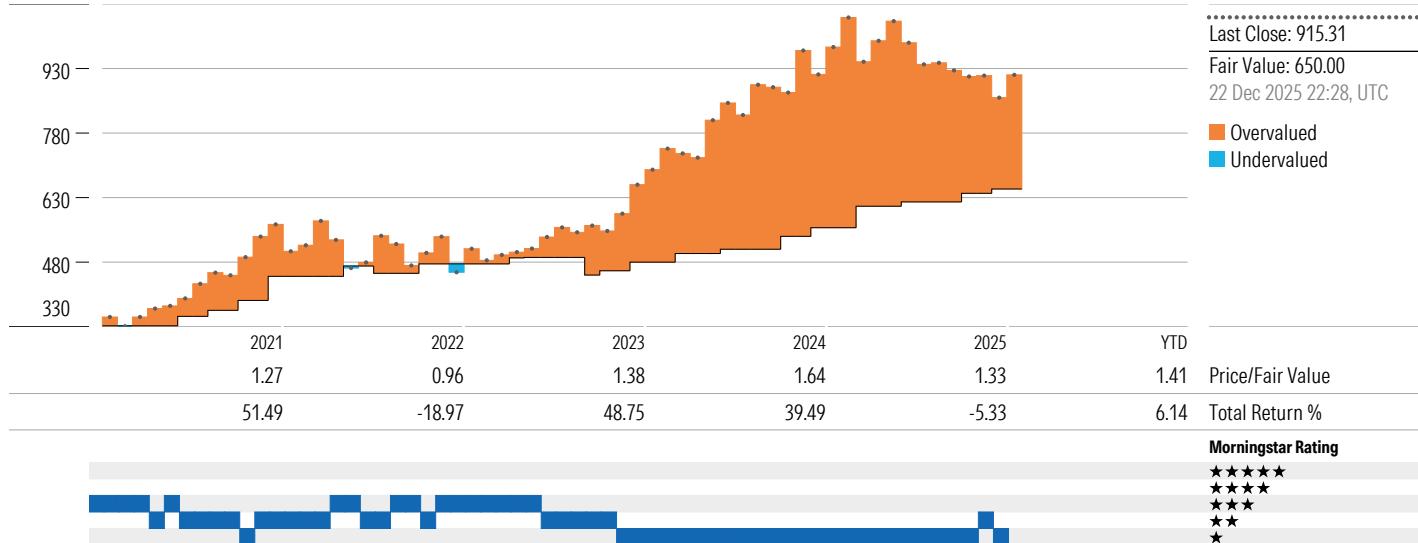


Costco Wholesale Corp COST ★ 8 Jan 2026 22:39, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment ¹
915.31 USD 8 Jan 2026	650.00 USD 22 Dec 2025 22:28, UTC	1.41	406.28 USD Bil 8 Jan 2026	Wide	Large Blend	Medium	Exemplary	 7 Jan 2026 06:00, UTC

Price vs. Fair Value



Total Return % as of 08 Jan 2026. Last Close as of 08 Jan 2026. Fair Value as of 22 Dec 2025 22:28, UTC.

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The primary analyst covering this company does not own its stock.

The ESG Risk Rating Assessment is a representation of Sustainalytics' ESG Risk Rating.

Costco's Disciplined Playbook and Globally Scalable Model Reinforce Its Value Retail Leadership

Business Strategy & Outlook

Brett Husslein, Analyst, 22 Dec 2025

Costco's strategy is built on a differentiated model for the mature, highly competitive retail industry. The firm earns most of its operating profit from membership fees, enabling it to sell merchandise at near-break-even prices. This reinforces its reputation as a price-leader, drives recurring traffic, and keeps renewal rates around 90%. We believe rising executive membership penetration (with 3 times higher average customer spending) strengthens this high-margin, predictable revenue stream, cementing itself as an industry leader with over 60% share of the domestic warehouse club market.

In the near term, we expect high-single-digit revenue growth, fueled by steady comparable sales, modest membership gains, and measured store expansion. The US remains its anchor market, with more than 600 warehouses generating annual sales of \$320 million each and room for about 15 additional locations per year. However, we believe the firm's most compelling growth opportunity lies abroad. Costco has already achieved strong acceptance in countries such as South Korea, Japan, Mexico, and Taiwan, with renewal rates in newer markets gradually converging toward North American levels (4% higher worldwide renewal rates compared with fiscal-year 2011). International sales now exceed \$38 billion, more than twice what they were a decade ago. This track record stands in contrast to peers that have struggled to profitably globalize their retail formats.

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Sector	Industry
 Consumer Defensive	Discount Stores

Business Description

Founded in 1983, Costco Wholesale now operates a global chain of membership-based warehouse clubs, delivering high-quality goods and services at consistently low prices. As of its most recent fiscal year, Costco operated approximately 910 warehouses, serving more than 80 million members across its three geographic segments: Costco US (approximately 73% of total revenue), Costco Canada (13%), and Costco International (14%). Costco's core value proposition—quality products at unbeatable prices—has yielded consistently strong member renewal rates (93% in the US and Canada and nearly 90% internationally). About 55% of Costco's fiscal 2025 revenue came from its grocery offerings, and another 25% from general merchandise.

Despite this, digital commerce represents a challenge for Costco. Walmart, Target, and Amazon have built more-advanced omnichannel networks, while Costco has deliberately underinvested to avoid eroding its cost advantage. Online penetration remains modest at 7% of sales. Yet Costco is relatively insulated, as two-thirds of its merchandise sales come from food and grocery categories, where bulk delivery is structurally less economical. We expect incremental investment in digital fulfillment, though the focus will likely remain on driving traffic to warehouses.

By leaning on membership loyalty, cost discipline, and its international runway, we posit Costco is well-positioned to defend its competitive edge, even as peers chase digital scale.

Bulls Say

Brett Husslein, Analyst, 22 Dec 2025

- Executive membership penetration continues to rise (11% higher than a decade ago), lifting the profitability of Costco's recurring fee base and merchandise sales, as these members spend 3 times more on average than a basic member.
- Kirkland Signature's 33% sales penetration strengthens Costco's brand equity while providing margin accretion in staple categories.
- International warehouses in South Korea and Taiwan are producing among the chain's highest sales volumes, suggesting durable global demand and that its brand power is resonating across borders.

Bears Say

Brett Husslein, Analyst, 22 Dec 2025

- Expansion into markets with stricter labor laws and zoning restrictions, such as parts of Europe, could slow Costco's growing footprint and ability to further replicate its US model.
- A decline in membership renewal rates (amid constrained consumer spending), currently around 90%, could weaken Costco's most durable profit engine and its ability to reinvest in prices without impairing operating margins.
- Digital sales remain at 7% of revenue, and continued underinvestment in e-commerce and last-mile fulfillment could cause Costco to lag peers in higher-margin discretionary categories.

