Europe Equity Market Outlook: Q4 2023

Holding On for Life

Morningstar Equity Research

Michael Field, CFA
Europe Market Strategist

Ben Slupecki, CFA
Associate Equity Analyst

MORNINGSTAR®

Table of Contents

Market Overview

Investor Confidence Is Continually Being Tested, but Markets Holding Up

Inflation Has Fallen, but We're Still Nowhere Near Targeted Levels

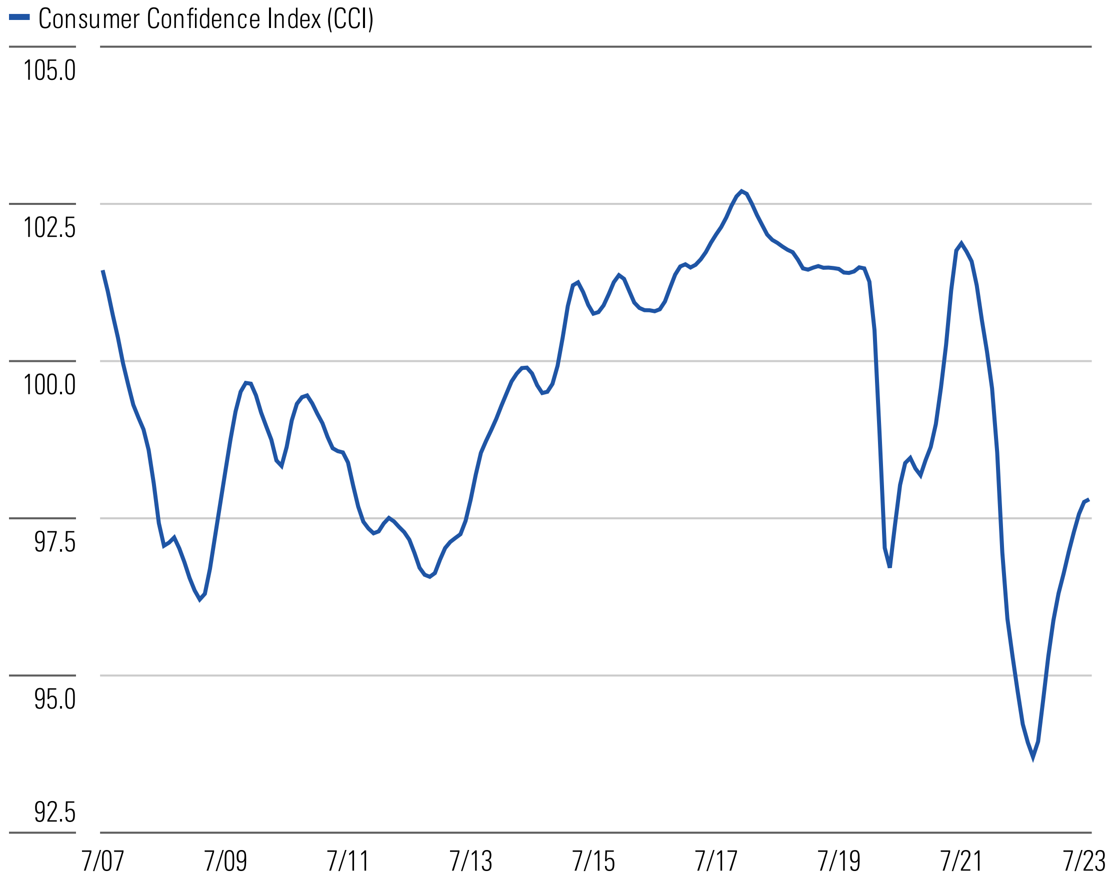
The eurozone's economy has been precariously poised for some time now, with growth essentially flat year over year in the second quarter. Meanwhile, the manufacturing purchasing managers' index in the eurozone hasn't been in growth territory since mid-2022.

However, on the upside inflation across the region is waning, falling to just north of 5% in August, half the level it was this time in 2022. Meanwhile, the labor market remains tight, meaning that firms across the region are less likely to lay off workers in response to slowing sales in case they can't find the staff again when the time comes to rehire.

Central banks still have their work cut out for them. Core inflation remains high and the sticky nature of this type of inflation means that progress in getting inflation back down to the 2% target could take significant time. This poses serious questions for central banks: keep rates high and risk a recession, or reduce rates and potentially have to deal with an overheating economy?

Consumer confidence hit its lowest point ever earlier this year. Thankfully, this has since risen, but remains in negative territory. However, this slight improvement might be of little consolation for businesses as consumers' salaries are still struggling to keep up with rising interest rates and general inflation.

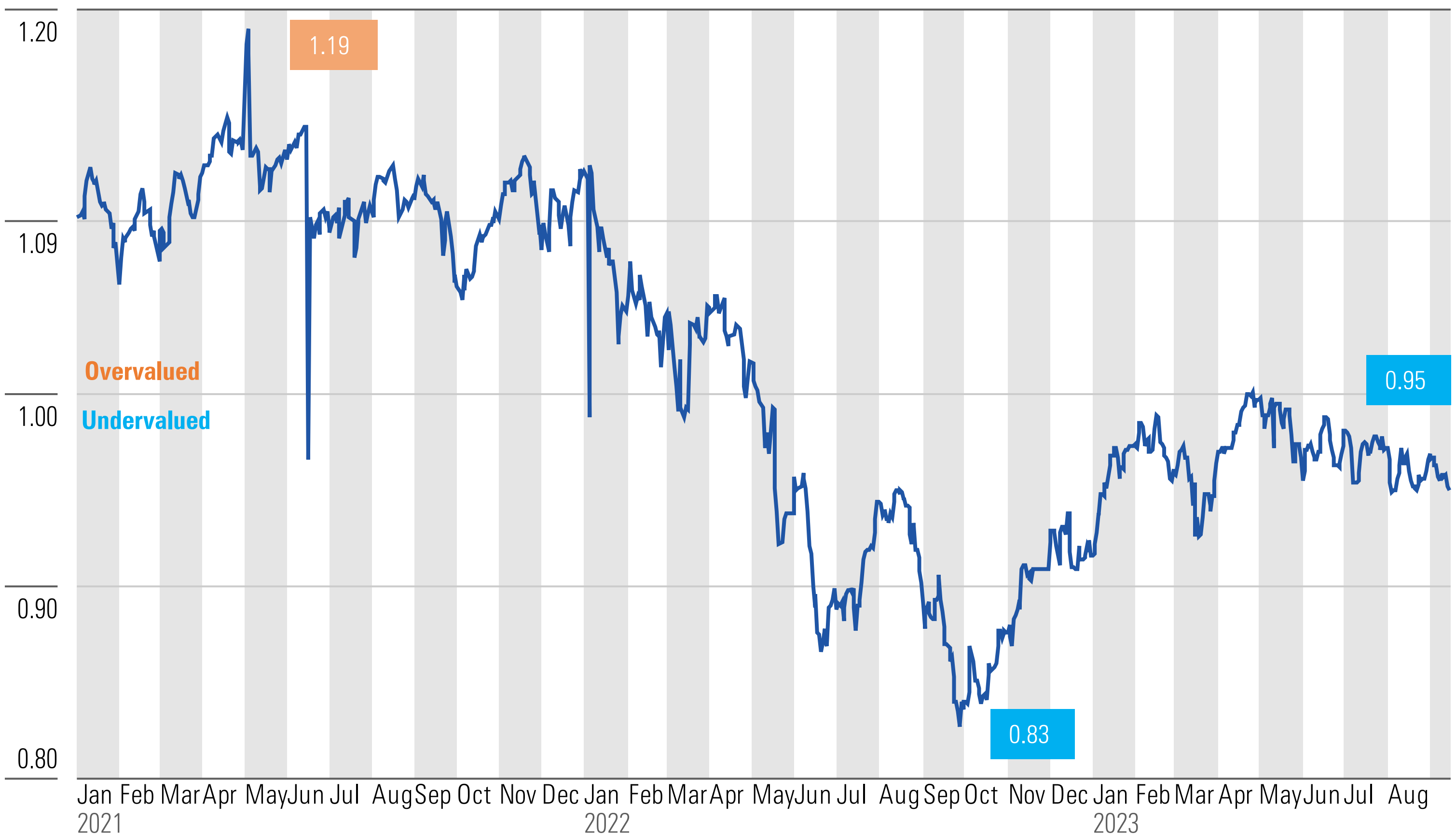
Consumer Confidence Still in Negative Territory



Source: Eurostat. Data as of Aug. 31, 2023.

Equity Market Valuations in a Holding Pattern

Market Cap-Weighted Price/Fair Value Estimate for Morningstar Europe-Domiciled Coverage



Source: Morningstar. Data as of Sept. 15, 2023.

Equity market valuations continue to trade downward after the peak in April this year. However, falls have been marginal with the market still trading at just a 5% discount to our intrinsic value estimate.

