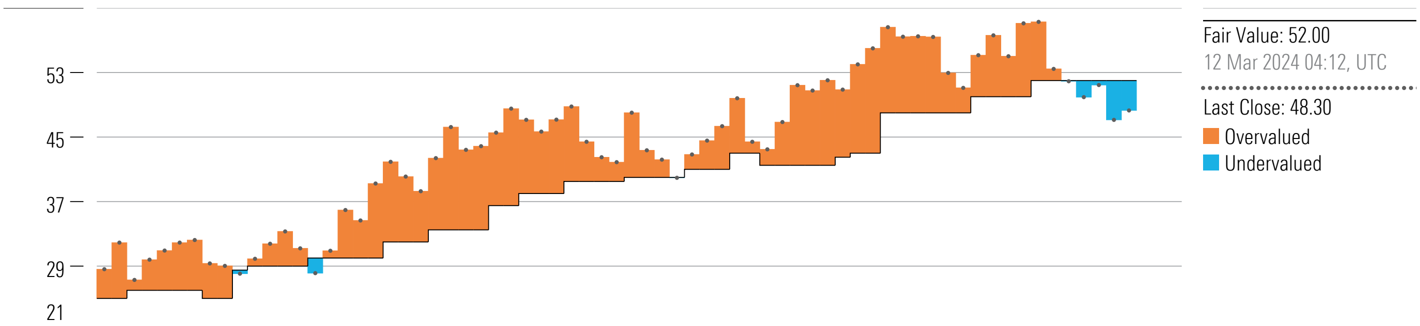
Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

Monster Beverage Corp MNST ★★★ 4 Sep 2024 21:30, UTC

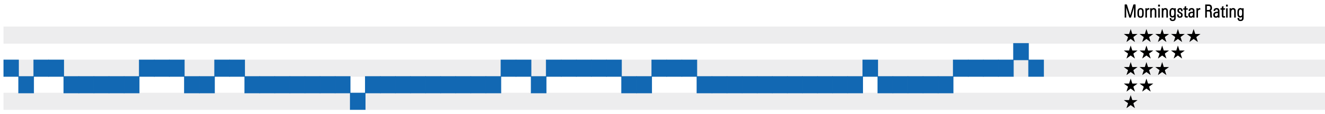
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
48.30 USD 3 Sep 2024	52.00 USD 12 Mar 2024 04:12, UTC	0.93	47.39 USD Bil 4 Sep 2024	Narrow	Mid Blend	Medium	Standard	7 Aug 2024 05:00, UTC

Price vs. Fair Value



	2019	2020	2021	2022	2023	YTD	
	1.10	1.38	1.20	1.22	1.15	0.93	Price/Fair Value
	29.11	45.52	3.85	5.72	13.48	-16.16	Total Return %

Morningstar Rating



Total Return % as of 03 Sep 2024. Last Close as of 03 Sep 2024. Fair Value as of 12 Mar 2024 04:12, UTC.

Contents

Important Disclosure

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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.

Monster Beverage Earnings: International Markets Contribute Bulk of Growth While US Demand Softens

Analyst Note Dan Su, CFA, Equity Analyst, 8 Aug 2024

Narrow-moat Monster Beverage hit a soft patch in the second quarter, increasing sales and earnings per share by 2.5% and 5%, respectively. This marks a deceleration from its double-digit-rate growth trajectory in the past five quarters, but we attribute the slowdown largely to consumer belt-tightening in the US (61% of total sales), in particular falling foot traffic at convenience stores, a key channel. As we expect the US macro backdrop to remain challenging for Monster and outweigh growth momentum internationally, we plan to trim our 2024 sales and EPS by a low-single-digit percentage. That said, we believe Monster's steadfast investment in innovation and brand marketing, with its long-term distribution partnership with wide-moat Coke, should drive high-single-digit annual sales growth and low 30s operating margins over the next decade. We plan no material change to our $52 fair value estimate. Shares look undervalued after the low-double-digit slide in earnings.

For the quarter, US sales were roughly flat, but we expect new product Monster Energy Ultra Vice Guava and new flavors from the Bang brand to provide a lift in the second half. International sales rose 14% in constant currency, led by strength in Latin America, Australia, and Asia-Pacific. We expect overseas markets will remain a growth driver, where the firm has prudently executed a two-pronged growth strategy, leveraging innovations to advance its Monster brand in developed economies, while expanding distribution of affordable brands Predator and Fury across emerging markets. Predator drinks launched in China and India both garnered positive market response and further rollouts are underway.

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Sector	Industry
Consumer Defensive	Beverages - Non-Alcoholic

Business Description

Monster Beverage is a leader in the energy drink subsegment of the nonalcoholic beverage market, generating two thirds of revenue in the US and Canada. The well-known Monster trademark includes brands such as Monster Energy, Monster Ultra, Java Monster, and Juice Monster. The firm also owns other energy drink brands, such as Reign, NOS, Burn, and Mother, and brews and distributes beers and flavored malt beverages following the acquisition of a craft brewer in 2022. Monster controls branding and innovation but outsources beverage manufacturing and packaging to copackers and finished goods distribution to bottlers in the global Coca-Cola system (pursuant to a 20-year agreement inked in 2015). Coke is the largest shareholder of Monster with a 19.5% stake.

Operating margins contracted 50 basis points to 27.7%, as easing freight and aluminum costs were more than offset by heavy investments in marketing and labor. We expect limited upside in this metric in the next few quarters as marketing expenses remain elevated behind Monster's accelerated product releases.

Business Strategy & Outlook Dan Su, CFA, Equity Analyst, 9 May 2024

Although not the pioneer in energy drinks, Monster has earned its perch in this attractive category through innovations that resonate with consumers and effective marketing that keeps its core brand top of mind. The long-term distribution partnership with wide-moat Coca-Cola, effective since 2015, further advances Monster's competitive standing, affording the firm impressive distribution breath and product availability that is hard to match by rivals. As such, we award a narrow economic moat rating for Monster.

We see Monster as remaining well positioned to capitalize on favorable energy drink demand in the coming years, thanks to a sharpened focus on user activation and engagement by expanding consumption occasions and adding better-for-you options, including zero sugar versions of its classic recipes and plant-based drinks. In addition, we expect Monster's efforts to reach more untapped consumers in vast emerging markets across Latin America and Eastern Europe to garner stronger support from the Coke system, now that Coca-Cola has scrapped its own energy offerings following a lackluster response. Monster has a two-pronged strategy in place, maintaining a premium positioning for the core Monster trademark in the modern retail and convenience channels, while rolling out Predator and Fury brands at more affordable price points to tap consumers not as well-heeled as the traditional Monster demographic. We believe the Coke system's close ties with the traditional trade will be particularly helpful to this affordability endeavor.