Economic Moat

Brett Husslein, Analyst, 22 Dec 2025

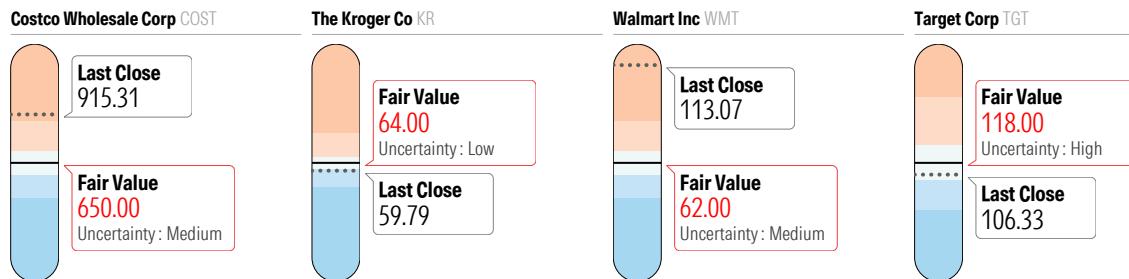
We assign Costco a Morningstar Economic Moat Rating of wide, underpinned by its cost advantage and intangible assets, both of which are reinforced by the firm's membership-driven business model, operational discipline, and brand trust. Over the past five years, Costco has generated an average return on invested capital of 24.6%, well above our 7.4% estimate of its cost of capital, and we expect these returns to persist for at least two decades.

Costco's cost advantage stems from three structural efficiencies: scale, merchandising discipline, and minimal overhead. Costco is one of the largest global retailers, providing it with tremendous purchasing leverage. Its limited stock-keeping units—offering only about 4,000 SKUs in its warehouses versus 100,000 or more at traditional grocers—support a more streamlined supply chain procurement process

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Competitors



Economic Moat	Wide	None	Wide	None
Currency	USD	USD	USD	USD
Fair Value	650.00 22 Dec 2025 22:28, UTC	64.00 9 Dec 2025 19:01, UTC	62.00 30 Nov 2025 22:45, UTC	118.00 23 Oct 2025 22:26, UTC
1-Star Price	877.50	80.00	83.70	182.90
5-Star Price	455.00	51.20	43.40	70.80
Assessment	Overvalued 8 Jan 2026	Fairly Valued 8 Jan 2026	Overvalued 8 Jan 2026	Fairly Valued 8 Jan 2026
Morningstar Rating	★ 8 Jan 2026 22:39, UTC	★★★ 8 Jan 2026 22:39, UTC	★ 8 Jan 2026 22:41, UTC	★★★ 8 Jan 2026 22:43, UTC
Analyst	Brett Husslein, Analyst	Dan Wasiolek, Senior Equity Analyst	Brett Husslein, Analyst	Brett Husslein, Analyst
Capital Allocation	Exemplary	Exemplary	Standard	Standard
Price/Fair Value	1.41	0.93	1.82	0.90
Price/Sales	1.40	0.27	1.29	0.45
Price/Book	12.93	5.58	9.35	3.04
Price/Earning	47.56	12.59	39.41	12.57
Dividend Yield	0.57%	2.26%	0.83%	4.36%
Market Cap	406.28 Bil	37.84 Bil	901.19 Bil	48.15 Bil
52-Week Range	844.06–1,078.24	58.12–74.90	79.81–117.45	83.44–145.08
Investment Style	Large Blend	Mid Value	Large Blend	Mid Value

and yield lower per-unit costs, which are passed directly to members, especially on grocery goods, where select items deliver over 30% in per-ounce savings versus major supermarkets. With over \$275 billion in sales and a commanding 60% share of the US warehouse club market, according to Euromonitor, Costco can purchase merchandise in bulk at favorable terms and spread fixed costs (distribution, administrative, and IT) over a large sales base. Its operating model—high volume per SKU, cross-docking distribution, minimal inventory handling, membership fee-based model, and no costly store fixtures or advertising—yields industry-low operating expenses with selling, general, and administrative expenses representing 9% of sales versus roughly 20% at Walmart and Target. As a result, Costco can profitably sell products at prices that competitors with higher costs cannot match. This pricing power is a formidable moat source in retail.

Complementing its cost edge, Costco has also built a strong brand known for quality and absolute low prices, earning deep trust from club members. The membership model itself creates a sense of

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exclusivity and loyalty, where members feel invested and shop to maximize the value of their annual fee. Costco's brand equity is evident in its roughly 90% membership renewal rate, which has held steady over the years regardless of the economic backdrop. The company's refusal to mark up products beyond a fixed modest margin and its famous loss-leaders (like the \$1.50 hot dog or \$4.99 rotisserie chicken, which Costco famously maintains even at financial loss) reinforce its intangible assets: a brand reputation for putting customer value first. Moreover, Costco's "no frills," treasure-hunt shopping experience creates customer enthusiasm that traditional retailers struggle to achieve.

Costco's brand and cost advantages reinforce each other. Its trusted brand draws more members and sales volume, which increases scale and lowers unit costs, allowing even lower prices that further enhance the brand's value promise. This self-reinforcing cycle is a hallmark of Costco's wide moat. This can also be seen in the company's private-label offering, Kirkland Signature, which comprises almost 33% of net sales, providing higher margins for Costco while reinforcing the value proposition for customers.

Costco's competitive dominance is exemplified by its sales per square foot of over \$2,000, which is more than double that of Walmart and nearly 5 times as much as Target. In our view, its US operations (more than 70% of sales) benefit from decades of infrastructure development, vendor relationships, and real estate scale. Inventory turns remain best in class at about 30 days compared with Walmart's 40 days and Target's 61 days. Even compared with its closest competitor, Costco is far more profitable (\$77 in EBIT per square foot versus \$26 at Sam's Club); Sam's Club (33% share of the warehouse club market) boasts sales per square foot of just \$1,150, despite launching in the same year as Costco and operating a similar size store base in the US (Costco 629, Sam's Club 600). We attribute this differential partly to the fact that Costco caters to a more affluent customer base, with an average household income of around \$125,000 versus just \$80,000 at Sam's Club. Given that buying in bulk tends to come with a higher absolute price tag, shopping in a warehouse club is more tenable for higher-income shoppers. Additionally, Costco's membership base continues to climb steadily, and members per warehouse have been increasing over time. Based on our estimates, members per warehouse averaged over 87,000 in the past fiscal year, up from around 59,000 in 2010. Growing members per location indicates that Costco is deepening its penetration and loyalty in markets over time, rather than cannibalizing its footprint, which suggests durability in its competitive edge and further spreads fixed costs over a larger member base.

In Canada (just a midteens percentage of revenue), Costco's position is even greater, as it faces less direct competition and often commands higher average transaction values with roughly \$2,352 and \$116 in sales and EBIT per square foot, respectively. Despite higher wage pressures and regional cost variance, we posit Costco Canada remains the company's strongest segment with efficient store-level operations and limited geographic sprawl.