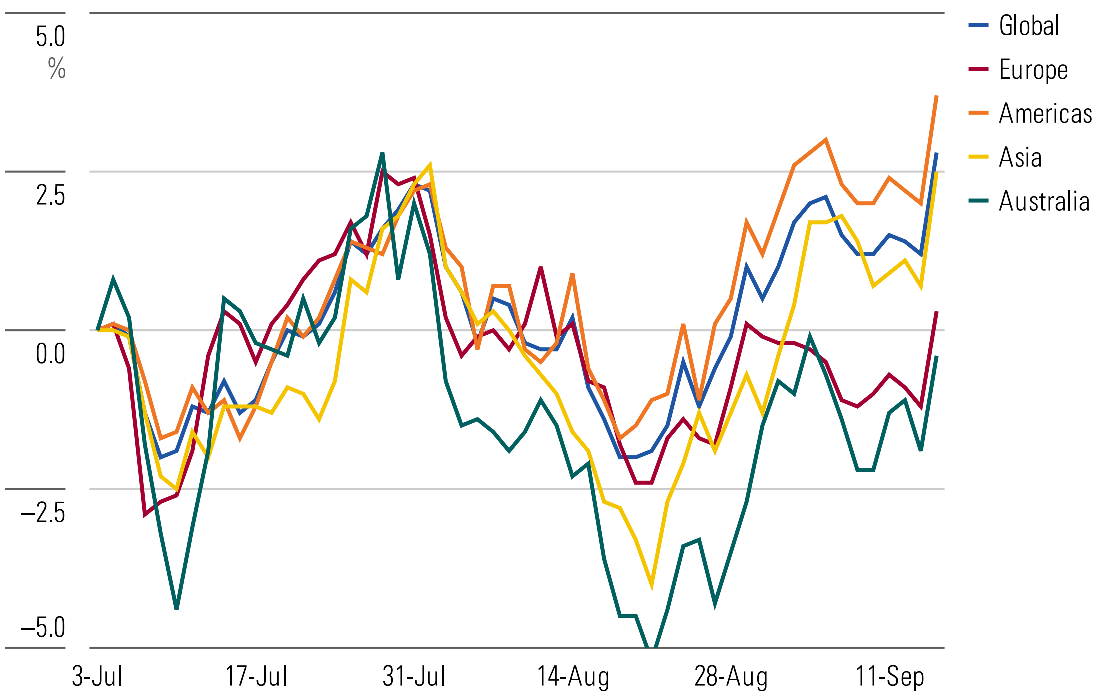
Despite the relative discount, we are still a long way from the bargain territory of late 2022, when markets were trading more than 20% below our fair value estimate. However, equally we are a way off the heady days of two years ago when markets were trading at a material premium to our valuation.

Getting to this point is one thing, but for markets to move north from here it will likely take a boost in investor confidence that can only come from a material improvement in the underlying market conditions, which is unlikely to occur before the end of 2023.

Europe Is Once Again the Straggler

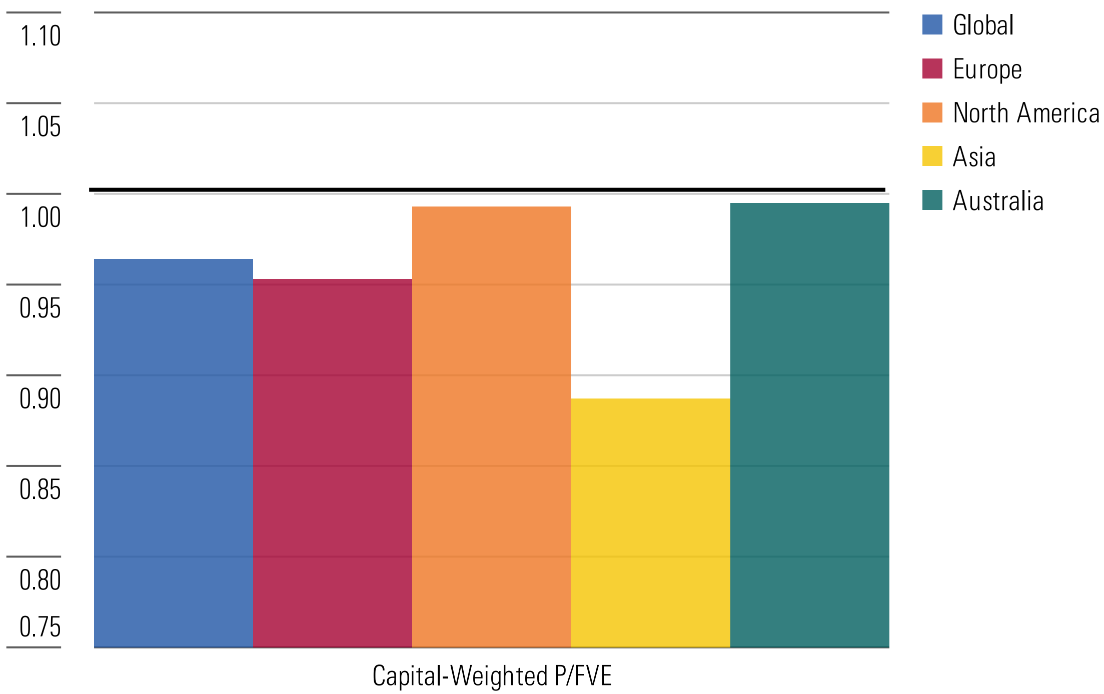
While the European market performance is still moving in the right direction, growth is once again trailing that of the U.S. and indeed the Morningstar Global Markets index. However, pleasingly for potential investors, European valuations are now trading below the U.S. and global levels.

Regional Price Movements Over the Third Quarter



Source: Morningstar. Data as of Sept. 15, 2023.

Capital-Weighted Price/Fair Value Estimate for the Regions



Source: Morningstar. Data as of June 15, 2023.

Value Remains Out of Favor, Growth Back to Being Fairly Valued

While the valuations of growth stocks in the U.S. rose over the quarter, they fell materially in Europe, highlighting the depth of the pool in the U.S. and potentially their greater growth prospects. Value stocks remain undervalued in Europe, offering almost 30% upside potential to our fair value estimate.

Investors in Europe Currently Favor Large-Cap Stocks, With Growth and Core More Highly Valued*

Europe Intrinsic Value-Weighted Price/Fair Value Estimate

Size	All	Style: Value	Style: Core	Style: Growth
All	0.87	0.78	0.88	0.99
Large	0.77	0.78	0.89	1.00
Mid	0.81	0.75	0.83	0.84
Small	0.79	0.64	0.92	0.95

US Intrinsic Value-Weighted Price/Fair Value Estimate

Size	All	Style: Value	Style: Core	Style: Growth
All	0.95	0.85	1.00	0.96
Large	0.97	0.87	1.04	0.97
Mid	0.88	0.82	0.89	0.93
Small	0.77	0.64	0.78	0.99

Overvalued
- ≥ 1.10
- 1.05 to 1.10

Fairly Valued
- 1.01 to 1.05
- 0.99 to 1.01
- 0.95 to 0.99

Undervalued
- 0.90 to 0.95
- ≤0.90

Source: Morningstar. Data as of Sept. 15, 2023. * May not be fully representative of investment styles due to limited coverage in certain segments.

Sector Valuation Overview

Opportunities Remain Despite Rising Valuations

European Equity Markets Continue to Tick Up

Despite the macroeconomic doom and gloom, equity markets rose once again this quarter, albeit marginally. This brings gains over the last 12 months to nearly 5%, not terrible in a normal year, but taking into account inflation, investors have made a slight loss on this basis.

On a sector basis, returns have been extremely pronounced. Energy led the way, rising by a double-digit percentage, closely followed by financial services; the latter has had two solid quarters in a row now. Healthcare rose by nearly 6%, while European tech received the wooden spoon, falling by almost 7%.

Over the last 12 months the risk-on sectors have experienced the largest gains with the industrials and consumer cyclicals rising by more than 20%, closely followed by financial services, and energy, the sector that keeps on giving.

Aggregated Stock Price Changes

Sector	TTM% Change	Trailing Quarter % Change
Aggregated European Market	4.6%	1.2%
Cyclical		
Basic Materials	9.1%	(2.9%)
Consumer Cyclical	21.9%	(2.9%)
Financial Services	19.9%	9.4%
Sensitive		
Communication Services	7.6%	(4.1%)
Energy	18.1%	11.1%
Industrials	22.1%	(0.8%)
Technology	14.5%	(6.8%)
Defensive		
Consumer Defensive	2.3%	(3.6%)
Healthcare	14.4%	5.6%
Utilities	6.2%	(0.8%)

Source: Morningstar. Data as of Sept. 15, 2023.

Valuation Gaps Open Up Across the Sectors

Valuation shifts across the sectors began to take shape in the third quarter, with large share price movements driving much of the change.