Despite our sanguine view, Monster's growth outlook is not without risks. Regulatory scrutiny and administrative restrictions on caffeine content and marketing constraints remain a threat to Monster's brand image and volume demand in North America and Western Europe. Competition ferocity is on the rise as well, as beverage giant wide-moat PepsiCo brings strong tier-two energy brands onto its own distribution network, while various emerging brands target energy drinkers that look for new fares. That said, we believe Monster is poised to continue thriving thanks to an advantaged competitive position and management's strong execution.

Bulls Say Dan Su, CFA, Equity Analyst, 9 May 2024

- Strong energy drink demand, coupled with Monster's strong innovation pipeline, bodes well for high-single-digit top-line growth in the coming years.
- Monster has broadened its appeal to health-conscious consumers with better-for-you drinks, including zero sugar, zero calorie offerings and beverages containing only natural ingredients.

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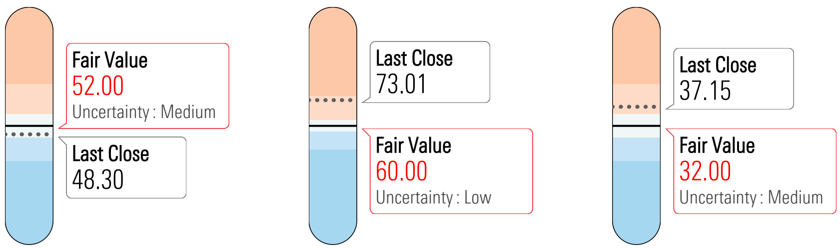
Competitors



	Monster Beverage Corp MNST	Coca-Cola Co KO	Keurig Dr Pepper Inc KDP
Economic Moat	Narrow	Wide	Narrow
Currency	USD	USD	USD
Fair Value	52.00 12 Mar 2024 04:12, UTC	60.00 13 Sep 2023 21:21, UTC	32.00 8 Jan 2024 19:50, UTC
1-Star Price	70.20	75.00	43.20
5-Star Price	36.40	48.00	22.40
Assessment	Fairly Valued 4 Sep 2024	Overvalued 4 Sep 2024	Overvalued 4 Sep 2024
Morningstar Rating	★★★4 Sep 2024 21:30, UTC	★★4 Sep 2024 21:31, UTC	★★4 Sep 2024 21:40, UTC
Analyst	Dan Su, Equity Analyst	Dan Su, Equity Analyst	Dan Su, Equity Analyst
Capital Allocation	Standard	Exemplary	Standard
Price/Fair Value	0.93	1.21	1.16
Price/Sales	6.87	6.80	3.43
Price/Book	8.10	12.17	2.04
Price/Earning	30.02	27.30	23.80
Dividend Yield	0.00%	2.59%	2.31%
Market Cap	47.39 Bil	312.72 Bil	50.49 Bil
52-Week Range	43.32—61.23	51.55—73.53	27.66—37.58
Investment Style	Mid Blend	Large Blend	Mid Blend

- Monster stands to gain volume share as the maker of rival brand Bang (with high-single-digit volume share in the US) filed for bankruptcy in 2022.

Bears Say Dan Su, CFA, Equity Analyst, 9 May 2024

- Regulatory scrutiny and administrative restrictions in the US and Europe will likely persist and erode Monster's brand intangibles and retail demand.
- PepsiCo has stepped up investments in its own energy drink portfolio, posing threats to Monster's dominance in North America.
- The firm faces an uphill battle to advance its low-single-digit volume share in Asia-Pacific (35% of global energy drink demand) given stiff competition from Red Bull's sister company T.C. Pharmaceutical and other well-established local brands.

Economic Moat Dan Su, CFA, Equity Analyst, 8 May 2024

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We believe Monster Beverage has carved out a narrow economic moat, thanks to strong brand affinity in the energy drink category and extensive distribution reach through a long-term partnership with the Coca-Cola system globally. The brand intangible-driven moat has helped the firm deliver returns on invested capital (including goodwill) that exceeded our estimate of its 7.5% weighted average cost of capital over the past 10 years, and we project excess investment returns to continue over the next decade. That said, Monster's narrow focus on energy drinks (which represent a low-single-digit percentage of overall soft drink volume), regulatory headwinds, and uncertainties surrounding the ultimate renewal of the Coke distribution agreement in 11 years, combine to constrain our confidence in the firm's ability to deliver excess returns for more than 20 years. We therefore cap our rating at a narrow moat.

Monster's intangible asset-driven moat is premised on the brand equity associated with its namesake Monster trademark. Although launched 15 years behind energy drink pioneer Red Bull, the Monster brand has amassed leading volume share globally (18% in 2023 versus 14% for Austria-based Red Bull GmbH, according to Euromonitor). And in its core North America market, where Monster generates two thirds of its revenue, the brand holds a whopping 44% volume share, far outpacing Red Bull at just 24%. We attribute this to Monster's constant stream of innovation that resonates with consumers and a series of high-profile sports sponsorships, including Nascar and MotoGP World Championship, that serve to keep its brand top of mind with consumers.

We see structural factors in the $78 billion global energy drink category that are conducive to Monster's brand equity. Favorable volume trends (averaging 6% in the US over the past decade, versus 2% in the overall soft drink sphere) fueled by demand from busy consumers looking for a quick and convenient energy boost have enabled top brands like Monster to increase sales and brand awareness with more productive spending in advertising and marketing. Based on our calculation, each incremental dollar that Monster spent on advertising and marketing drove $13.10 in increased revenue on average over the past five years, ahead of its larger nonalcoholic beverage peers Coca-Cola ($12.00), PepsiCo ($11.40), and Keurig Dr Pepper ($10.20). Moreover, brand differentiation is largely based on perceived functional benefits (such as mental alertness and improved energy level) and to a lesser extent flavor profiles, which underpin consumer loyalty and repeat purchase frequency. As such, private-label penetration is low in energy drinks, at low single digits versus the midteens or low-20s common in the domestic consumer goods sphere. As a result, Monster has been able to grow volumes at midteens rates annually over the past five years while keeping prices flat. Even though the firm does not publish retail-level product pricing information to facilitate an analysis of pricing trends, we'd point to Monster's high gross margins (averaging 56% over the past five years, comparable with Coca-Cola at 60% and PepsiCo at 54%), as a strong indication of consumers' willingness to pay a premium.

We also view Monster's success over the years in adding new product lines and pricing ladders under the Monster banner as evidence of its brand prowess in engaging and maintaining its loyal customer

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base. Ten product lines have been added to the Monster franchise over the past 20 years, including Monster Super Fuel (containing magnesium and electrolytes for workout enthusiasts), bubbly Juice Monster with various fruit flavors, non-carbonated tea-flavored Monster Rehab, and coffee-infused dairy-based Java Monster. We believe these line extensions have expanded consumption occasions and created more buzz for the existing consumer community while broadening the palate appeal to convert new customers to the trademark in the US and internationally.