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Internationally, we estimate that Costco's ROIC has been rising over the last decade (averaging 16%) and that this trend will likely continue. Costco's international success has primarily been the result of carefully selecting new markets to enter and differentiating itself from existing retailers, allowing it to attract customers with little direct warehouse club competition. Globally, Costco has 53% market share in the warehouse club industry, including 65% share in South Korea, 25% in Mexico (behind Sam's Club's 72%), and captures the entire market in Japan, Australia, France, and the United Kingdom. Management has stated plans to allocate more of its new-store openings to international markets in the coming years, and we believe its historical success indicates the company has a unique ability to tailor its product offerings to consumer preferences across countries.

Overall, Costco's wide moat is rooted in its structural cost advantages and powerful intangible assets, both of which are magnified by the firm's membership-driven model and operational rigor. Its US and Canadian operations are firmly entrenched as moat-bearing in mature markets, and international operations offer additional promise for growth and continued long-term economic value creation as the company continues to expand its reach globally.

With moat-bearing attributes across each of its segments, minimal promotional expense, best-in-class customer retention, and a growing global presence, Costco is one of the few retailers positioned to thrive amid supply chain complexity and rising cost pressures. We believe its scale, loyalty economics, and private-label strength will reinforce its ability to deliver excess economic returns for at least the next 20 years.

Fair Value and Profit Drivers Brett Husslein, Analyst, 22 Dec 2025

We raised our fair value estimate for Costco to \$650 per share from \$640, due to the time value of money. Recently reported first-quarter results were strong, with net sales up 8.2% and a 20-basis-point lift in gross margin (13.1%). We view these productivity and continued traffic gains as evidence of its durable value proposition.

Costco US remains the primary earnings driver, representing about 73% of consolidated revenue and, together with Canada, roughly 84% of operating income. We forecast gross US revenue to expand at a 7.2% CAGR, driven by average traffic and ticket growth of 4% and 1.2%, respectively, steady warehouse expansion of about 15 units annually, and continued growth in executive memberships. We believe Costco will continue to gain market share in the US by reinforcing its price leadership and membership loyalty, driven by deep vendor relationships, disciplined cost controls, and a curated merchandise mix that consistently delivers value. Canada should see mid-single-digit sales growth, further building upon its strong segment-level efficiency.

We estimate Costco international growth at a 10.4% CAGR, reflecting an average of 12 new stores per year in markets such as South Korea, Japan, Mexico, and Taiwan. These regions are expected to

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accelerate their profit contribution, with international overtaking Canada to represent about 20% of operating income by the end of our forecast (up from 16% currently). Early successes abroad highlight the adaptability and profitability of the warehouse club model, with disciplined site selection, strong customer reception, and rising global renewal rates, making international Costco's clearest long-term growth lever.

Membership income is a critical underpinning of our valuation. We project total memberships to reach roughly 130 million by the end of the forecast period. With renewal rates hovering around 90% and executive membership penetration climbing, we anticipate membership fee income to nearly double, providing a recurring, high-margin income stream that underwrites reinvestment in price leadership while maintaining profitability.

By bringing these pillars together, we project that consolidated revenue will compound at 7.5%. After year five, growth should tilt more heavily toward international as the US footprint approaches saturation. Finally, we model operating margins to rise from 3.8% in fiscal 2025 to 4.8% by the end of the explicit forecast, driven by membership growth, SG&A leverage, and greater private-label contribution.

Risk and Uncertainty

Brett Husslein, Analyst, 22 Dec 2025

We assign Costco a Medium Uncertainty Rating, reflecting confidence in the durability of its cash flows but acknowledging risks tied to competition and international execution. The membership-driven model, with renewal rates around 90%, provides recurring revenue that reduces volatility relative to most retailers. Still, several factors could alter our forecast.

Competition and digital disruption are the most pressing threats. Costco has been slower than Walmart, Target, and Amazon in adopting omnichannel fulfillment, with only 7% of sales occurring online. While its bulk grocery mix is insulated from online substitution, discretionary categories like apparel, electronics, and home goods face pressure if digital penetration accelerates. Our forecast assumes Costco maintains its leading market share (60% of the domestic warehouse club market) through price discipline and its treasure-hunt shopping experience, but a consumer shift toward digital channels could weigh on traffic and productivity.

International execution adds further uncertainty. We model international sales at a 10.4% CAGR, with growth in South Korea, Japan, Mexico, and China. Yet, regulatory and cultural barriers could slow adoption or compress margins, particularly in Europe, where labor and zoning laws are restrictive. If Costco fails to replicate its international success to date, SG&A leverage may fall short of our forecast 40-basis-point improvement.

On the environmental, social, and governance front, Costco faces risks around labor standards, supply chain oversight, and environmental compliance. Above-market wages mitigate some labor issues, but

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global vendor oversight remains critical, and lapses could bring reputational or regulatory consequences.

Capital Allocation Brett Husslein, Analyst, 22 Dec 2025

We assign Costco an Exemplary Capital Allocation Rating, reflecting a conservative balance sheet, disciplined investment approach, and shareholder distributions that are both manageable and value-accretive. Management's track record of balancing reinvestment back into its competitive advantages with meaningful cash returns to shareholders inspires confidence that capital will continue to be allocated prudently.

Costco enters its next stage of growth with a capital structure that is among the most resilient in global retail. The firm carries approximately \$10 billion in debt and \$14 billion in cash and short-term investments, leaving the company in a net cash position (as of fiscal 2025-end). The 10-year average debt/EBITDA of 1.0 times underscores its conservative leverage, and we forecast the company will continue to deleverage. This provides ample capacity to fund international growth and special dividends without jeopardizing financial stability. Given Costco's history of net interest income exceeding expenses in some years, debt service is effectively immaterial. We see no risk of material value destruction from financial leverage.

Reinvestment remains one of Costco's highest and best uses of capital. Over the past decade, the firm's capital expenditures have held steady around 1.9% of revenue but the amount per year has doubled, now over \$5 billion. These investments in warehouse openings and remodels have supported consistent traffic growth and membership expansion. Costco is much less acquisitive than its rival Walmart, but it acquired Innovel Solutions in 2020 for \$1 billion to further its last mile capacity and bolster its e-commerce delivery, which in our view, is a sound investment. We forecast annual capital spending of roughly 1.7% of sales over our explicit forecast, which should enable it to open 25-30 new warehouses per year. Initially, expansion will remain weighted toward the US, but over time, we expect a greater tilt toward international markets such as South Korea, Japan, Mexico, and Taiwan, where Costco's model has already demonstrated productivity. This, in turn, should deepen its scale advantages, grow its membership base, and expand Kirkland Signature's reach. We also anticipate incremental but measured investment in omnichannel capabilities, as management continues to weigh digital convenience against the risk of undermining its cost advantage. In our view, these reinvestments are clearly value-enhancing with expected returns well above our 7.4% cost of capital.