Energy became the only fairly valued sector in Europe, with every other sector under coverage trading at a discount to our fair value estimate. Big moves were also seen in utilities, which now trades at a 15% discount to our fair value estimate, and in Industrials, which now offers close to 10% upside.

Last quarter it was very easy to point to the dichotomy between cyclically exposed sectors, which were cheaper, and the defensive sectors, which were more expensive. This quarter the picture is cloudier, with consumer defensive and healthcare, both defensive in nature, becoming cheaper and in line with movements in some of the more cyclically exposed sectors.

Morningstar European Coverage Average Price/Fair Value Estimate by Sector

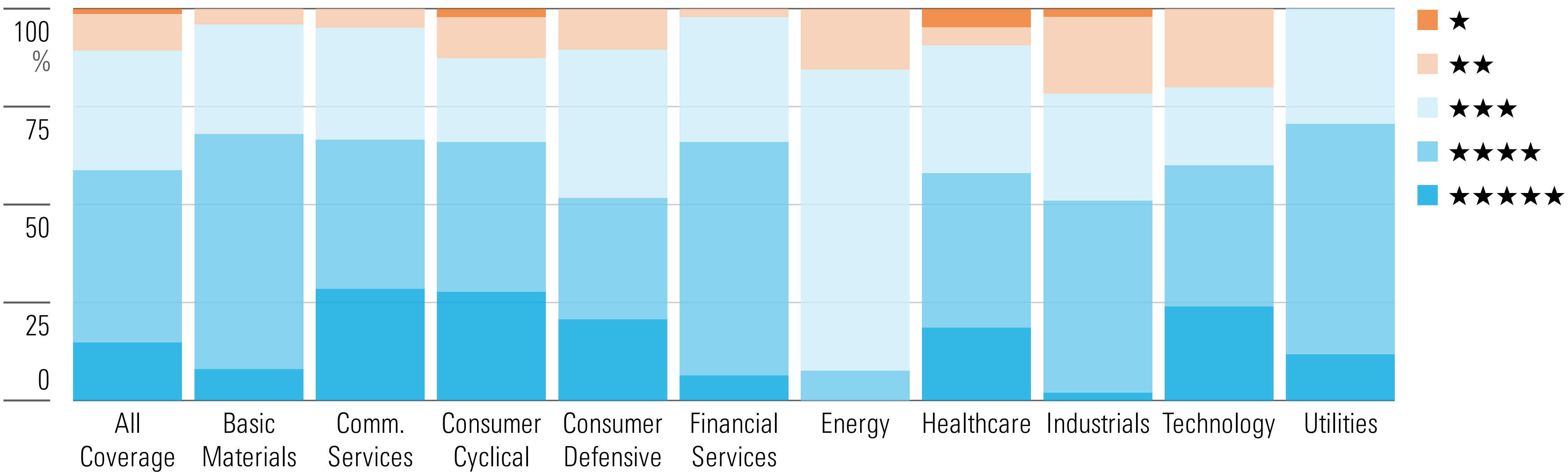
Cyclical Sectors	Average Price/Fair Value	Sensitive Sectors	Average Price/Fair Value	Defensive Sectors	Average Price/Fair Value
Consumer Cyclical	0.76	Comm. Services	0.80	Consumer Defensive	0.87
Financial Services	0.85	Energy	1.00	Healthcare	0.84
		Industrials	0.93	Utilities	0.87

Source: Morningstar. Data as of Sept. 15, 2023.

Various 4-Star and 5-Star Opportunities Abound

Retreating valuations, for the most part, have meant more 4-star and 5-star stocks showing themselves, with almost 60% of the stocks we cover in this territory. Conversely, only around 10% of the stocks we cover are currently overvalued.

Star Rating Distribution by Sector



Source: Morningstar. Data as of Sept. 13, 2023.

Communication Services

Javier Correonero | javier.correonero@morningstar.com

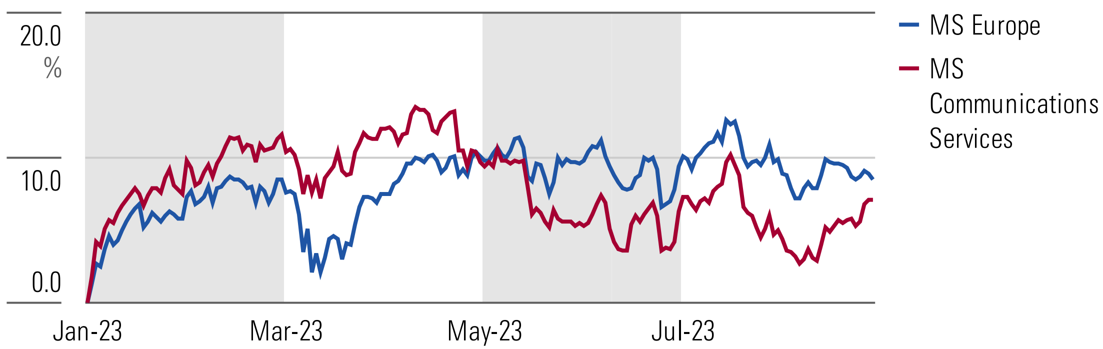
Underperformance Means More Opportunities, but Stock Selection Is Key

The Morningstar European Communications Index has underperformed the Morningstar European Index in 2023. At this point most stocks are in 4-star and 5-star territory, offering attractive upside relative to our fair value estimates. Although the European telecommunication sector is challenged as a whole, we believe the market has over penalized some of these stocks. While several stocks have performed poorly year to date, other European telecommunication shares have shown resilience, showing flat or even positive shareholder returns .

Conglomerates such as Vodafone, Telefonica, or Liberty Global have seen their share prices underperform leaner companies with exposure to healthier markets, such as KPN, Swisscom, or Deutsche Telekom. We believe the latter three have benefited from higher cash flow visibility, lower exposure to emerging markets, and better ability to pass on price increases to customers. Although operators like KPN, Tele2, and Deutsche Telekom offer less upside potential, they remain our preferred stocks given their better management and capital allocations, exposure to healthy markets, and cost controls.

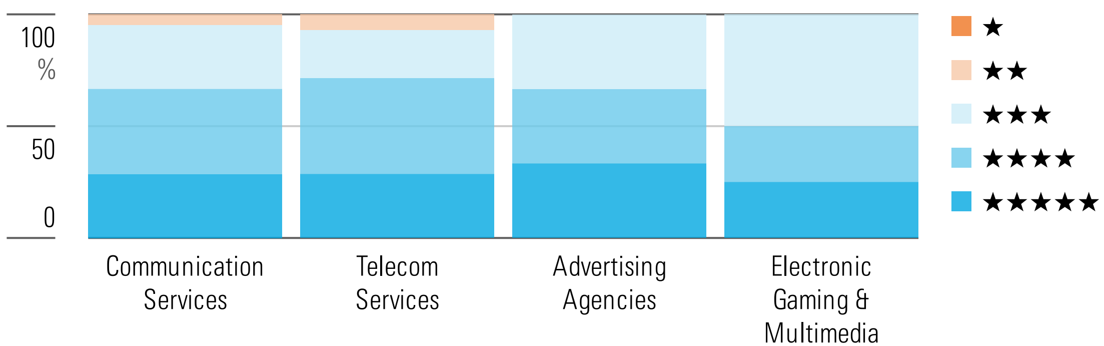
The European tower firms Inwit and Cellnex are our two top picks due to the attractive unit economics of wireless tower businesses. They remain in 4-star and 5-star territory, respectively.

Communication Services vs. the Morningstar European Index



Source: Morningstar. Data as of Sept. 13, 2023.

Communication Services Star Rating Distribution by Industry



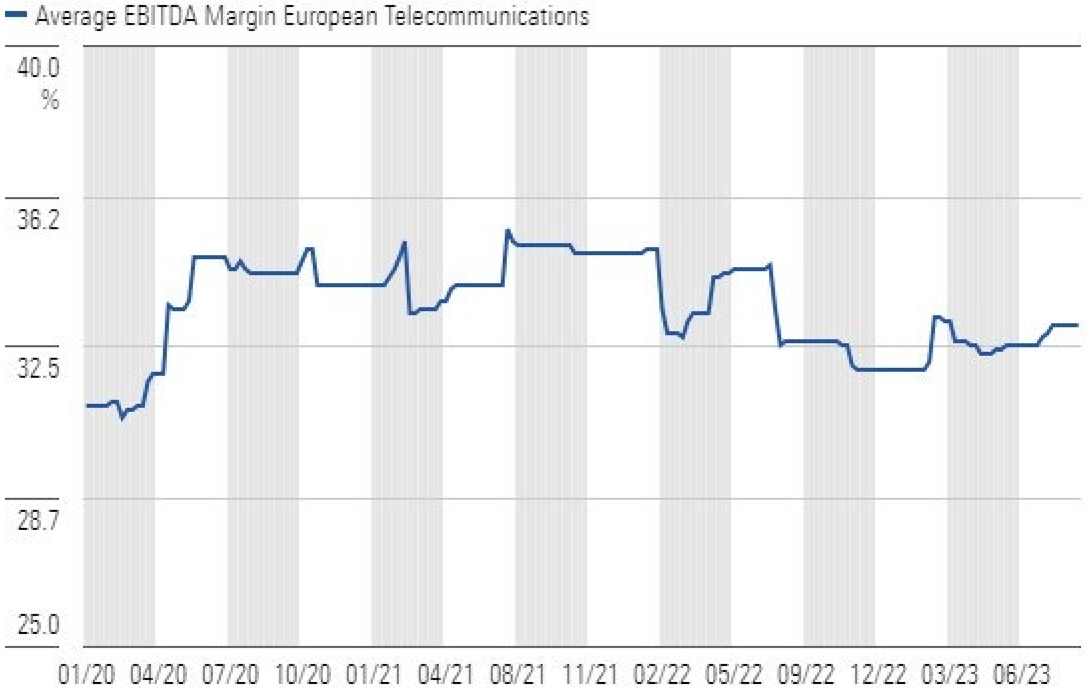
Source: Morningstar. Data as of Sept. 13, 2023.