In addition to the Monster trademark, we see the firm's distribution agreement with Coke as the second pillar to our economic moat rating. Effective since 2015, the initial 20-year partnership has essentially made Monster the exclusive energy play in the Coke system, giving Monster invaluable access to Coke's extensive distribution footprint in the US and internationally, while enabling Coke to benefit from Monster's strong volume growth in terms of distribution density to help offset stagnating trends in Coke's core soda business. The tie-up has accelerated Monster's share gains, enabling the firm to further distance itself from Red Bull in North America and to narrow the gap materially in Western Europe. According to Euromonitor, Monster's global volume share received an immediate lift following the agreement, expanding to 17% in 2016 (compared with 13% in 2014), and continued to tick up steadily in the following years to reach 18% by 2023. In comparison, Red Bull GmbH's volume share has stagnated at around 14% over the past decade, which we attribute to conservative product and marketing strategies from the family-owned business. Although Coke launched energy drinks under its own Coke trademark in 2020 in an attempt to go it alone, the product line was discontinued within 18 months due to weak performance. We believe Coke's short-lived endeavor has reaffirmed the strength of the Monster franchise, and we expect the Coke system to reinforce its commitment to the leading energy drink brand.

Aided by the Coke system, the Monster products are now sold in over 140 countries and territories around the world, affording brand recognition and product accessibility that is hard to match by its energy drink peers. Over the next 10 years, we think the Coke relationship should deliver more volume upside, particularly in emerging markets such as Latin America, where energy drink consumption volume remains low (at 8% of global volume, versus a 14% share in the overall soft drink aisle). These growth initiatives, which dovetail well with Coke's strategic priorities of tapping consumption upgrade tailwinds in these regions, should drive another leg of volume growth for Monster, supporting our mid-single-digit volume projection for the firm (ahead of the low-single-digit rate we forecast for the overall nonalcoholic beverages).

As energy drinks remain a niche in the broader soft drink space (low-single-digit volume share), we don't think Monster benefits from a cost advantage given its negligible scale relative to beverage behemoths such as wide-moats Coke and PepsiCo. Monster has little bargaining power in sourcing ingredients (sweeteners, vitamins, and flavors) or packaging materials (aluminum, PET, and paper

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cartons) given the substantial overlap with the purchasing baskets of much larger beverage peers. Also, with packaging and distribution outsourced to third-party copackers, bottlers, and distributors, Monster has limited wiggle room in negotiating reduced per unit costs. Moreover, its advertising and marketing budget of approximately $550 million in 2023 (8% of sales) is a fraction of the $5.0 billion at Coke (11%) and $5.7 billion at PepsiCo (6%), putting the firm at a disadvantage in bidding for sports and music event sponsorships or securing a popular time slot in broadcast media campaigns.

While we see strong evidence of brand intangibles and extensive distribution via the Coke partnership that underpin a durable competitive position, our confidence in Monster's ability to deliver excess investment returns for over 20 years is constrained by the firm's narrow focus on the energy drink category, ongoing regulatory scrutiny, and potential restrictive measures for energy drink makers (such as reduced caffeine content, marketing venue restrictions, or even minimum age requirements for purchase). Furthermore, the Coke distribution agreement is up for renewal in 11 years (2035), which introduces further uncertainties around the continuity of the partnership and the economic terms. As such, we view a narrow economic moat as appropriate for Monster.

Fair Value and Profit Drivers Dan Su, CFA, Equity Analyst, 8 May 2024

We are maintaining our $52 per share fair value estimate for Monster Beverage after digesting its first-quarter results. Our intrinsic valuation implies a 26 times multiple against our adjusted 2025 earnings estimate and a 2025 enterprise value/adjusted EBITDA multiple of 22 times. For the March quarter, sales and EPS both grew 12% led by double-digit volume gains, reaffirming our optimism on the firm’s long-term outlook underpinned by brand strength and partnership with wide-moat Coke. International growth was a highlight, with sales up 20% (30% in constant currency), accelerating from the 15% pace in 2023 thanks to volume share gains as well as higher prices in select markets. We attribute the strong performance to the release of zero sugar recipes across Europe and wider distribution in Latin America, which are consistent with updates from major Coke bottlers. In the coming quarters, we expect volumes to also benefit from the launches of the Predator brand in the Philippines and a noncarbonated formula in a 500 ml PET bottle specifically for the Chinese market.

Over the next 10 years, our 8% revenue CAGR forecast is driven by our expectation for steady increases in energy drink volume expansion (at a mid-single-digit rate each year) and in pricing (2%-3% annually), which are consistent with trends forecast by Euromonitor. We expect the core Monster trademark (90% of sales) will remain the key revenue growth driver, with incremental revenue from new product launches including more better-for-you offerings. Further, we expect the newly acquired craft beer brands, together with the malt beverage offerings in the pipeline to ramp up sales at double-digit rates in the next few years once integration is complete, although from a very small revenue base. Given a lack of brand intangibles and stiff competition in the unfamiliar alcoholic beverage sphere for Monster, we expect this new category to make up only 4% of sales by 2033.

On the profitability front, we have modeled operating margins to expand by 640 basis points to 34.3% at the end of our 10-year forecast period, relative to 2023. It's worth noting that margins were depressed the past three years due to temporary factors, including pandemic-driven supply chain disruptions that drove significantly higher costs in co-packing and imported aluminum cans. Against this backdrop, we believe a more suitable base of comparison would be year 2019, when Monster posed a 33.4% operating margin, or 90 basis points shy of our terminal-year projection. For the forecast period, we have modeled 210 basis points of gross margin contraction (against 2019), mainly due to lower margins anticipated for Monster's affordability initiatives in 2023 and onward to tap additional demand in emerging markets with the launch of the lower-priced Predator and Fury brands. In addition, we expect the newly acquired alcoholic beverage business to carry lower gross margins (compared with the energy drink unit) given a lack of brand intangibles and small scale. We expect contraction on the gross margin line to be more than offset by effective leverage of advertising spending (7.3% of sales by 2033 versus 9.3% in 2019) and enhanced efficiency in its labor and distribution expenses (16.3% of sales by 2033 versus 17.2% in 2019).

Risk and Uncertainty Dan Su, CFA, Equity Analyst, 8 May 2024

We assign a Medium Uncertainty Rating to Monster Beverage. The company is exposed to regulatory scrutiny and administrative restrictions that may erode the brand perception and retail demand. A narrow focus on energy drinks further exposes the firm to material and sudden demand shifts away from this category. Monster also faces competitive threats in the energy drink sphere led by PepsiCo and in the malt beverage category where Monster has weak brand perception and distributor relationships.