Costco's approach to capital return is notable for its consistency and restraint. The regular dividend has compounded at a roughly 13% rate since 2010, rising from under \$1 per share annually to \$5.20 today, signaling management's confidence in long-term cash generation. Rather than pursue an aggressive buyback program, Costco has favored returning surplus liquidity through infrequent but substantial special dividends; five such payouts since fiscal 2013 have totaled over \$44 per share, effectively

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supplementing the base dividend without straining leverage. We expect this pattern of steady ordinary dividends, punctuated by opportunistic special payouts, to continue. Share repurchases have been pretty much limited to offsetting dilution from stock-based compensation, which serves as a better alternative to a large-scale buyback program given the company's elevated trading multiple. This measured approach ensures that capital is not misallocated to chasing expensive equity while still offering shareholders attractive cash returns.

Overall, Costco's capital allocation is a model of balance and discipline. The balance sheet is conservative, leaving ample flexibility to fund growth and withstand competitive shocks. Investments are tightly aligned with defending its competitive advantage, particularly through warehouse expansion, membership growth, and private-label penetration. Shareholder distributions are appropriately structured, with ordinary dividends providing stability and special payouts offering flexibility without pressuring leverage. Costco's ability to reinvest at high returns while maintaining balance sheet resilience is a rare strength that should continue to drive shareholder value creation.

Analyst Notes Archive

Costco Earnings: Digital Focus Gains Traction Amid Strong Results; Shares Expensive Brett Husslein, Analyst, 12 Dec 2025

Costco's first-quarter results featured 8.2% net sales growth, 6.4% comparable sales, and diluted EPS of \$4.50. Digitally-enabled comparable sales rose 20.5%, while artificial intelligence-enabled pharmacy initiatives helped drive a 20-basis-point improvement in gross margin (13.1%). Why it matters: Costco is showing it can layer digital and AI capabilities onto its warehouse model. Rising productivity and value are evidenced by record \$250 million Black Friday e-commerce sales and AI tools that pushed pharmacy in-stocks above 98% and drove midteens prescription growth. Strong 14% membership fee growth was partially offset by modest renewal softness among digitally-acquired younger members. We expect renewals to improve as Costco builds out its data and tech platforms to deliver more targeted, personalized member communications. The bottom line: We expect to lift our \$640 fair value estimate for wide-moat Costco by a low-single-digit percentage due to the time value of money. We view shares as more than 35% overvalued, with the price implying compounded midteens EPS growth, which we see as unrealistic amid competition. Costco's shares are down almost 3% year to date, materially underperforming the Morningstar Global Markets Index (up 22%). Down slightly in after-hours trading after results, investors signaled uncertainty over whether renewal rates can meaningfully advance from current levels. We plan to raise our capital spending as a share of sales in fiscal 2026 to 2.2% (from 2%), following management's guidance for new warehouse openings, additional remodels in high-volume units, and expanded digital investments, which would partially offset the lift in our fair value estimate. Coming up: Management expects digital sales to outpace consolidated sales growth over the long term as it rolls out more AI tools, ramps up its retail media offerings, and expands its

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omnichannel options to support store productivity.

Costco: Despite an Enduring Wide Moat, Valuation Looks Quite Rich

Brett Husslein, Analyst, 24 Oct 2025

Unrelenting competition has failed to thwart Costco's standing as an industry leader, with over 60% share of the domestic warehouse club market. Through its membership-based warehouse clubs, Costco serves over 80 million members, delivering high-quality goods and services at low prices. The bottom line: We've lifted our fair value estimate for Costco to \$640 per share from \$620, reflecting the time value of money. We reaffirm Costco's wide moat rating, underpinned by a cost advantage and intangible assets. Our forecast assumes 7.4% annual sales growth and a 100-basis-point increase in operating margin to 4.8% by fiscal 2035. Shares trade about 50% above our fair value estimate, as the market price inflates the margin gains likely to emerge amid intense competition. We model 10.5% compounded EPS growth, underpinned by warehouse expansion, membership scale, and cost discipline, but the mid-teens earnings growth that the market price implies could prove a stretch as the firm works to thwart competition at home and build its footprint abroad. Long view: Despite operating in an increasingly competitive retail landscape and a secular shift toward e-commerce negatively affecting traditional retailers, we believe Costco's differentiated business model, trusted brand, and membership economics will provide structural advantages that peers lack. With the US nearing saturation, we see Costco's global success and rising renewal rates supporting long-term international growth. We project overseas operations to reach 20% of operating income by the end of our forecast period (up from 16% currently). Costco has a loyal membership base, with global renewal rates hovering around 90%, and we estimate the number of members to reach over 130 million by fiscal 2035, nearly doubling fee income.

Costco Earnings: Robust Comparable Sales Growth, but Shares Remain Overvalued

Kristoffer Inton, Senior Equity Analyst, 26 Sep 2025

Costco's revenue grew 8% in the fourth quarter of fiscal year 2025, driven by 5.7% comparable sales growth. Operating margin expanded 10 basis points to 3.9% and adjusted EPS grew by 11% to \$5.29. However, the membership renewal rate fell 40 basis points to 89.8%. Why it matters: Despite a decrease in the renewal rate due to a higher proportion of online signups, paid memberships grew 6.3%. We think Costco's value proposition, combined with ongoing warehouse expansion, should continue to broaden its customer base. The introduction of extended operating hours for executive members (who have higher average ticket sizes) and increased checkout efficiency resulted in 3.5% traffic growth and 1.5% ticket growth. Ultimately, these initiatives led comparable sales in the US to grow by 5.1%. Costco opened five new warehouses in the US, one in Canada, and three internationally, roughly in line with our expectations. We surmise that ongoing expansion positions Costco to penetrate new and existing markets and continue to take market share. The bottom line: With fiscal year 2025 coming within our

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expectations, we do not expect a substantial change to our \$620 fair value estimate for wide-moat Costco. While we remain optimistic about growth initiatives, we view shares as overvalued, trading at a 50% premium to our valuation. Costco should continue to increase its market share and cost advantage in the long run by leveraging its attractive product mix and vast scale. We forecast 6%-7% top-line growth and operating margins above 4%, but the market price implies larger increases. To mitigate tariffs, Costco is consolidating its buying efforts globally to lower the cost of goods across all markets. Additionally, management indicated that it may adjust its product assortment to protect its gross margins. We forecast minimal effects from tariffs.