Dividend Yields Remain High at Around 6.5%, but We Advise Caution Over Yield Maintainability

Dividend yields of European telecoms are almost 7%, one of its highest points since 2020. Although this yield is attractive, we recommend investors check how maintainable these dividends are in the long term. Telia, Vodafone, and Proximus offered yields of close to 10% as of September 2023, but we don't believe this is maintainable in the long term. EBITDA margins have felt pressure from inflation across many geographies, which together with high capital expenditure and debt servicing can be a risk to dividend yields.

Inflationary Pressures Have Eaten Up Profit Margins

Significant Hit to Cost Base of Proximus and BT Group



Source: Morningstar, PitchBook data.

Yields At About 6.5% Are High Versus Its Historical Average (4%-5%)

Deutsche Telekom, KPN, or Swisscom Offer Maintainable 3.5%-5.0% Yields

Source: Morningstar, PitchBook data.

Communication Services | Top Picks

Name/Ticker		Rating	
Cellnex Telecom (CLNX)		★★★★★	Narrow-moat Cellnex owns and operates more than 100,000 wireless towers in Europe as a result of continued merger and acquisition activities since its IPO in 2015. Cellnex's business model is protected by long-term contracts, which provide high cash flow visibility, inflation protection, and growth optionality. Based on our unit economic calculations, we estimate Cellnex acquires towers at an internal rate of return in line with or slightly above its cost of capital, but we estimate returns will get closer to the 10% range as the acquired tower portfolios are made more efficient. Since late 2022, Cellnex's strategy has become more organic as it aims to improve its tower portfolio and achieve a better credit rating.
Price	Fair Value Estimate	Uncertainty	
EUR 36.04	EUR 52.00	Medium	
Market Cap (B)	Economic Moat	Capital Allocation	
EUR 25.4	Narrow	Standard	

Name/Ticker		Rating	
Inwit (INW)		★★★★	Narrow-moat Inwit is the leading wireless tower operator in Italy, with Telecom Italia and Vodafone as its anchor tenant. Inwit has the highest tenancy ratio among European operators (close to 2.2 times) and leading EBITDAaL margins of more than 65%. We believe Inwit is a good company to navigate the current inflationary environment as its contracts are linked to the consumer price index with no cap and a 0% floor. In the next few years, we expect Inwit's EBITDAaL margins to expand above 70% due to new tenancy additions coupled with wireless towers' inherent operating leverage. We see Inwit as a good play for investors looking for lower uncertainty with growing dividends (Inwit's 2024 dividend will increase by 40%). Our fair value estimate is EUR 12.60.
Price	Fair Value Estimate	Uncertainty	
EUR 11.78	EUR 12.60	Low	
Market Cap (B)	Economic Moat	Capital Allocation	
EUR 11.20	Narrow	Standard	

Consumer Cyclical

Grant Slade, CFA | grant.slade@morningstar.com
Ioannis Pontikis, CFA | ioannis.pontikis@morningstar.com
Jelena Sokolova, CFA | jelena.sokolova@morningstar.com

Luxury Segment Slightly Overvalued; Opportunities in Apparel and Food Delivery

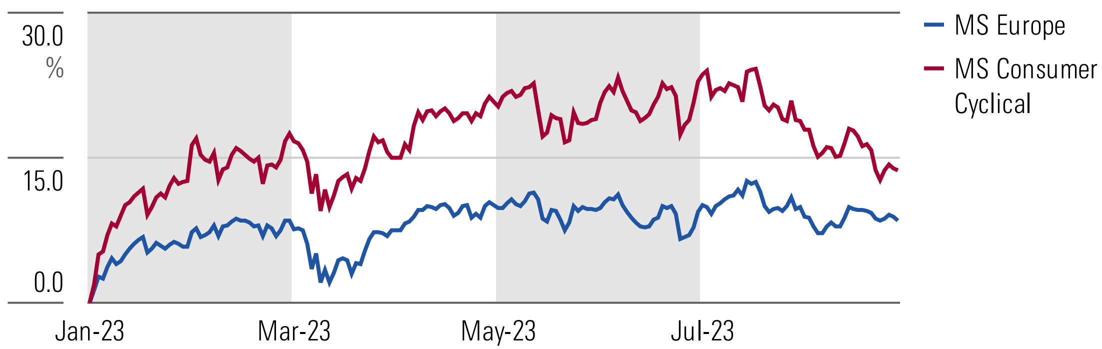
The Morningstar Europe Consumer Cyclicals Index experienced a sharp recovery so far in 2023. Moderating inflation and the removal of COVID-19 restrictions in China boosted consumer spending materially, leading to a more favorable outlook for consumer stocks.

The sector is largely attractively valued with luxury goods trading close to fair values, but internet retail companies' valuations remain alluring. Within the diverse internet retail segment of our coverage, we see pockets of opportunities in food delivery. Zalando and Pandora look particularly attractive in the apparel retail and jewelry segments respectively. Swatch looks very attractive in the luxury sector.

Food delivery stocks are long-duration assets, meaning that a combination of increasing interest rates, the anticipation of a tighter capital markets environment, and elevated inflationary pressures, have all weighed on stock performance lately. Despite an expected top-line growth slowdown as order growth decreases in the medium term, we remain constructive, but investors need to be selective.

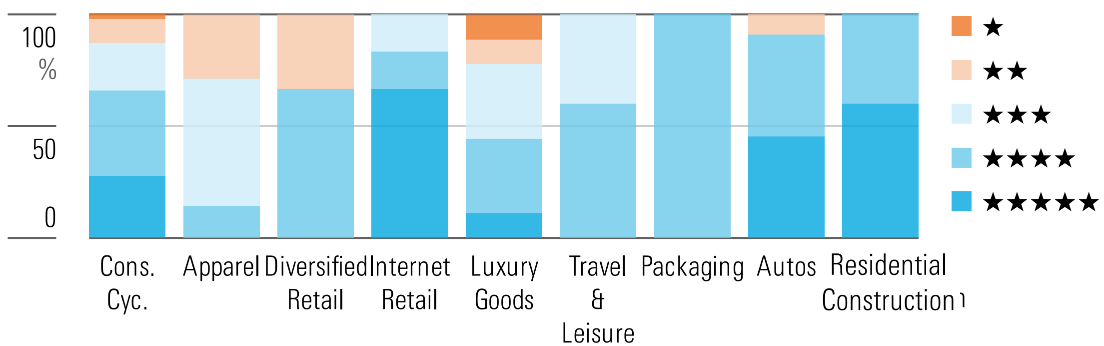
The U.K. homebuilders remain appealing despite the cyclical challenges that presently weigh on their share prices. Tightened financial conditions have fostered a housing market downturn in 2023, placing profitability under distinct pressure in the near term. Still, the industry’s long-term fundamentals remain robust. We think each of the U.K. volume homebuilders are ideally positioned to contribute significantly to the supply of new housing that a growing and ageing U.K. population requires and are likely to deliver meaningful shareholder value in the process.

Consumer Cyclical vs. the Morningstar European Index



Source: Morningstar. Data as of Sept. 13, 2023.

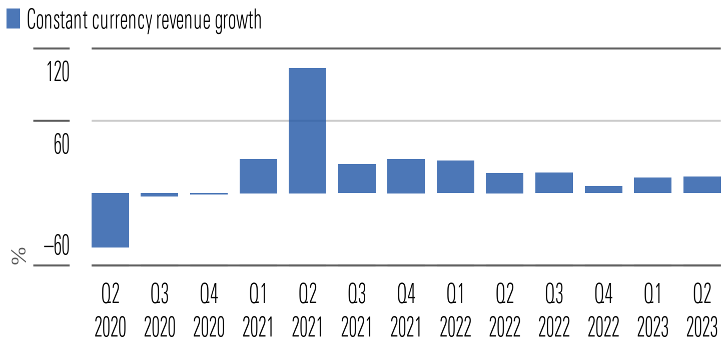
Consumer Cyclical Star Rating Distribution by Industry



Source: Morningstar. Data as of Sept. 13, 2023.