Outsourced manufacturing and distribution make Monster vulnerable to disruptions in third-party co-packing and distribution capacity that could result in production delays and inflated costs. While distribution risks are likely under control due to its alliance with the Coke system and the latter's distribution scale, it will remain a challenge for the firm to secure reliable third-party co-packers in emerging markets where the firm looks to ramp up volume.

On sourcing, Monster's recent entry into craft beer brewing may subject it to low availability of rare hops (for premium beers) that affects the brewing schedule and output. In addition, we expect the firm to constantly contend with tight aluminum can supply as more beverage makers adapt to increasing preference for this packaging among environmentally conscious consumers.

The highly visible Monster trademark is constantly under the scrutiny of consumers given the ubiquity of mobile phones and social media. Any brand messaging, consumer experience, social, or sustainability practice that is perceived to be inconsistent with the company's positioning could be brought into the limelight. Without a timely and appropriate response, brand damage and a hit to volume demand and pricing power could ensue. That said, we don't expect environmental, social, and governance risks will materially affect Monster' operational results and investment returns long term.

Capital Allocation Dan Su, CFA, Equity Analyst, 8 May 2024

We assign a Standard Capital Allocation Rating to Monster, based on our view that the company has a strong balance sheet, a fair track record of investments for long-term value creation, and an appropriate shareholder distribution practice with stock buybacks.

First, we view Monster as in solid financial health. Its balance sheet is strong, with no long-term debt and $3.6 billion in cash and short-term investments as of March 2024. This, coupled with steady free cash flow to equity over the next 10 years (averaging 24% of sales), gives us confidence that the company is positioned well to withstand macro volatilities and to invest for long-term growth.

On the investment front, capital outlays for organic growth have been the priority, with the firm spending an average of 8% of sales on marketing and advertising over the past five years, though just 2% on capital expenditure as the firm outsources the bulk of manufacturing and distribution. We expect the firm to maintain investments in advertising at similar levels over the next 10 years, while ticking up spending in capacity to 2.6% of sales due to investments in brewing and warehousing capabilities for the newly acquired malt beverage business. We believe these investments are crucial to maintaining the firm's long-term competitive position and supporting revenue growth.

Monster made a few sizable acquisitions over the past 10 years, namely the $690 million purchase of major flavor supplier American Fruits & Flavors (AFF) in 2016, the $330 million deal buying California-based craft brewer CANarchy in 2022, and the $360 million acquisition of Bang energy drink maker Vita Pharmaceuticals in 2023. Given that AFF contributes under 1% of operating profits to Monster, we believe the transaction is most likely a strategic one to lock in high-quality fruit ingredients and flavors that help differentiate Monster from peers. Regarding the CANarchy acquisition in 2022, we think the firm is prudently diversifying into the alcoholic beverage category for new avenues of growth and, if successful, should alleviate investor concern about Monster's narrow focus on energy drinks. That said, given Monster's lack of well-known malt beverage brands and stiff competition led by entrenched players, including Constellation, AB InBev, and Boston Beer, Monster will need to invest heavily in marketing and distributor relationship building for several years at least before generating tangible benefits from the acquisition. The 2023 acquisition of the Bang brand portfolio and manufacturing facilities should help Monster expand access to the wellness and lifestyle-focused consumer segment that Bang has built a strong connection with in past years. Once Monster ramps up manufacturing and migrates the distribution of Bang-branded products to the Coke system, we expect the Bang portfolio to contribute to revenue and profit growth in the near 12 to 18 months.

We believe the swap of Monster's nonenergy assets for Coke's seven-brand energy drink portfolio in

2015 (as part of the long-term partnership agreement) was an important transaction as well, which helped to cement Monster's status as the exclusive energy play in the Coke system and eliminated potential conflicts of interests between the two partners. However, the price tag for the Coke assets was undisclosed, making it impossible for us to quantify investment returns from this deal.

On shareholder distributions, Monster has not paid any cash dividends since inception and has no such plans in the foreseeable future. However, the company did return more than $5 billion in cash to shareholders over the past 10 years via share buybacks, with a remaining balance of $642 million under the authorized buyback plan as of March 2024. In addition, Monster announced a tender offer for $3 billion in May 2024, to be funded by $2 billion cash on hand and the balance by revolving credit and term loans. Co-CEOs Sachs and Schlosberg, both in their 70s, plan to participate by selling down their stakes, which we view as indicating that succession planning is in motion. Given Sachs' plan to step back from day-to-day management but to retain the board chairman position starting in 2025 while Schlosberg becomes the sole CEO, we expect the gradual transition over the next few years should ensure continuation of Monster's growth roadmap and allow time to groom the next generation of top managers.

Analyst Notes Archive

Monster Earnings: Strong Growth Led by International Markets; Pricing Holds Steady in US Dan Su, CFA, Equity Analyst, 3 May 2024

We don't plan any material changes to our $52 fair value estimate for narrow-moat Monster Beverage after digesting first-quarter results. Sales and earnings per share both grew 12%, led by double-digit volume gains, reaffirming our optimism on the firm's long-term outlook underpinned by brand strength and Monster's partnership with wide-moat Coke. We expect Monster to continue with a two-pronged growth strategy, leveraging innovations (zero-sugar recipes, new fruit flavors, slim packaging) to drive growth of the core Monster brand in developed economies while widening distribution of affordable brands Predator and Fury across Asia, Latin America, and Africa. Our 10-year projections for high-single-digit annual sales growth and operating margin averaging in the low 30s remain in place. The shares appear slightly overvalued.

International growth was a highlight, with sales up 20% (30% in constant currency), accelerating from the 15% pace in 2023 thanks to volume share gains as well as higher prices in select markets. We attribute the strong performance to the release of zero-sugar recipes across Europe and wider distribution in Latin America, consistent with updates from major Coke bottlers. In the coming quarters, we expect volume to also benefit from the launches of the Predatory brand in the Philippines and a noncarbonated formula in a 500-milliliter PET bottle specifically for the Chinese market. In the US, energy drink demand remained strong, though management echoed the cautious views of beverage peers regarding belt-tightening by lower-income consumers. We expect Monster to hold prices steady while stepping up innovation to preserve the value proposition of its products. At the corporate level, average net sales per unit case dipped 4% to $8.70, but we think this was largely driven by sizable currency headwinds. We expect underlying pricing should remain on a positive low-single-digit trajectory in the coming years.

Monster Beverage Earnings: Innovation, International Markets Fuel Growth; Pricing Discipline Intact

Dan Su, CFA, Equity Analyst, 29 Feb 2024

We plan to raise our $50 fair value estimate for narrow-moat Monster Beverage by a mid-single-digit percentage to account for strong 2023 results and the time value of money. Increases of 13.1% for revenue and 38.0% for earnings per share in 2023 outpaced our estimates of 12.8% and 34.6% on strong volume expansion and better-than-expected margin gain, reaffirming our confidence in Monster's long-term outlook underpinned by strong brands and the long-term partnership with Coca-Cola. In the coming years, we expect innovations (zero-sugar recipes, new fruit flavors, variety packs, and slim packaging) will continue to drive the bulk of growth in the US. Meanwhile, the firm has multiple levers to pull internationally, including new products, wider distribution, and the rollout of affordable brands Predator and Fury to tap energy drink consumers across emerging markets. Our 10-year projections for high-single-digit annual sales growth and operating margin averaging in the low 30s remain in place. We view the shares, which popped 5% in after-hours trading, as overvalued.