Costco Earnings: Market Share Gains Look Impressive, but Investors Baking in Overzealous Assumptions

Noah Rohr, Equity Analyst, 30 May 2025

Costco's revenue improved by 8% in its fiscal third quarter 2025, underpinned by 5.7% comparable sales growth (8% excluding gas and currency) and modest store growth. Operating margin expanded 20 basis points to 4.0% and adjusted EPS grew by 13% to \$4.28. Membership renewal rate exceeded 90%. Why it matters: Costco's financial marks remain the envy of the retail industry as the firm's treasure hunt experience and attractive price points yielded strong sales growth. The retailer looks poised to continue taking market share even amid a precarious economic environment. Comparable sales in the US grew by 7.9%, led by a 5.5% uptick in traffic. Comp growth outpaced peers such as Sam's Club (up 6.7%), Walmart US (up 4.5%), Target (down 3.8%), and BJ's (up 3.9%). Share gains should persist as Costco adds members and increases existing customers' spending. Sundries, fresh food, and nonfood categories all enjoyed comparable sales growth in the mid-single digits or better. We're unsurprised by the strong performance in high-frequency food categories, but remain impressed by the firm's ability to drive demand for discretionary products. The bottom line: We plan to raise our \$610 fair value estimate on wide-moat Costco by a low-single-digit percentage due to the time value of money. We remain optimistic about the firm's growth prospects, but think shares, trading at 55 times our estimate for fiscal 2025 earnings, look overvalued. We expect Costco to take market share over the ensuing decade, but think investors are overlooking the potential for greater store cannibalization and slower membership gains in the US, which will likely make it difficult for the firm to consistently exceed its historical pace of growth. Management noted that one-third of its US sales are sourced internationally and less than 10% from China. We expect Costco to shift its supply chain to mitigate potential tariff impacts but acknowledge that higher prices could still weigh on discretionary sales.

Costco Earnings: Top-Line Growth Is Still Best in Class, but Shares Baking in Lofty Expectations

Noah Rohr, Equity Analyst, 7 Mar 2025

We plan to raise our \$560 fair value estimate on wide-moat Costco by a high-single-digit percentage after the warehouse club behemoth posted strong fiscal 2025 second-quarter results. The increase in our fair value stems from a couple of key factors. First, we expect to raise our forecast for companywide

Costco Wholesale Corp COST ★ 8 Jan 2026 22:39, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment ¹
915.31 USD 8 Jan 2026	650.00 USD 22 Dec 2025 22:28, UTC	1.41	406.28 USD Bil 8 Jan 2026	 Wide	 Large Blend	Medium	Exemplary	 7 Jan 2026 06:00, UTC

comparable sales growth in fiscal 2025 to about 7% from 6%. Second, we plan to bring our operating margin forecast closer to 5% by 2034 (the end of our explicit forecast period), up from our current 4.5% estimate, as the firm's relative scale advantage should translate into a gross margin benefit over time. Despite our favorable view of Costco's competitive position and the planned uptick to our fair value, shares look very overvalued, trading at about 55 times our estimate for fiscal 2025 earnings. We surmise that the market is extrapolating Costco's growth trajectory over the previous five years (companywide comparable sales growth averaged 9% from 2020-24) well into the future. In contrast, we expect comp growth to settle into a mid-single-digit trajectory in the long term as its stout presence in the US and Canada continues to mature. Companywide comparable sales expanded 9% (excluding gas and currency impacts), underpinned by about 6% growth in customer traffic and a 3% gain in average ticket. Internationally, sales grew by 10%, while comparable sales in the US expanded 8.6%. Notably, domestic growth comfortably outpaced the results from competing retailers under our coverage, including wide-moat Walmart's US business (comp sales grew 4.6%), no-moat Target (1.5%), and Sam's Club (6.8%). Costco's enviable top-line trajectory reinforces its wide moat rating as shoppers increasingly gravitate to the firm's attractive price points and compelling treasure hunt experience. Regarding profitability, an operating margin of 3.6% expanded by 10 basis points, primarily due to a modest improvement in gross margin and favorable operating leverage.

Costco Earnings: Attractive Merchandise and Low Prices Drive Continued Traffic Growth, Share Gains

Noah Rohr, Equity Analyst, 13 Dec 2024

We plan to modestly raise our \$540 fair value estimate for wide-moat Costco following its solid fiscal 2025 first-quarter earnings release, primarily due to the time value of money. Results were mostly in line with our expectations as net sales expanded 7.5%, and adjusted earnings per share of \$3.82 modestly trailed our \$3.98 forecast. We continue to think that Costco's attractive merchandise assortment and vast scale should drive further market share gains and a widening cost advantage in the long run. As such, we still model 6%-7% top-line growth in the long term and a midcycle operating margin above 4% (versus 3.6% in fiscal 2024). However, we think shares look overvalued, trading at more than 50 times our forecast for fiscal 2025 EPS. Comparable sales in the US (excluding fuel) continued to impress, expanding 7.2% amid a 5% uptick in traffic. Notably, the firm's top-line growth was consistent with results from its main warehouse club competitor, Sam's Club, and continued to outpace recent comparable sales growth from wide-moat Walmart's domestic business (5.3%), no-moat Target (0.3%), and no-moat Kroger (2.3%). International results also proved admirable as comparable sales expanded 6.7% in Canada and 7.1% in other international markets. We were pleased to see management cite high-single-digit sales growth in the fresh foods category and a mid-single-digit gain in food and sundries, both comfortably outpacing the 1.3% average annual growth in food-at-home inflation from September to November 2024. Digital sales also expanded by an impressive 13%, with management citing strength across several discretionary categories, including home furnishings,

Costco Wholesale Corp COST ★ 8 Jan 2026 22:39, UTC

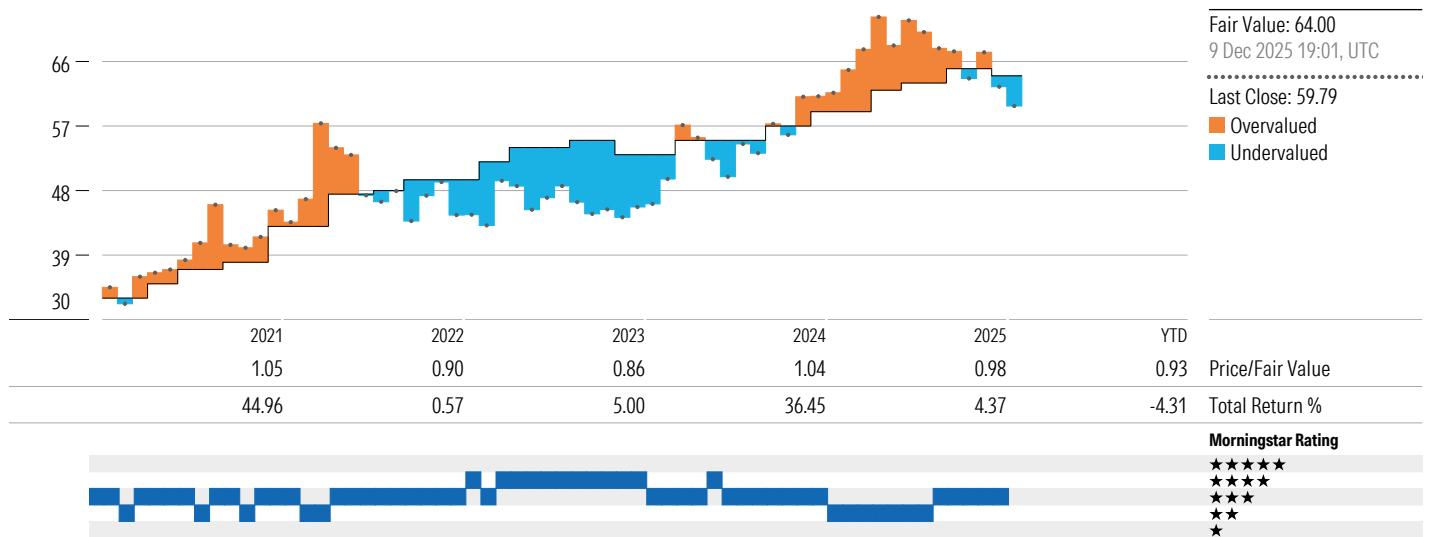
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment ¹
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jewelry, and sporting goods. 