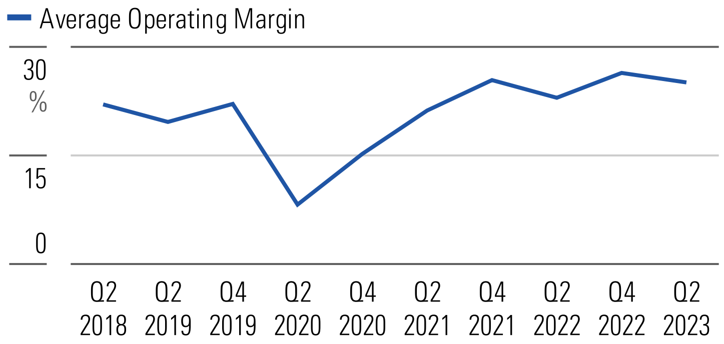
Luxury Sector Valuations Get Fairer As Concerns About Chinese Demand Recovery and Weakness in U.S. Mount

Luxury Sales Growth Remains Strong



Source: Company reports, Morningstar. Data as of June 30, 2023.

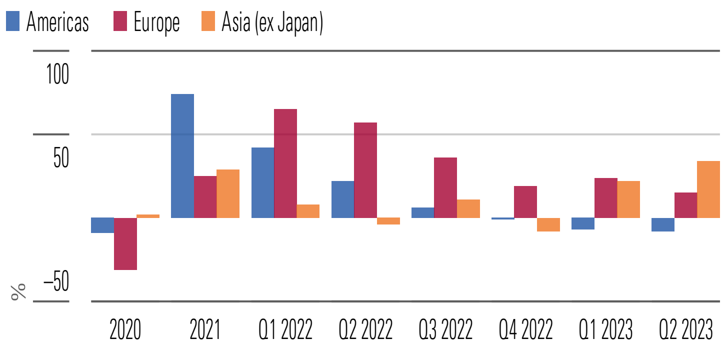
Margins Hold Up Well



Source: Company reports, Morningstar. Data as of June 30, 2023.

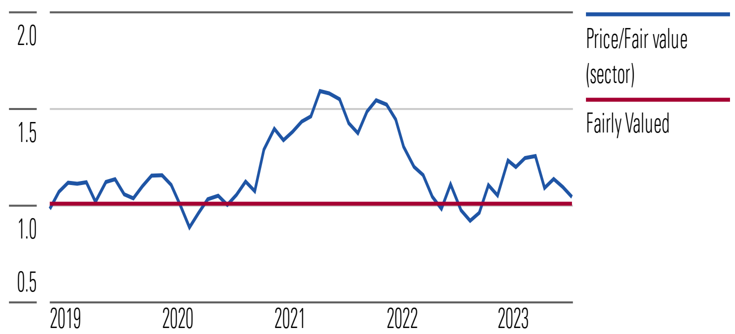
Luxury sector shares came under pressure due to concerns about the macroeconomy, the pace of the post-COVID-19 consumption recovery in China, and weakening consumer demand in the US. The latter we anticipated given exceptional post-pandemic growth boosted by nonrecurring factors, such as savings from foregone experiences such as travel and dining and payment checks. That said, fundamental performance for the sector remains strong and valuations are now looking more reasonable.

Recovery in Asia Offsets U.S. Weakness



Source: Company data, Morningstar. Data as of June 30, 2023.

Valuations Are Becoming More Appealing



Source: Morningstar. Data as of August 2023.

We still expect Chinese consumers to drive short-term sector demand, helped by pent-up spending as luxury sales to Chinese nationals are around one third below prepandemic levels, and helped in the long term by high-wage professions. We see attractive opportunities emerging in the luxury sector. We like 5-star-rated narrow-moat Swatch group, 4-star-rated wide-moat Richemont group (both with above-sector exposure to Chinese consumption), as well as narrow-moat 4-star-rated Pandora and narrow-moat 4-star-rated Kering Group.

Consumer Cyclical | Top Picks

Name/Ticker		Rating	
Persimmon (PSN)		★★★★★	Persimmon screens as materially undervalued amid tough U.K. housing market conditions. The U.K. housing market is in the throws of a cyclical downturn in 2023. Consequently, U.K. homebuilders' earnings are under significant pressure as home completion volumes fall, house prices face headwinds from rising interest rates and build cost inflation—while showing recent signs of improvement—remains nonetheless elevated. Still, we think Persimmon's current share price overemphasizes the near-term pain while ignoring Persimmon's long-term fundamentals, which remain robust. Persimmon's differentiated focus on first-time homebuyers and the lower-priced segment of the U.K.'s housing market is an attractive niche. Persimmon has demonstrated the capacity of its differentiated model to deliver handsomely for shareholders, having produced industry-leading profit margins and returns on invested capital over the preceding housing cycle of 2013-22.
Price	Fair Value Estimate	Uncertainty	
GBX 1,079.00	GBX 2,300	High	
Market Cap (B)	Economic Moat	Capital Allocation	
GBP 3.42	None	Standard	

Name/Ticker		Rating	
Just Eat Takeaway (TKWY)		★★★★★	Just East Takeaway is the best-positioned food delivery stock. According to our estimates, in Germany alone, where the company is a dominant player, it is worth more than the current market cap. This means investors get the rest of the business for free. The recent divestment of its iFood stake has removed refinancing concerns in the midterm while the Amazon/Grubhub partnership provides scope for profitable growth in the U.S. and a potential Amazon minority stake in future. 2023 guidance for adjusted EBITDA of EUR 275 million and positive free cash flow mid-2024 reflect the group's profitable marketplace business and logistical efficiencies. The market appears skeptical about the sector's long-term growth potential, but Just Eat Takeaway's strong balance sheet and resilient marketplace business places the company in a strong position over the long term. From a valuation perspective, Just Eat Takeaway offers a rare investment opportunity in the food delivery segment.
Price	Fair Value Estimate	Uncertainty	
EUR 13.09	EUR 81.00	Very High	
Market Cap (B)	Economic Moat	Capital Allocation	
EUR 2.89	Narrow	Exemplary	

Name/Ticker		Rating	
Swatch Group (UHR)		★★★★★	Swatch benefits from a narrow moat through brand intangible assets and manufacturing scale. Its valuation is very appealing as tailwinds are not priced in. Notably, Swatch should benefit from high exposure to Chinese consumption, which we expect to recover strongly thanks to pent-up demand in the wake of the pandemic and long-term income growth. The fall in demand for lower-priced watches has finally stopped, while smartwatches, a competitive threat, are finally reaching maturity. Lastly, the company is exercising its significant operating leverage through cost cuts and the implementation of automation.
Price	Fair Value	Uncertainty	
CHF 247.10	CHF 368.00	Medium	
Market Cap (B)	Economic Moat	Capital Allocation	
CHF 12.53	Narrow	Standard	

Consumer Defensive

Ioannis Pontikis, CFA | ioannis.pontikis@morningstar.com
Philip Gorham, CFA, FRM | philip.gorham@morningstar.com

As Pricing Subsides, a Step-Up in Marketing During H2 Should Lift Volumes

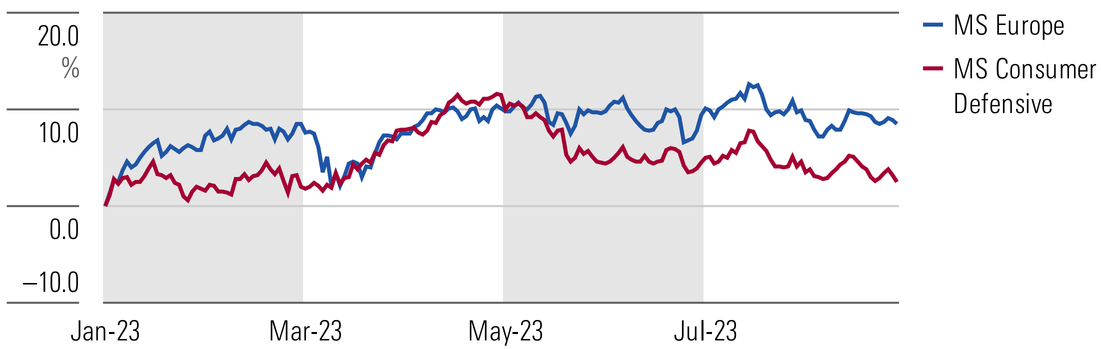
The Morningstar Consumer Defensive Index slightly outperformed in early 2023 as turmoil in the banking sector led to some risk-averse sector rotation, but this has been reversed in recent months. Inflation concerns and the robustness of consumer demand across major economies are top of mind for investors in the sector.