In 2023, Monster Energy drinks segment revenue (92% of the total) grew 13% on 10% volume expansion, showcasing the firm’s ability to engage its consumer base with innovation and marketing. Volume contribution was limited from the Bang acquisition, which closed in July, and newly launched alcoholic beverages such as Beast Unleashed hard tea, but we expect more volume upside as these new products gain traction in distribution. Pricing increases of 2% were disciplined; we expect a similar range for 2024 as management continues to focus on the value proposition and remains cautious about a softer consumer backdrop in the core US market. Operating margin widened 230 basis points to 27.4% due to lower raw material and freight costs, but we expect margin gains to moderate in the next two to three years as Monster invests more in supply chain and marketing to accelerate its international expansion.

Monster Beverage Earnings: Strong Volume on Innovation and Marketing, Pricing Discipline Upheld

Dan Su, CFA, Equity Analyst, 3 Nov 2023

Narrow-moat Monster Beverage posted accelerating volume and better-than-expected profit growth in the third quarter, reinforcing our confidence in its long-term prospects underpinned by brand intangibles and the strategic partnership with wide-moat Coca-Cola. Sales grew 14% (on an 11% volume expansion, accelerating from 8% in the first half) and EPS rose 43%, outpacing our estimates for 13% and 25% increases, respectively. We plan to tick up our 2023 forecasts, but our 10-year projections

Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 11 of 22

Monster Beverage Corp MNST ★★★ 4 Sep 2024 21:30, UTC

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48.30 USD 3 Sep 2024	52.00 USD 12 Mar 2024 04:12, UTC	0.93	47.39 USD Bil 4 Sep 2024	Narrow	Mid Blend	Medium	Standard	7 Aug 2024 05:00, UTC

for high-single-digit annual sales growth and operating margin averaging 32% remain in place. As such, our $48 fair value estimate will likely rise by a low-single-digit percentage. We view the shares as fairly valued.

Net sales for the Monster Energy drinks segment (90% of sales) grew 15% on a constant-currency basis, with low-teens volume expansion showcasing the firm's ability to retain and expand its consumer base through product innovation (zero-sugar recipes, new fruit flavors, and slim packaging), effective digital marketing that resonates with consumers, and expanding distribution in Europe and Asia, including China, where Monster currently holds a low-single-digit volume share. We see volume upside from the Bang acquisition, which closed in July and should expand Monster's exposure to the lifestyle segment of the energy drink market as well as help fend off competition from new entrants including Celsius and C4. However, we expect the volume contribution to be small in the coming quarters as distribution migrates to the Coke system. We think management is prudent to limit price hikes to 2%-3%, consistent with historical levels, which should help preserve its value proposition amid consumer belt-tightening. Operating margin expanded 180 basis points to 27.5%, thanks to easing freight and aluminum cost inflation and efficiency initiatives, and we think the firm remains on track to bring margins back to the low 30s over the next three years.

Monster Beverage Earnings: Innovation and Value Brands Fuel Top Line; Volume Upside From Bang Deal Dan Su, CFA, Equity Analyst, 4 Aug 2023

We plan to maintain our $48 fair value estimate for narrow-moat Monster Beverage after absorbing second-quarter results that matched our estimates. Sales grew 12% (or 14% on a currency-neutral basis) and EPS rose 50%, keeping the firm on track to meet our 2023 targets for sales and EPS to grow 13% and 31%, respectively. We see no reason to alter our 10-year projections for high-single-digit annual sales growth and operating margin averaging 32%. Despite our constructive view of Monster's long-term prospects, anchored by brand intangibles and the long-term partnership with wide-moat Coca-Cola, we see the shares as expensive, trading at a 17% premium to our intrinsic valuation.

Monster's core energy drink segment (91% of sales) grew 12% on a currency-neutral basis, outpacing the energy drink market's 10% growth per management. We attribute this to innovation, such as Monster Zero Sugar and Java Monster Triple Shot Mocha and Vanilla, as well as expanded distribution in Europe and Asia-Pacific. We find the 26% sales growth in the strategic brands segment (5% of sales) encouraging and believe it was primarily driven by affordability brands (Predator and Fury) as the firm targets emerging-market consumers across Latin America, the Middle East, and Southeast Asia with lower price points and through the traditional trade.

Additionally, the firm confirmed the July acquisition of energy drink rival Vital Pharmaceuticals, owner of the Bang Energy brand, which has a mid-single-digit volume share in the United States. We view the deal favorably, given Bang's brand standing in performance energy drinks, accessibility upside from

Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 12 of 22

Monster Beverage Corp MNST ★★★ 4 Sep 2024 21:30, 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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transitioning to Coke's distribution, and reasonable valuation with a purchase price at roughly 1 times sales. We plan to assess the deal's impact on Monster's valuation when more operational details become available in the November earnings release.

Monster Beverage: Favorable Demand Trends and Coke Partnership to Fuel Growth; Shares Expensive Dan Su, CFA, Equity Analyst, 25 May 2023

We are raising our fair value estimate for Monster Beverage to $48 (from $43), which implies a 2024 enterprise value to adjusted EBITDA multiple of 22 times. The increase is driven by higher interest income estimates over the next 10 years (2% return on cash, versus 0.1% in the prior model) alongside faster growth (7%, versus 4% previously) in earnings before interest (excluding tax) in the five years following the 10-year explicit forecast period, as we anticipate more robust volume expansion.

Our 10-year sales growth and operating margin projections remain unchanged. We anticipate Monster to grow volume in line with the energy drink category (at a mid-single-digit rate annually) in addition to 2%-3% pricing, resulting in 8% top-line expansion each year. In addition, we have modeled operating margins to expand by 80 basis points (relative to 2019 levels) to 34.2% by 2032 and view 2019 as a more suitable base of comparison to exclude temporary, pandemic-induced factors. Specifically, we project lower margins in the newly acquired craft brewer business and associated with Monster's affordability initiatives to drive a 130-basis-point gross margin contraction to 58.7% in 2032. However, this will be more than offset by efficiency gains in advertising spending (8.0% of sales by 2032, versus 9.3% in 2019) and in labor and distribution expenses (16.5% of sales, versus 17.2%)

We believe Monster Beverage has carved out a narrow economic moat around its category-leading energy drink portfolio, thanks to brand-driven intangible assets and expansive distribution breadth backed by a long-term distribution alliance with wide-moat Coca-Cola.