Costco Wholesale Corp COST ★ 8 Jan 2026 22:39, UTC

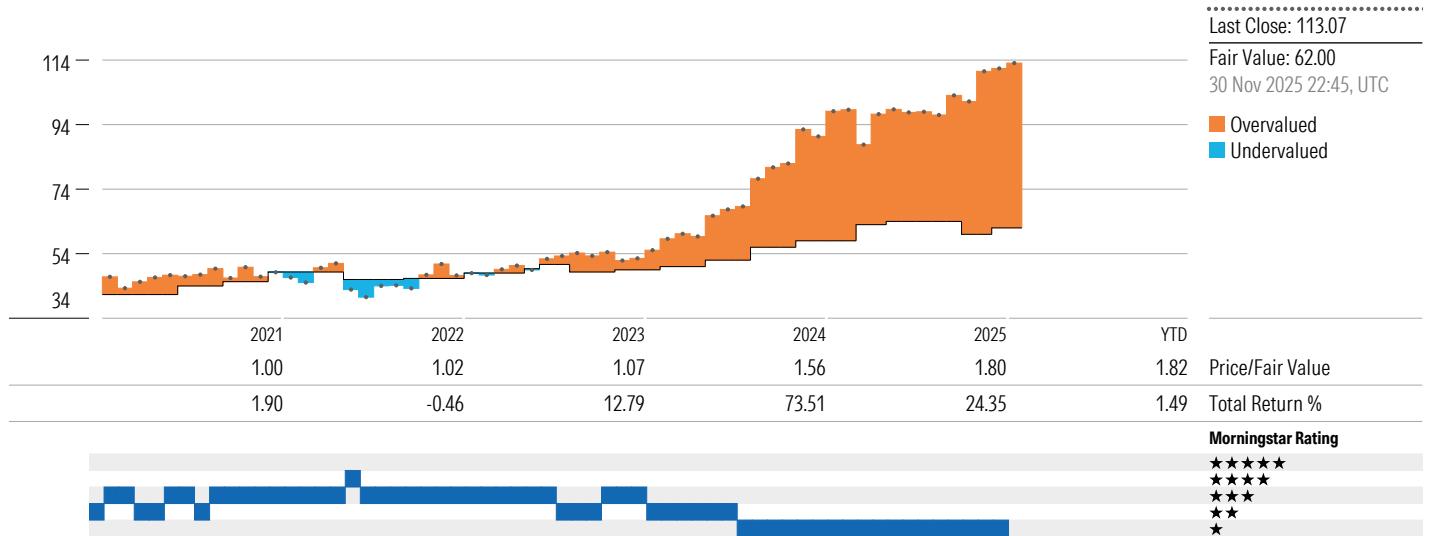
Competitors Price vs. Fair Value

The Kroger Co KR



Total Return % as of 08 Jan 2026. Last Close as of 08 Jan 2026. Fair Value as of 9 Dec 2025 19:01, UTC.

Walmart Inc WMT

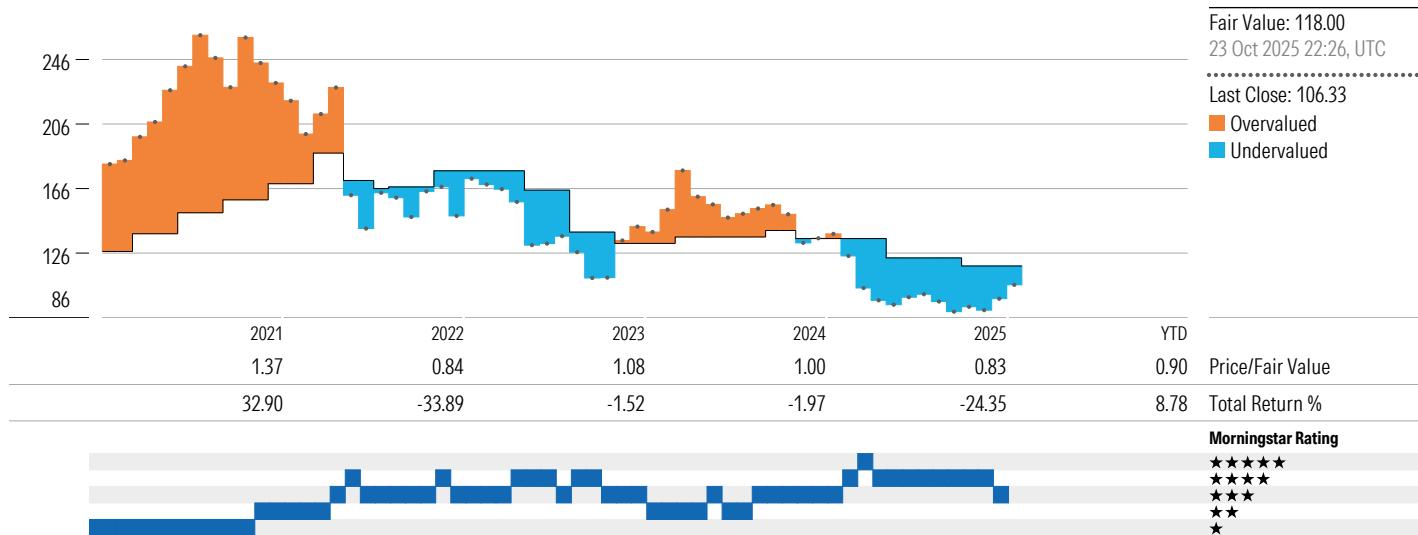


Total Return % as of 08 Jan 2026. Last Close as of 08 Jan 2026. Fair Value as of 30 Nov 2025 22:45, UTC.

Costco Wholesale Corp COST ★ 8 Jan 2026 22:39, UTC

Competitors Price vs. Fair Value

Target Corp TGT



Total Return % as of 08 Jan 2026. Last Close as of 08 Jan 2026. Fair Value as of 23 Oct 2025 22:26, UTC.