First-half earnings reports were resilient, with many Tier 1 companies beating our estimates on revenue and profit (Nestle and Unilever), primarily driven by pricing and lower freight costs, respectively. Spot prices have slowed down across most commodities and manufacturers are signaling lower levels of cost inflation in the second half. Looking ahead, we expect companies in the space to step up investments in marketing and promotional activity to boost volume growth as prices decline and consumers become even more price-conscious.

The consumer defensive sector often outperforms in market downturns, but those cycles have usually been accompanied by falling interest rates. However, this time low-income consumers may struggle. Middle-income consumers' savings are back to prepandemic levels and despite broad-based inflationary pressure, so far they seem willing to accept higher prices. That said, increasingly, more companies have commented on downtrading and intensifying competition from private labels, especially in more discretionary consumer categories with weak brand power and high elasticities.

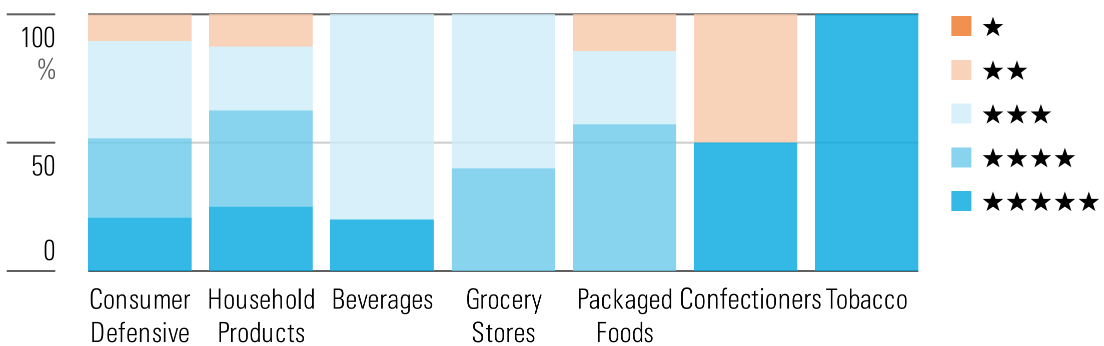
The sector appears to be undervalued with plenty of opportunities among confectioners, food, and beverages, and household product manufacturers. Despite a strong rally this year some tobacco stocks remain undervalued.

Consumer Defensive vs. the Morningstar European Index



Source: Morningstar. Data as of Sept. 13, 2023.

Consumer Defensive Star Rating Distribution by Industry



Source: Morningstar. Data as of Sept. 13, 2023.

Discounters Are Big Winners, Tesco and Sainsbury's Holding Up Well

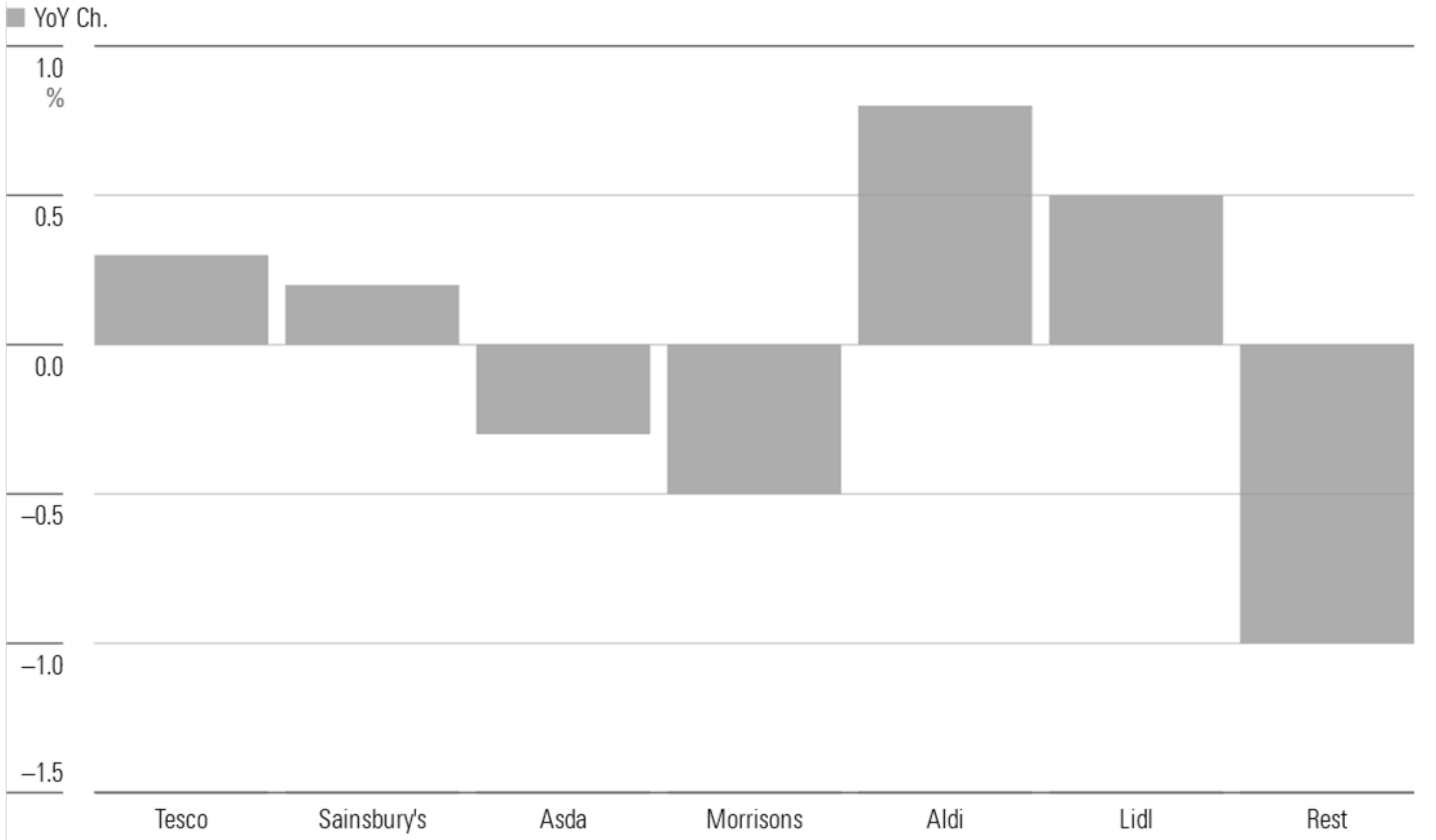
Higher inflation could spell trouble as consumers trade down, in which case traditional grocers without a strong market offering will find it difficult to compete with discounters. Recent share gains in the U.K. corroborate this. That said, a potential discounter-led price war would hit grocers in our list.

However, we don't think this is likely as:

- at current price levels, discounters continue to gain market share;
- discounters' profit margins are significantly lower than in the past; and
- grocers are much better positioned in the market-entry, value segment with significantly narrower price gaps versus discounters than in the past.

Market share development over the last 12 months reflects a continuation of hard-discounters' share gains (from peaking in the first quarter) with Asda, Morrisons, and smaller retailers/grocers being the biggest donors. Meanwhile, Tesco and Sainsbury's are holding up well and gaining share.

U.K. Grocery Market Share Developments



Source: Kantar U.K. data as of Sept. 3, 2023.

Consumer Defensive | Top Picks

Name/Ticker		Rating
Anheuser-Busch InBev (ABI)		★★★★★
Price	Fair Value Estimate	Uncertainty
EUR 53.33	EUR 83.00	Medium
Market Cap (B)	Economic Moat	Capital Allocation
EUR 105.08	Wide	Exemplary

Anheuser-Busch InBev is a high-quality business with monopolistic positions in several emerging markets in Latin America and Africa. While the company has lost share in developed markets, particularly to craft beer in the U.S., AB InBev should benefit from premiumization into its global brands in other markets, making mix a strong growth driver. In our view, the stock is undervalued in part because of its high debt load, and more recently due to marketing missteps in the U.S. In mid-2023, AB InBev reported net debt/EBITDA of 3.7 times, slow progress year over year and still much higher than the level of around 2.5 times that we think is maintainable in the long term. However, we expect leverage to fall to 2.3 times by the end of 2025. AB InBev reports in U.S. dollars, but generated less than one third of its EBIT in the U.S. in 2022. The strength of the U.S. dollar has weighed on earnings in the last few quarters and reduced revenue by 3 percentage points in the first 9 months of 2022. The reversal in the dollar's strength should boost earnings growth in the next few quarters.