Despite this, we continue to view Monster Beverage's shares as richly valued, trading at a 24% premium to our intrinsic valuation. Given uncertainties associated with regulatory headwinds for energy drinks and Monster's narrow focus in the category, we'd wait for a more attractive entry point before building a position in this name.

Monster Beverage Earnings: Pricing Power Seems Intact as Firm Benefits From Hikes; Shares Not Cheap Zain Akbari, CFA, Equity Analyst, 4 May 2023

Our $43 per share valuation of narrow-moat Monster Beverage should rise by a mid-single-digit percentage, largely reflecting the time value of money after the company posted first-quarter earnings that suggest it is on pace to meet our full-year targets. The company saw sales and profitability improve in the wake of recent pricing actions taken to cover rising costs with little impact to market share, a dynamic that suggests the pricing power underlying our moat rating is intact. Despite our favorable view of the company's competitive position, we believe the shares are priced such that they assume

Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 13 of 22

Monster Beverage Corp MNST ★★★ 4 Sep 2024 21:30, 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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perfect execution (particularly challenging considering that Monster is increasingly dependent on less established markets and product lines for growth).

Monster's first-quarter sales rose 12%, spurred by 11% expansion in the core energy drinks segment. The top-line growth and normalizing freight rates contributed to the firm's roughly 230 basis points of operating margin expansion (to 28.6%), and we expect the situation to improve further as the company works down its inventory of aluminum cans acquired from suboptimal locations at the height of supply chain challenges in 2021-22. Our full-year targets should not change significantly, calling for 12% top-line growth and around 330 basis points of adjusted operating margin expansion (to a little more than 28%).

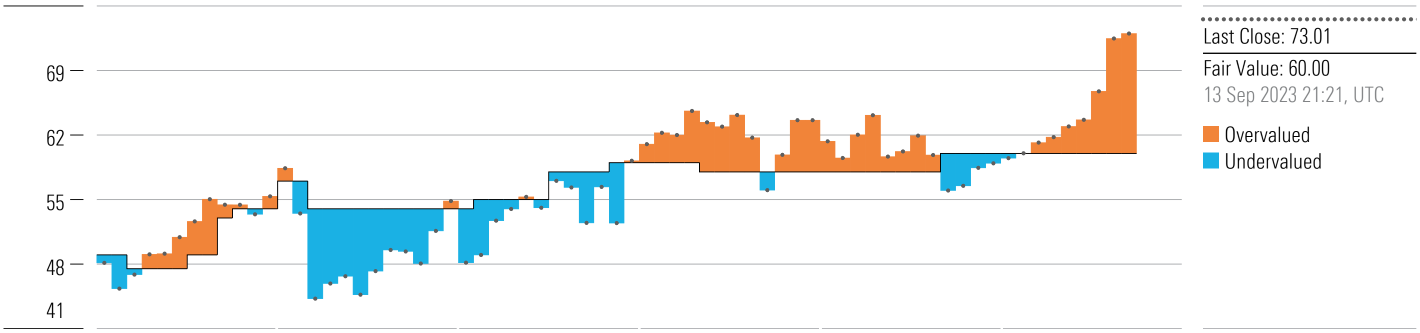
Although management indicated that the category has softened somewhat as economic uncertainty has risen, we believe Monster should benefit from its diverse portfolio and burgeoning international scale in the event of a downturn. The energy drink category benefits from a functional orientation and low private-label penetration, and we believe Monster's standing as a top-two brand in major markets bodes well. We continue to expect adjusted returns on invested capital to rebound into the mid-30s on average over the next five years, from 28% in 2022.

Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 14 of 22

Monster Beverage Corp MNST ★★★ 4 Sep 2024 21:30, UTC

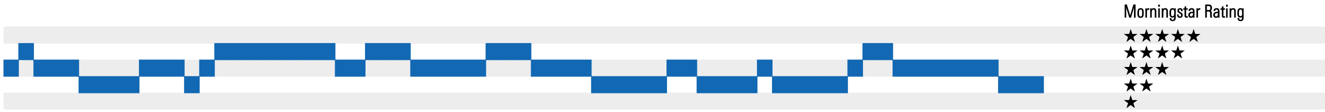
Competitors Price vs. Fair Value

Coca-Cola Co KO



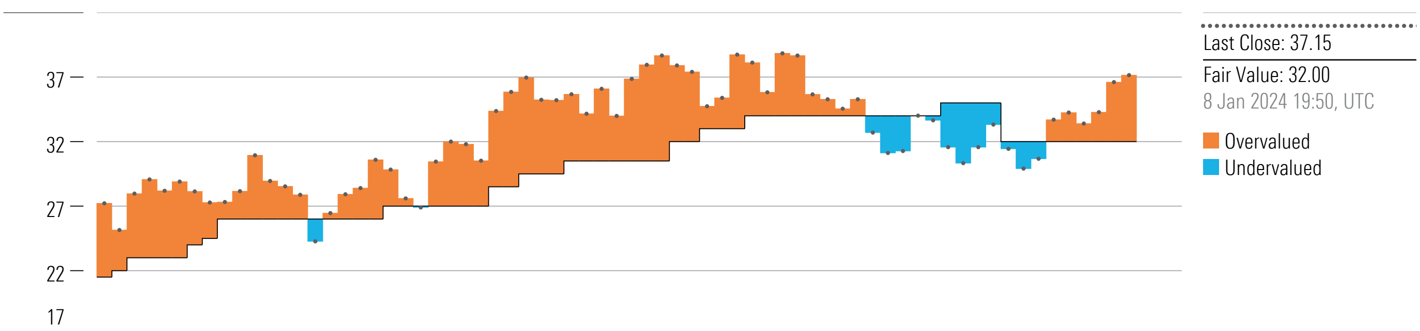
2019	2020	2021	2022	2023	YTD	
1.03	1.02	1.00	1.10	0.98	1.21	Price/Fair Value
20.27	2.04	11.03	10.40	-4.46	25.54	Total Return %

Morningstar Rating



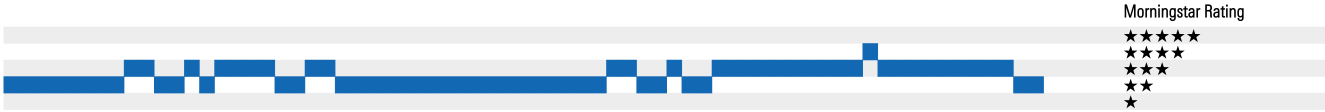
Total Return % as of 03 Sep 2024. Last Close as of 03 Sep 2024. Fair Value as of 13 Sep 2023 21:21, UTC.