Costco Wholesale Corp COST ★ 8 Jan 2026 22:39, UTC

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Morningstar Valuation Model Summary

Financials as of 22 Dec 2025

	Actual			Forecast				
	2023	2024	2025	2026	2027	2028	2029	2030
Fiscal Year, ends 31 Aug								
Revenue (USD Mil)	242,290	254,453	275,235	300,156	323,204	347,371	372,584	398,928
Operating Income (USD Mil)	8,114	9,285	10,383	11,378	12,532	13,644	14,882	16,561
EBITDA (USD Mil)	10,191	11,522	12,809	14,028	15,386	16,713	18,175	20,088
Adjusted EBITDA (USD Mil)	10,191	11,522	12,809	14,028	15,386	16,713	18,175	20,088
Net Income (USD Mil)	6,292	7,367	8,099	8,942	9,601	10,500	11,417	12,784
Adjusted Net Income (USD Mil)	6,292	7,167	8,036	8,942	9,601	10,500	11,417	12,784
Free Cash Flow To The Firm (USD Mil)	5,081	4,526	5,824	5,237	7,072	7,225	8,964	10,171
Weighted Average Diluted Shares Outstanding (Mil)	444	445	444	443	443	442	441	440
Earnings Per Share (Diluted) (USD)	14.16	16.56	18.23	20.17	21.69	23.76	25.89	29.04
Adjusted Earnings Per Share (Diluted) (USD)	14.16	16.11	18.09	20.17	21.69	23.76	25.89	29.04
Dividends Per Share (USD)	3.84	4.36	4.92	5.39	5.90	6.45	7.01	7.88

Margins & Returns as of 22 Dec 2025

	Actual			Forecast					5 Year Avg
	3 Year Avg	2023	2024	2025	2026	2027	2028	2029	2030
Operating Margin %	3.6	3.4	3.7	3.8	3.8	3.9	3.9	4.0	4.2
EBITDA Margin %	4.5	4.2	4.5	4.7	4.7	4.8	4.8	4.9	5.0
Adjusted EBITDA Margin %	—	4.2	4.5	4.7	4.7	4.8	4.8	4.9	5.0
Net Margin %	2.8	2.6	2.9	2.9	3.0	3.0	3.0	3.1	3.2
Adjusted Net Margin %	2.8	2.6	2.8	2.9	3.0	3.0	3.0	3.1	3.2
Free Cash Flow To The Firm Margin %	2.0	2.1	1.8	2.1	1.7	2.2	2.1	2.4	2.6

Growth & Ratios as of 22 Dec 2025

	Actual			Forecast					5 Year CAGR
	3 Year CAGR	2023	2024	2025	2026	2027	2028	2029	2030
Revenue Growth %	6.6	6.8	5.0	8.2	9.0	7.7	7.5	7.3	7.7
Operating Income Growth %	10.0	4.1	14.4	11.8	9.6	10.1	8.9	9.1	11.3
EBITDA Growth %	10.8	5.1	13.1	11.2	9.5	9.7	8.6	8.8	10.5
Adjusted EBITDA Growth %	9.7	5.1	13.1	11.2	9.5	9.7	8.6	8.8	10.5
Earnings Per Share Growth %	11.5	7.7	17.0	10.1	10.6	7.5	9.6	9.0	12.2
Adjusted Earnings Per Share Growth %	11.5	7.7	13.8	12.3	11.5	7.5	9.6	9.0	—

Valuation as of 22 Dec 2025

	Actual			Forecast				
	2023	2024	2025	2026	2027	2028	2029	2030
Price/Earnings	63.0	58.6	50.6	45.4	42.2	38.5	35.4	—
Price/Sales	1.6	1.6	1.5	1.4	1.3	1.2	1.1	—
Price/Book	15.8	17.8	13.9	11.6	11.7	9.8	9.6	—
Price/Cash Flow	—	—	—	—	—	—	—	—
EV/EBITDA	38.6	35.7	31.0	28.3	25.8	23.8	21.9	—
EV/EBIT	48.5	44.3	382.5	34.9	31.7	29.1	26.7	—
Dividend Yield %	0.4	0.5	0.5	0.6	0.6	0.7	0.8	—
Dividend Payout %	27.1	120.1	27.2	26.7	96.4	27.1	85.0	27.1
Free Cash Flow Yield %	—	—	—	—	—	—	—	—

Operating Performance / Profitability as of 22 Dec 2025

	Actual			Forecast				
	2023	2024	2025	2026	2027	2028	2029	2030
Fiscal Year, ends 31 Aug								
ROA %	9.1	9.1	10.5	10.5	10.1	10.5	10.3	10.8
ROE %	28.3	25.1	31.2	27.8	25.5	27.7	25.4	27.2
ROIC %	24.6	23.5	25.5	26.5	26.0	26.0	26.0	26.2

Costco Wholesale Corp COST ★ 8 Jan 2026 22:39, UTC

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Financial Leverage (Reporting Currency)	Actual			Forecast				
	2023	2024	2025	2026	2027	2028	2029	2030
Fiscal Year, ends 31 Aug								
Debt/Capital %	3.5	2.0	1.9	3.3	3.3	3.2	3.2	3.1
Assets/Equity	2.8	3.0	2.6	2.5	2.6	2.5	2.5	2.4
Net Debt/EBITDA	-0.6	-0.3	-0.6	-0.5	-0.2	-0.4	-0.3	-0.6
Total Debt/EBITDA	0.9	0.7	0.6	0.7	0.7	0.7	0.6	0.6
EBITDA/ Net Interest Expense	-27.3	-25.3	-29.4	-36.1	-152.0	-97.0	-129.4	-77.5

Forecast Revisions as of 22 Dec 2025	2026		2027		2028	
Prior data as of 23 Oct 2025	Current	Prior	Current	Prior	Current	Prior
Fair Value Estimate Change (Trading Currency)	650.00	642.27	—	—	—	—
Revenue (USD Mil)	300,156	300,391	323,204	323,291	347,371	346,671
Operating Income (USD Mil)	11,378	11,388	12,532	12,551	13,644	13,653
EBITDA (USD Mil)	14,028	14,040	15,386	15,406	16,713	16,715
Net Income (USD Mil)	8,942	8,950	9,601	9,622	10,500	10,517
Earnings Per Share (Diluted) (USD)	20.17	20.18	21.69	21.74	23.76	23.80
Adjusted Earnings Per Share (Diluted) (USD)	20.17	20.18	21.69	21.74	23.76	23.80
Dividends Per Share (USD)	5.39	5.39	5.90	5.90	6.45	6.45

Key Valuation Drivers as of 22 Dec 2025		USD Mil
Cost of Equity %	7.5	
Pre-Tax Cost of Debt %	5.3	
Weighted Average Cost of Capital %	7.4	
Long-Run Tax Rate %	24.0	
Stage II EBI Growth Rate %	7.2	
Stage II Investment Rate %	37.2	
Perpetuity Year	20	