Name/Ticker		Rating
Barry Callebaut (BARN)		★★★★★
Price	Fair Value Estimate	Uncertainty
CHF 1,448.00	CHF 1,910.00	Low
Market Cap (B)	Economic Moat	Capital Allocation
CHF 7.94	Wide	Standard

Barry Callebaut is well positioned in an inflationary environment due to its cost-plus pricing model (contractually passing on input cost inflation to clients, including freight cost inflation due to container scarcity) and is currently trading in 5-star territory, presenting an attractive opportunity for long-term investors. The company is undergoing significant changes internally, with a recent salmonella outbreak at Barry Callebaut's Wieze factory, prompting some clients to consider collaborations with competitors, resulting in a significant management reshuffle. This shift not only casts uncertainty on midterm growth projections, but also implies a potential rebase in volumes due to the dual challenges of potential client attrition and stock-keeping unit adjustments. The new CEO will provide a detailed strategic update with the publication of full-year results on Nov. 1. Despite this, we believe the company's cost advantage and innovation partner status are intact with recent weakness in shares creating opportunities for long-term investors.

Consumer Defensive | Top Picks

Name/Ticker		Rating
Tesco (TSCO)		★★★★
Price	Fair Value Estimate	Uncertainty
GBX 270.70	GBX 298.00	Medium
Market Cap (B)	Economic Moat	Capital Allocation
GBP 19.00	None	Standard

Despite the negative macroeconomic environment and cost-of-living crisis in the U.K, we think the outlook for Tesco is not as bad as the share price suggests. The grocer's holistic approach to groceries due to its scale and dominant offline (27% market share), online (37.5% market share), and food-service (largest-player) position in the core U.K. market, have enabled it to gain market share over discounters and some of its competitors recently. A discounter-led price war is the bear case for the large U.K. supermarkets. However, we don’t believe this is likely. We think management's guidance on fiscal 2024 free cash flow is conservative. Apart from an attractive dividend yield, Tesco shares are attractively priced, trading in 4-star territory.

Name/Ticker		Rating
Nestle (NESN)		★★★★
Price	Fair Value Estimate	Uncertainty
CHF 105.42	CHF 116.00	Low
Market Cap (B)	Economic Moat	Capital Allocation
CHF 281.27	Wide	Standard

Earlier this year we thought that fiscal 2023 top-line guidance looked conservative and posited that if Nestle could carry first-quarter momentum into the second quarter, growth guidance would have to be raised with the first-half release. Following another good quarter, Nestle upgraded organic growth guidance from 6%-8% to 7%-8% and confirmed expectations of margins at 17%-17.5%. This was a good all-around print for the first half with a solid underlying profit beat. Our estimates are at the low end of the guidance range for top-line and bottom-line numbers as we expect any benefit that Nestle derives from an expected improvement in gross margin to be at least partially offset by a significant increase in marketing investments in the second half. This, in turn, should substantially support volume/mix as pricing subsides. For the first time in a while, Nestle shares trade in 4-star territory.

Energy

Allen Good, CFA | allen.good@morningstar.com

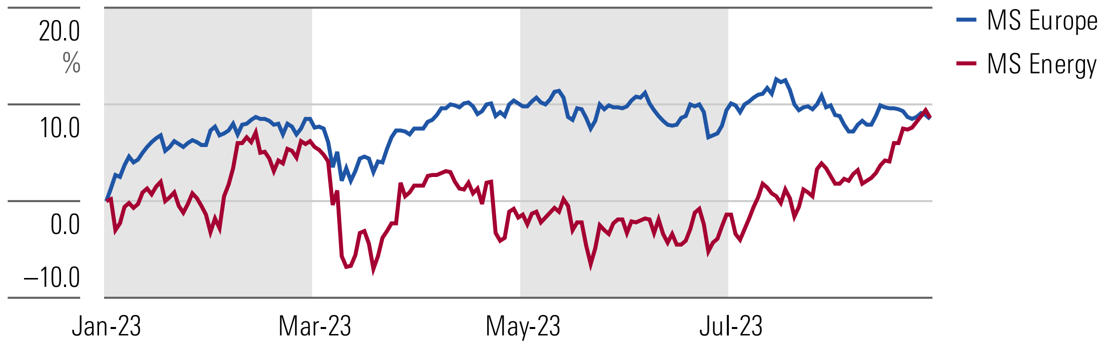
Energy Stocks Recover in Weak Gas Market

European energy stocks have staged a bit of a comeback midyear and now closely match the overall European market performance. This is supported by the European Union's strong performance from a gas storage perspective, which has buoyed optimism by investors.

The EU is in excellent shape entering the winter, but it must remain vigilant, in our view. The region's goal of filling its storage to 90% of capacity by Nov. 1 was already exceeded in September, with the EU at nearly 94%. However, we view the situation as fragile. We think the EU Commission's proposal to extend the voluntary gas consumption cuts of 15% from April 1, 2023 to March 31, 2024 demonstrates an appropriate level of caution. Lower gas prices in the EU are not triggering a recovery in gas consumption, with consumption down about 11% in the first half of the year, led primarily by declines in power generation and industrial demand. To some extent, the storage gains reflect the decline in consumption as well as a relative flood of liquid natural gas cargoes, primarily from the U.S. We remain concerned about the possibility of a colder-than-normal winter, threatened strikes at multiple LNG export plants in Australia, and a stronger-than-normal hurricane season in the U.S. curtailing exports when they are most needed in the EU.

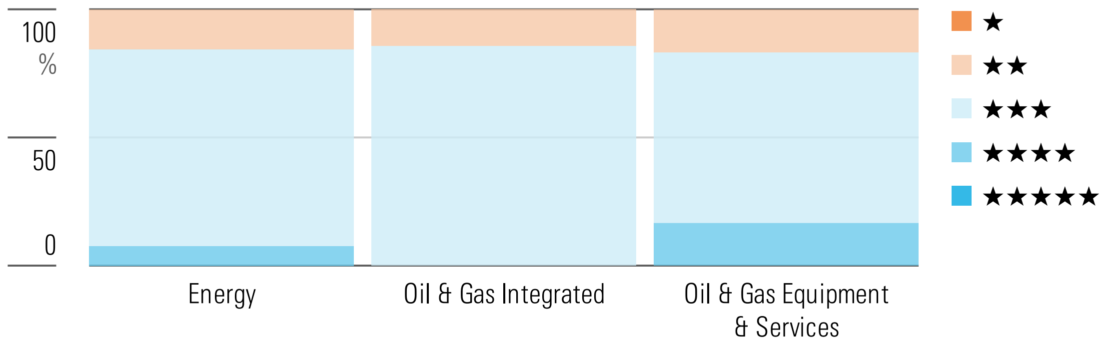
Bargains remain relatively few in the energy sector, and the oil and gas services segment remains the most undervalued. Investors don't seem to appreciate the ability of services firms to boost profits toward midcycle levels, likely because it takes more time for higher activity levels to translate to greater pricing power on the services side.

Energy vs. the Morningstar European Index



Source: Morningstar. Data as of Sept. 13, 2023.

Energy Star Rating Distribution by Industry



Source: Morningstar. Data as of Sept. 13, 2023.

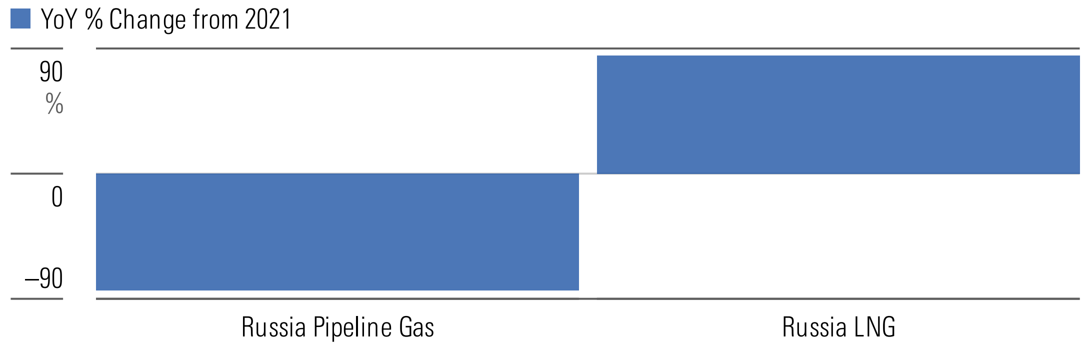
Russian LNG Presents an Energy Security Challenge for the EU

While the REPowerEU plan laid out numerous goals across multiple end markets for eliminating the use of Russian pipeline gas, the EU has no such plan for Russian LNG, which we think will come as a surprise to investors. The EU has reduced Russian pipeline gas imports by over 80% in a very short time, but Russian LNG imports have surged recently and now make up 50% of overall Russian gas imports to the EU. If Russian LNG imports are not addressed, the EU will still rely somewhat on Russian energy imports, reducing its overall energy security.