Keurig Dr Pepper Inc KDP



2019	2020	2021	2022	2023	YTD	
1.11	1.19	1.21	1.05	0.95	1.16	Price/Fair Value
15.25	12.61	17.30	-1.19	-4.28	13.43	Total Return %

Morningstar Rating



Total Return % as of 03 Sep 2024. Last Close as of 03 Sep 2024. Fair Value as of 8 Jan 2024 19:50, UTC.

Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 15 of 22

Monster Beverage Corp MNST ★★★ 4 Sep 2024 21:30, UTC

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Morningstar Historical Summary

Financials as of 30 Jun 2024

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
Revenue (USD Mil)	2,465	2,723	3,049	3,369	3,807	4,201	4,599	5,541	6,311	7,140	3,800	7,386
Revenue Growth %	9.7	10.5	12.0	10.5	13.0	10.3	9.5	20.5	13.9	13.1	6.9	10.4
EBITDA (USD Mil)	773	763	1,126	1,248	1,341	1,464	1,690	1,848	1,646	2,022	1,109	2,090
EBITDA Margin %	31.4	28.0	36.9	37.0	35.2	34.8	36.8	33.3	26.1	28.3	29.2	28.3
Operating Income (USD Mil)	748	732	1,085	1,199	1,284	1,403	1,633	1,797	1,585	1,953	1,069	2,014
Operating Margin %	30.3	26.9	35.6	35.6	33.7	33.4	35.5	32.4	25.1	27.4	28.1	27.3
Net Income (USD Mil)	483	547	713	821	993	1,108	1,410	1,377	1,192	1,631	867	1,687
Net Margin %	19.6	20.1	23.4	24.4	26.1	26.4	30.7	24.9	18.9	22.8	22.8	22.8
Diluted Shares Outstanding (Mil)	1,046	1,156	1,200	1,154	1,129	1,093	1,070	1,071	1,066	1,058	1,044	1,050
Diluted Earnings Per Share (USD)	0.46	0.48	0.60	0.71	0.88	1.02	1.32	1.29	1.12	1.54	0.83	1.60
Dividends Per Share (USD)	—	—	—	—	—	—	—	—	—	—	—	—

Valuation as of 30 Aug 2024

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Price/Sales	7.8	10.3	9.2	11.0	7.6	8.5	11.2	9.7	8.7	8.8	7.2	6.7
Price/Earnings	43.3	51.8	39.8	46.3	29.3	31.9	41.7	33.6	44.8	39.1	31.6	29.5
Price/Cash Flow	39.8	122.0	97.1	34.2	27.5	30.1	40.0	38.3	66.7	38.6	31.0	27.5
Dividend Yield %	—	—	—	—	—	—	—	—	—	—	—	—
Price/Book	13.1	6.5	7.4	9.5	6.9	8.3	10.5	8.1	7.8	7.6	5.7	7.9
EV/EBITDA	22.2	36.0	22.0	27.7	19.1	22.4	28.4	27.0	30.6	28.2	0.0	0.0

Operating Performance / Profitability as of 30 Jun 2024

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD	TTM
ROA %	28.8	14.6	14.7	18.4	21.3	22.9	24.8	19.7	14.8	18.1	9.8	19.5
ROE %	38.5	17.3	17.5	22.7	26.5	28.5	30.2	23.5	17.5	21.4	12.3	24.6
ROIC %	38.5	17.3	17.5	22.7	26.5	28.5	30.2	23.5	17.5	21.4	10.5	22.2
Asset Turnover	1.5	0.7	0.6	0.8	0.8	0.9	0.8	0.8	0.8	0.8	0.4	0.9

Financial Leverage

Fiscal Year, ends 31 Dec	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Recent Qtr	TTM
Debt/Capital %	—	—	—	—	—	—	—	—	—	—	11.3	—
Equity/Assets %	78.1	86.3	80.2	81.3	79.8	81.0	83.2	84.1	84.7	84.9	72.8	—
Total Debt/EBITDA	—	—	—	—	—	—	—	—	—	—	0.7	—
EBITDA/Interest Expense	—	—	—	—	—	—	—	—	—	—	—	—

Morningstar Analyst Historical/Forecast Summary as of 08 May 2024

Financials

Fiscal Year, ends 31 Dec 2023	2022	2023	Estimates 2024	2025	2026
Revenue (USD Mil)	6,311	7,140	7,977	8,827	9,625
Revenue Growth %	13.9	13.1	11.7	10.7	9.0
EBITDA (USD Mil)	1,646	2,022	2,433	2,794	3,152
EBITDA Margin %	26.1	28.3	30.5	31.7	32.8
Operating Income (USD Mil)	1,587	1,992	2,329	2,675	3,017
Operating Margin %	25.2	27.9	29.2	30.3	31.4
Net Income (USD Mil)	1,192	1,631	1,933	2,180	2,449
Net Margin %	18.9	22.8	24.2	24.7	25.4
Diluted Shares Outstanding (Mil)	1,066	1,058	1,044	1,037	1,030
Diluted Earnings Per Share(USD)	1.12	1.54	1.85	2.10	2.38
Dividends Per Share(USD)	0.00	0.00	0.00	0.00	0.00

Forward Valuation

	2022	2023	Estimates 2024	2025	2026
Price/Sales	8.4	8.4	5.9	5.4	4.9
Price/Earnings	90.7	37.4	26.2	23.0	20.3
Price/Cash Flow	—	—	—	—	—
Dividend Yield %	—	—	—	—	—
Price/Book	15.4	7.4	5.2	4.4	3.7
EV/EBITDA	30.6	28.2	19.1	16.7	14.8

Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 16 of 22

Monster Beverage Corp MNST ★★★ 4 Sep 2024 21:30, UTC

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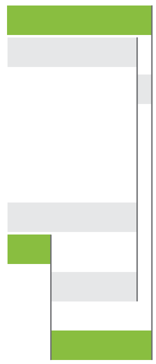
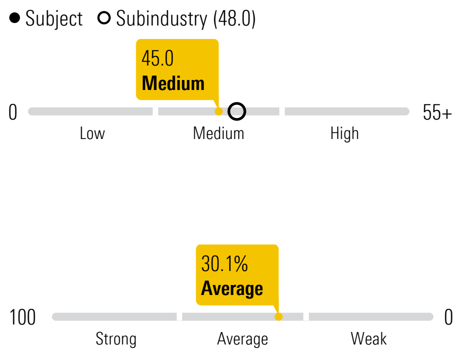
48.30 USD 3 Sep 2024	52.00 USD 12 Mar 2024 04:12, UTC	0.93	47.39 USD Bil 4 Sep 2024	Narrow	Mid Blend	Medium	Standard	7 Aug 2024 05:00, UTC

ESG Risk Rating Breakdown

Exposure		
Company Exposure[1]	45.0	
– Manageable Risk	40.4	
Unmanageable Risk[2]	**4.6**	
Management		
Manageable Risk	40.4	
– Managed Risk[3]	12.2	
Management Gap[4]	**28.3**	
Overall Unmanaged Risk	**32.8**	





