Growth %	26.2	14.5	22.9	41.3	51.7	1.1	19.0	17.8	14.7	20.9
Adjusted EBITDA Growth %	25.8	14.5	22.9	41.3	51.7	1.1	19.0	17.8	14.7	19.8
Earnings Per Share Growth %	33.1	26.3	36.5	36.7	58.1	-1.7	20.7	19.4	17.0	21.2
Adjusted Earnings Per Share Growth %	33.1	19.0	27.4	31.1	18.2	15.9	11.3	12.1	13.4	21.2

Valuation as of 11 Jun 2025	Actual			Forecast				
	2022	2023	2024	2025	2026	2027	2028	2029
Price/Earning	19.6	17.1	16.9	22.7	19.7	17.7	15.8	13.9
Price/Sales	3.5	3.8	4.5	6.6	4.9	4.4	4.0	3.6
Price/Book	1.9	1.8	1.9	2.6	2.4	2.3	2.2	2.0
Price/Cash Flow	—	—	—	—	—	—	—	—
EV/EBITDA	17.5	15.0	12.5	14.5	14.4	12.1	10.3	9.0
EV/EBIT	26.7	18.8	14.4	19.9	15.7	13.0	11.0	9.5
Dividend Yield %	—	1.5	1.6	1.6	1.8	2.5	2.8	3.2
Dividend Payout %	0.0	25.9	26.4	35.5	35.7	44.7	44.7	44.8
Free Cash Flow Yield %	—	—	—	—	—	—	—	—

Operating Performance / Profitability as of 11 Jun 2025	Actual			Forecast				
Fiscal Year, ends 31 Dec	2022	2023	2024	2025	2026	2027	2028	2029
ROA %	5.5	6.5	7.4	10.2	9.4	10.7	11.9	12.8
ROE %	7.5	8.6	9.5	12.7	11.9	13.6	15.2	16.4
ROIC %	9.4	14.1	22.0	27.8	34.2	40.7	47.9	54.9

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Tencent Music Entertainment Group ADR TME ★★★ 11 Jun 2025 02:42, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
18.34 USD 10 Jun 2025	21.50 USD 11 Jun 2025 02:39, UTC	0.85	28.26 USD Bil 10 Jun 2025	Narrow	Large Blend	High	Standard	7 May 2025 05:00, UTC

Financial Leverage (Reporting Currency)	Actual			Forecast				
Fiscal Year, ends 31 Dec	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Debt/Capital %	29.6	28.8	23.9	2.2	2.0	1.9	1.8	1.7
Assets/Equity	1.4	1.3	1.3	1.2	1.3	1.3	1.3	1.3
Net Debt/EBITDA	-3.0	-2.9	-2.5	-3.5	-3.7	-3.4	-3.2	-3.1
Total Debt/EBITDA	1.2	1.0	0.7	0.4	0.4	0.4	0.3	0.3
EBITDA/ Net Interest Expense	-8.1	-6.6	-7.7	-11.0	-10.5	-12.0	-12.9	-13.3

Forecast Revisions as of 10 Jun 2025	2025		2026		2027	
Prior data as of 14 May 2025	**Current**	**Prior**	**Current**	**Prior**	**Current**	**Prior**
Fair Value Estimate Change (Trading Currency)	21.50	18.04	—	—	—	—
Revenue (CNY Mil)	31,654	31,654	42,515	35,323	46,953	38,681
Operating Income (CNY Mil)	9,391	9,391	11,901	10,738	14,358	12,107
EBITDA (CNY Mil)	12,881	12,881	13,016	11,853	15,483	13,231
Net Income (CNY Mil)	9,245	9,245	10,602	10,393	11,671	11,433
Earnings Per Share (Diluted) (CNY)	3.35	3.46	3.30	2.95	3.98	3.29
Adjusted Earnings Per Share (Diluted) (CNY)	2.90	2.98	3.35	3.39	3.73	3.77
Dividends Per Share (CNY)	1.03	1.05	1.20	1.20	1.67	1.67

Key Valuation Drivers as of 11 Jun 2025	
Cost of Equity %	9.0
Pre-Tax Cost of Debt %	5.3
Weighted Average Cost of Capital %	9.4
Long-Run Tax Rate %	25.0
Stage II EBI Growth Rate %	6.0
Stage II Investment Rate %	15.0
Perpetuity Year	15

Additional estimates and scenarios available for download at https://pitchbook.com/.