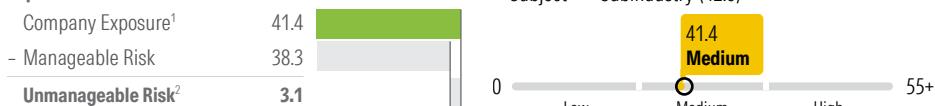
Discounted Cash Flow Valuation as of 22 Dec 2025		
Present Value Stage I		70,330
Present Value Stage II		62,955
Present Value Stage III		143,397
Total Firm Value		276,682
Cash and Equivalents		14,161
Debt		9,935
Other Adjustments		0
Equity Value		280,908
Projected Diluted Shares		444
Fair Value per Share (USD)		650.00

Costco Wholesale Corp COST ★ 8 Jan 2026 22:39, UTC

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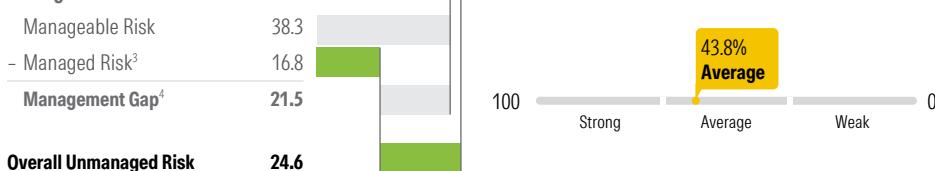
ESG Risk Rating Breakdown

Exposure



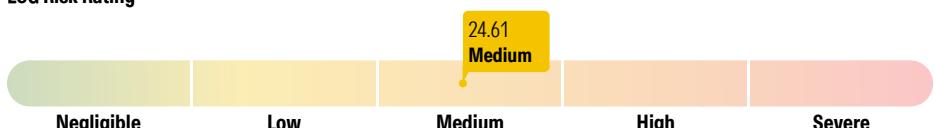
- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

Management



- 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

Overall Unmanaged Risk



ESG Risk Rating Assessment⁵



ESG Risk Rating is of Dec 03, 2025. Highest Controversy Level is as of Dec 08, 2025. Sustainalytics Subindustry: Food Retail. 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/.

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 43.8% 4. Management Gap assesses risks that are not managed, but are considered manageable 5. ESG Risk Rating Assessment = Overall Unmanaged Risk = Management Gap plus Unmanageable Risk

Peer Analysis 07 Jan 2026

Company Name	Exposure	Management	ESG Risk Rating
Costco Wholesale Corp	41.4 Medium	43.8 Average	24.6 Medium
The Kroger Co	47.3 Medium	55.3 Strong	23.1 Medium
Walmart Inc	43.1 Medium	61.3 Strong	18.6 Low
Target Corp	33.2 Low	61.9 Strong	14.3 Low
BJ's Wholesale Club Holdings Inc	45.4 Medium	40.7 Average	28.3 Medium

Appendix

Historical Morningstar Rating

Costco Wholesale Corp COST 8 Jan 2026 22:39, UTC

Dec 2026	Nov 2026	Oct 2026	Sep 2026	Aug 2026	Jul 2026	Jun 2026	May 2026	Apr 2026	Mar 2026	Feb 2026	Jan 2026
—	—	—	—	—	—	—	—	—	—	—	★
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
★★	★	★★	★★	★★	★★	★★★	★★★	★★★	★★★	★★★	★★★

The Kroger Co KR 8 Jan 2026 22:39, UTC

Dec 2026	Nov 2026	Oct 2026	Sep 2026	Aug 2026	Jul 2026	Jun 2026	May 2026	Apr 2026	Mar 2026	Feb 2026	Jan 2026
—	—	—	—	—	—	—	—	—	—	—	★★★
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
★★★	★★	★★★	★★★	★★	★★★	★★★	★★★	★★★	★★	★★★	★★★

Walmart Inc WMT 8 Jan 2026 22:41, UTC

Dec 2026	Nov 2026	Oct 2026	Sep 2026	Aug 2026	Jul 2026	Jun 2026	May 2026	Apr 2026	Mar 2026	Feb 2026	Jan 2026
—	—	—	—	—	—	—	—	—	—	—	★
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
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★

Target Corp TGT 8 Jan 2026 22:43, UTC

Dec 2026	Nov 2026	Oct 2026	Sep 2026	Aug 2026	Jul 2026	Jun 2026	May 2026	Apr 2026	Mar 2026	Feb 2026	Jan 2026
—	—	—	—	—	—	—	—	—	—	—	★★★
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
★★	★	★	★	★	★	★	★	★	★	★	★

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, in-depth 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	

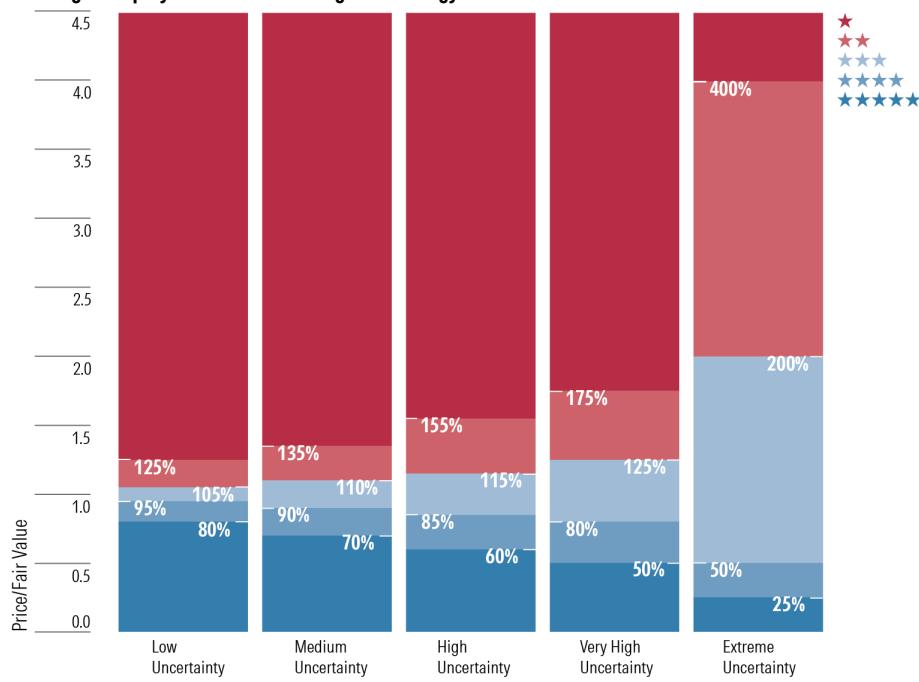
Our uncertainty rating is based on the interquartile range, or the middle 50% of potential outcomes, covering the 25th percentile–75th percentile. This means that when a stock hits 5 stars, we expect there is a 75% chance that the intrinsic value of that stock lies above the current market price. Similarly,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

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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/

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