- 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 30.1% 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 Aug 07, 2024. Highest Controversy Level is as of Aug 08, 2024. Sustainalytics Subindustry: Soft Drinks. 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 Aug 2024

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

Company Name	Exposure		Management		ESG Risk Rating	
Monster Beverage Corp	45.0 | Medium	0 – 55+	30.1 | Average	100 – 0	32.8 | High	0 – 40+
Coca-Cola Co	46.7 | Medium	0 – 55+	53.7 | Strong	100 – 0	24.2 | Medium	0 – 40+
PepsiCo Inc	57.1 | High	0 – 55+	68.7 | Strong	100 – 0	20.8 | Medium	0 – 40+
Keurig Dr Pepper Inc	49.0 | Medium	0 – 55+	57.4 | Strong	100 – 0	23.7 | Medium	0 – 40+
Nongfu Spring Co Ltd	43.7 | Medium	0 – 55+	46.4 | Average	100 – 0	25.2 | Medium	0 – 40+

Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 17 of 22

Appendix
Historical Morningstar Rating

Monster Beverage Corp MNST 4 Sep 2024 21:30, UTC

Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
—	—	—	★★★	★★★★	★★★	★★★	★★★	★★★	★★	★★	★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★	★★	★★★	★★	★★	★★	★★	★★	★★	★★	★★	★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★	★★	★★★	★★★	★★★	★★	★★	★★★	★★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★	★★★	★★★	★★	★★	★★	★★	★★	★★	★★	★★	★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★	★★	★★	★★	★★	★★	★★	★★	★★★	★★★	★★	★★
Dec 2019	Nov 2019	Oct 2019	Sep 2019	Aug 2019	Jul 2019	Jun 2019	May 2019	Apr 2019	Mar 2019	Feb 2019	Jan 2019
★★★	★★★	★★★	★★	★★	★★	★★	★★	★★★	★★★	★★	★★★

Coca-Cola Co KO 4 Sep 2024 21:31, UTC

Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
—	—	—	★★	★★	★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★	★★★★	★★★★	★★★	★★	★★	★★	★★	★★	★★★	★★	★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★	★★	★★★	★★★	★★	★★	★★	★★	★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★
Dec 2019	Nov 2019	Oct 2019	Sep 2019	Aug 2019	Jul 2019	Jun 2019	May 2019	Apr 2019	Mar 2019	Feb 2019	Jan 2019
★★★	★★★	★★★	★★	★★	★★	★★	★★★	★★★	★★★	★★★★	★★★

Keurig Dr Pepper Inc KDP 4 Sep 2024 21:40, UTC

Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
—	—	—	★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★	★★★	★★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★	★★	★★	★★★	★★	★★	★★★	★★★	★★	★★	★★	★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★	★★	★★★	★★★	★★	★★	★★★	★★★	★★★	★★★	★★	★★★
Dec 2019	Nov 2019	Oct 2019	Sep 2019	Aug 2019	Jul 2019	Jun 2019	May 2019	Apr 2019	Mar 2019	Feb 2019	Jan 2019
★★	★★	★★★	★★★	★★	★★	★★	★★	★★	★★	★★	★★

Research Methodology for Valuing Companies

Overview

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

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

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

1. Economic Moat

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

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

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

2. Estimated Fair Value

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

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

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

Stage II: Fade

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

Stage III: Perpetuity

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

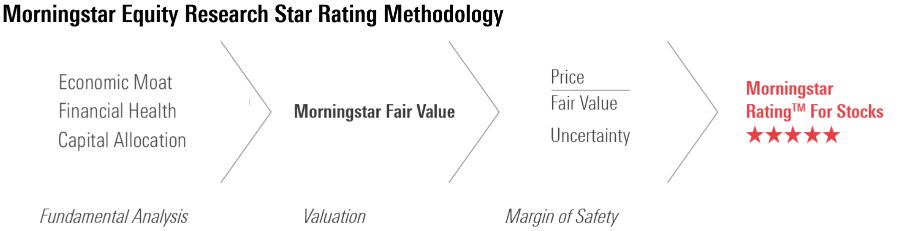
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return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

3. Uncertainty Around That Fair Value Estimate

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

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

Morningstar Equity Research Star Rating Methodology



Morningstar Equity Analyst Report | Report as of 4 Sep 2024 22:59, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 19 of 22

Research Methodology for Valuing Companies

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

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

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

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

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

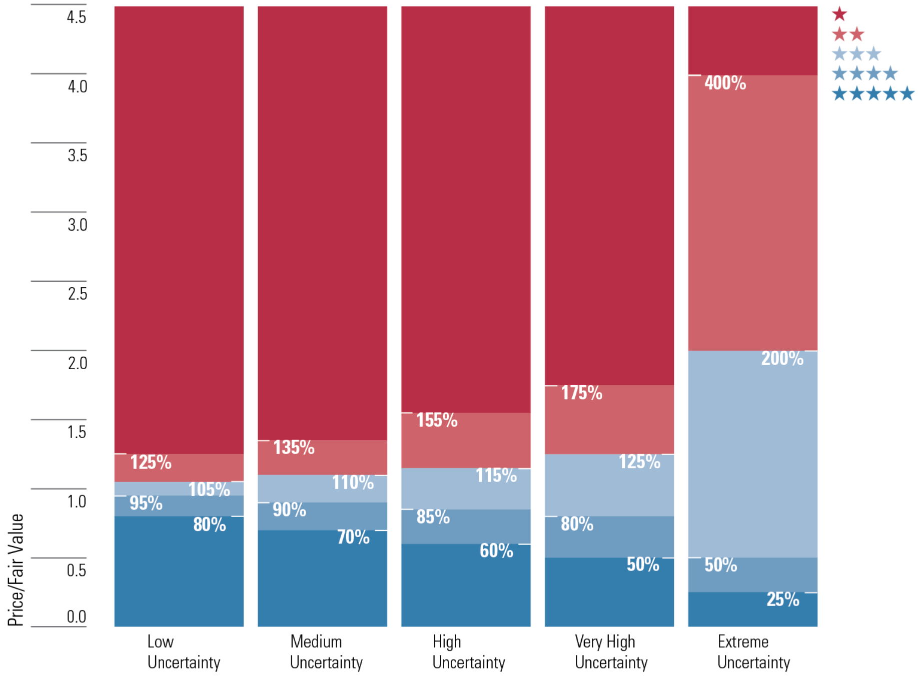
4. Market Price

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

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

Morningstar Star Rating for Stocks

Morningstar Equity Research Star Rating Methodology



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

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

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

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

The Morningstar Star Ratings for stocks are defined below:

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

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

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

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

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

Other Definitions

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

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

Research Methodology for Valuing Companies

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

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

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

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

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

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

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

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

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

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