Discounted Cash Flow Valuation as of 11 Jun 2025	**CNY Mil**
Present Value Stage I	29,394
Present Value Stage II	75,148
Present Value Stage III	86,218
Total Firm Value	**190,761**
Cash and Equivalents	37,593
Debt	5,726
Other Adjustments	14,498
Equity Value	**237,126**
Projected Diluted Shares	3,194
Fair Value per Share (USD)	**21.50**

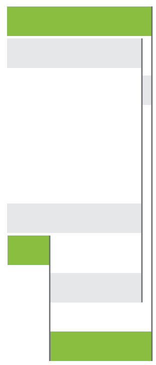
Morningstar Equity Analyst Report | Report as of 11 Jun 2025 02:46, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 16 of 23

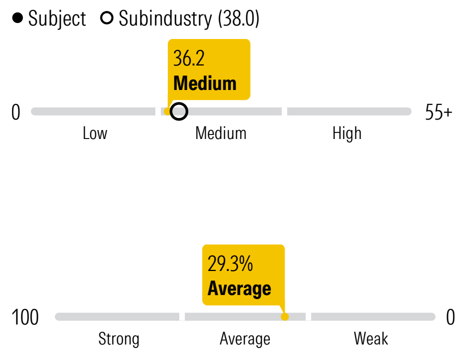
Tencent Music Entertainment Group ADR TME ★★★ 11 Jun 2025 02:42, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
18.34 USD 10 Jun 2025	21.50 USD 11 Jun 2025 02:39, UTC	0.85	28.26 USD Bil 10 Jun 2025	Narrow	Large Blend	High	Standard	3 of 5 globes 7 May 2025 05:00, UTC

ESG Risk Rating Breakdown

Exposure	
Company Exposure[1]	36.2
– Manageable Risk	33.7
Unmanageable Risk[2]	**2.4**
Management	
Manageable Risk	33.7
– Managed Risk[3]	9.9
Management Gap[4]	**23.8**
Overall Unmanaged Risk	**26.3**

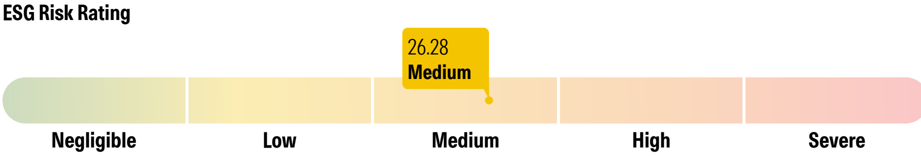




- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

- 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 29.3% 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 May 07, 2025. Highest Controversy Level is as of Jun 08, 2025. Sustainalytics Subindustry: Internet Software and Services. Sustainalytics provides Morningstar with company ESG ratings and metrics on a monthly basis and as such, the ratings in Morningstar may not necessarily reflect current Sustainalytics' scores for the company. For the most up to date rating and more information, please visit: sustainalytics.com/esg-ratings/.

Peer Analysis 07 May 2025

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	
Tencent Music Entertainment Group	36.2 | Medium	0 – 55+	29.3 | Average	100 – 0	26.3 | Medium	0 – 40+
Sirius XM Holdings Inc	24.2 | Low	0 – 55+	39.9 | Average	100 – 0	14.8 | Low	0 – 40+
Spotify Technology SA	36.5 | Medium	0 – 55+	48.2 | Average	100 – 0	20.0 | Medium	0 – 40+
NetEase Cloud Music Inc	37.2 | Medium	0 – 55+	40.4 | Average	100 – 0	23.2 | Medium	0 – 40+
—	— | —	0 – 55+	— | —	100 – 0	— | —	0 – 40+

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Appendix
Historical Morningstar Rating

Tencent Music Entertainment Group ADR TME 10 Jun 2025 22:02, 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
—	—	—	—	—	—	—	—	—	—	—	—

Sirius XM Holdings Inc SIRI 10 Jun 2025 21:38, 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
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★	★★

Spotify Technology SA SPOT 10 Jun 2025 22:03, 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
★	★	★★	★★	★	★★	★	★★★	★★★	★★★	★★★	★★★

Morningstar Equity Analyst Report | Report as of 11 Jun 2025 02:46, UTC | Reporting Currency: CNY | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 18 of 23

NetEase Cloud Music Inc 09899 10 Jun 2025 16:54, 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 —

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.

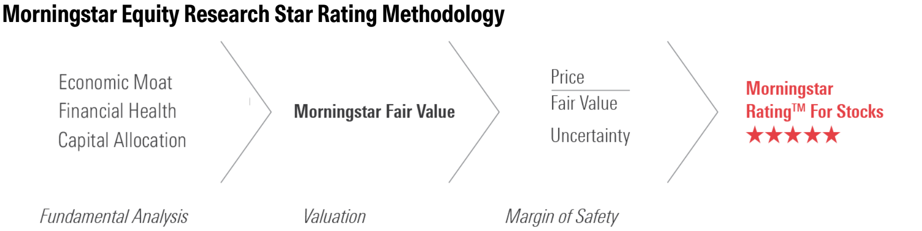
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return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

Morningstar Equity Research Star Rating Methodology



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

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

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

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

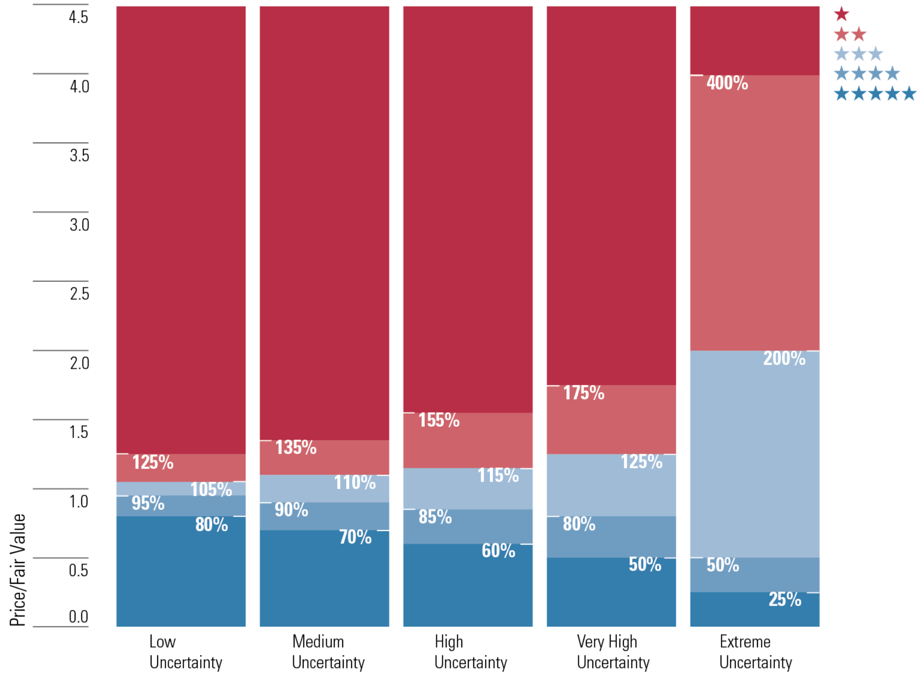
Our uncertainty rating is based on the interquartile range, or the middle 50% of potential outcomes, covering the 25th percentile–75th percentile. This means that when a stock hits 5 stars, we expect there is a 75% chance that the intrinsic value of that stock lies above the current market price. Similarly,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

4. Market Price

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

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

Morningstar Equity Research Star Rating Methodology



Morningstar Star Rating for Stocks

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,

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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.

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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