Russian LNG currently accounts for about 19 billion cubic meters (or 14 million tons per year) of EU LNG imports annually. This is about 5%-6% of the EU's overall gas consumption and about 15% of its overall LNG consumption. However, by 2030, considering the EU's success at reducing gas consumption via the REPowerEU plan and increasing its use of renewables, among other efforts, we expect EU LNG consumption to decline. If Russian LNG consumption by the EU remained unchanged at 19 bcm, this implies that about a third of EU LNG consumption would be from Russia. As we expect Russian pipeline gas to be largely eliminated from EU gas consumption within a few years, this implies that any Russian LNG imports in the latter half of the decade would be essentially all the EU's Russian gas imports.

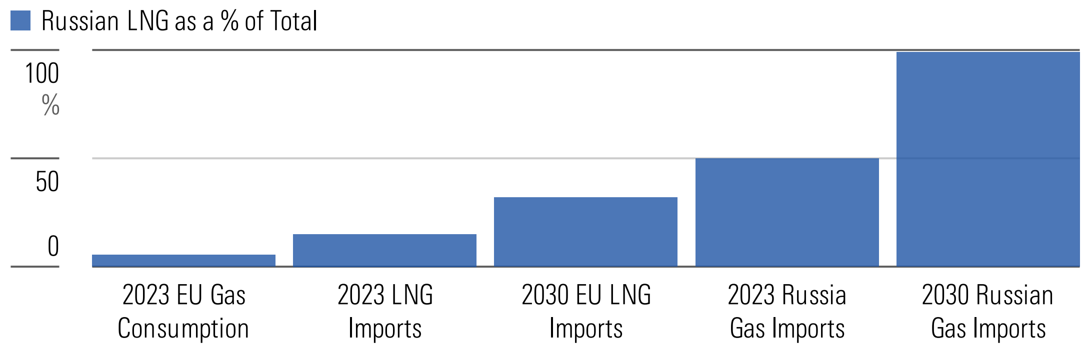
The EU to date has not been heavily involved in signing new contracts for U.S. LNG, instead it has been relying on spot cargoes. There are about 46 million tons per year in permit projects in the U.S. that must obtain a final investment decision, more than the 14 mtpa in Russian LNG imports to the EU that currently need to be displaced.

Russian Pipeline Gas Consumption Has Declined; LNG Consumption Has Not



Source: European Network of Transmission System Operators for Gas, Eurostat.

If Not Eliminated, Russian LNG Would Be a Sizable Problem for the EU by 2030



Source: Morningstar.

Energy | Top Picks

Name/Ticker		Rating
Shell (SHEL)		★★★
Price	Fair Value Estimate	Uncertainty
GBX 2,580.00	GBX 2,600.00	High
Market Cap (B)	Economic Moat	Capital Allocation
GBP 171.84	None	Standard

Shell's new CEO Wael Sawan is reigning in spending, divesting low-return power assets, and increasing shareholder returns in a bid to close the valuation gap with U.S. peers. We do not think it will prove entirely successful, but it is a step in the right direction. Meanwhile, the higher payout ratio of 30%-40% of cash flow brings it in line with peer TotalEnergies. Shell is unlikely to ever match the hydrocarbon-focused strategy of ExxonMobil and Chevron, but there is plenty of room to improve returns and address low-return investments while offering an appealing energy transition alternative among integrated oils. By reigning in its low-carbon power ambitions, stemming the declines in its oil production, and emphasizing the value of its LNG and trading organization, Shell could be that option.

Name/Ticker		Rating
Schlumberger (SLB)		★★★
Price	Fair Value Estimate	Uncertainty
USD 60.58	USD 56.00	High
Market Cap (B)	Economic Moat	Capital Allocation
USD 86.10	Narrow	Exemplary

Industry leader SLB (formerly Schlumberger) offers broad exposure to the global oilfield services segment due to its highly diversified product portfolio with a tilt toward international markets. High demand for oilfield services lends service firms a good deal of pricing power, supporting elevated margins into 2024. SLB's leading-edge technological advancements—key drivers behind the firm's narrow moat—continue to distinguish the firm from peers: its myriad innovations consistently add value for customers, preserving SLB's ability to command premium pricing over and above the currently favorable operating environment.

Name/Ticker		Rating
TotalEnergies (TTE)		★★★
Price	Fair Value	Uncertainty
EUR 62.37	EUR 61.00	High
Market Cap (B)	Economic Moat	Capital Allocation
EUR 149.72	None	Standard

TotalEnergies' latest strategic plan remains the same, aiming to achieve net-zero emissions by 2050 while delivering near-term financial performance. Its emissions-reduction goal is in line with many of its European peers, but in contrast to some, TotalEnergies does not plan a quick retreat from oil and gas. Instead, it plans to reduce emissions over time by expanding its ownership of renewable power assets. Its plan to return 35%-40% of cash flow to shareholders through the cycle, rates as one of the highest payouts among peers.

Financial Services

Henry Heathfield, CFA | henry.heathfield@morningstar.com
Johann Scholtz, CFA | johann.scholtz@morningstar.com
Niklas Kammer, CFA | niklas.kammer@morningstar.com

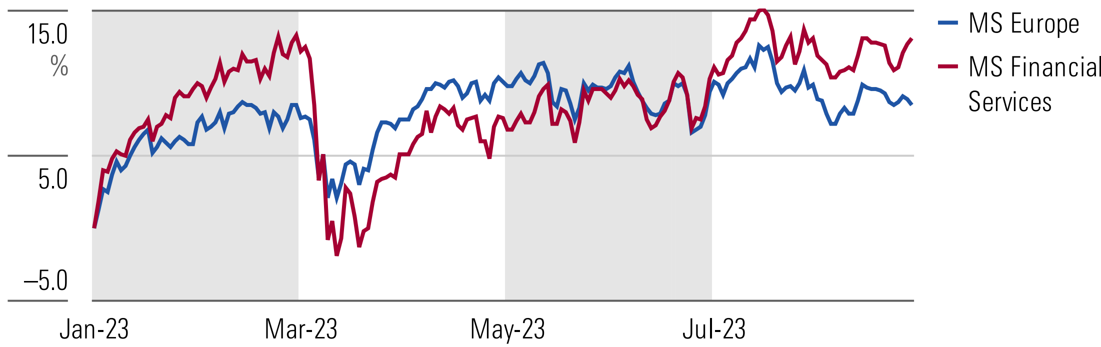
Financial Services Continue to Be Beneficiary of Higher Interest Rates

The Morningstar Financial Services Index has outpaced the Morningstar Europe Index since September last year. While most banks and the broader financial service companies' share prices were hit hard by the Silicon Valley Bank implosion, in broad terms higher inflation that has pushed up interest rates has been good for financial services. This rise has led to the expansion of net interest income margins, especially in retail banking. We maintain that large banks with low funding costs will be the long-term winners in the higher interest-rate regime. Those operating in well-set-up environments have good long-term prospects.

In insurance, inflation has initially hit the quality of underwriting. That is because claims inflation tends to lead pricing and some insurers operate with a lack of pricing power. Good-quality insurers with a track record of delivering profitable underwriting over the long term perform the best. Those which struggled with pricing and identifying better risks to underwrite historically have, in the extreme end, been exposed to regulator intervention. We continue to believe that intangible assets remain the best source of competitive advantage to gain an edge in underwriting. In the case of growth that can be effectively combined with a cost advantage.

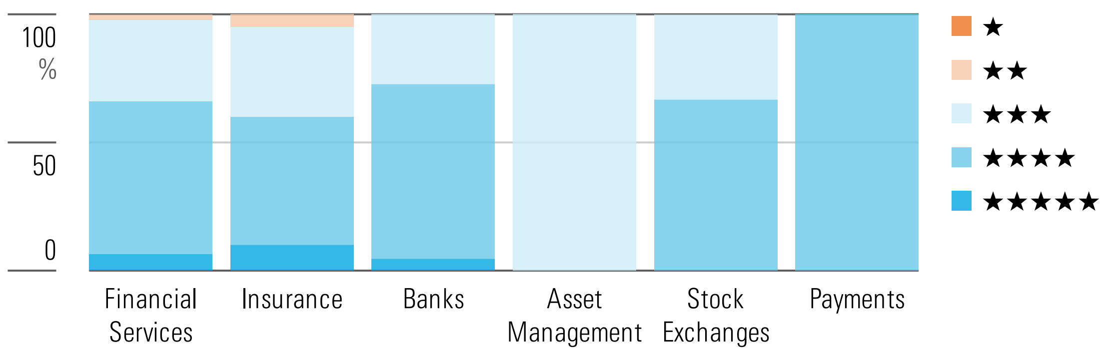
Payment providers, in our view, remain one of the most undervalued parts of European financial services. The market remains pessimistic about the long-term growth prospects for these businesses. However, we believe our forecasts for revenue growth and margin expansion are not unreasonable. That continues to provide interesting investment opportunities.

Financial Services vs. the Morningstar European Index



Source: Morningstar. Data as of Sept. 13, 2023.

Financial Services Star Rating Distribution by Industry



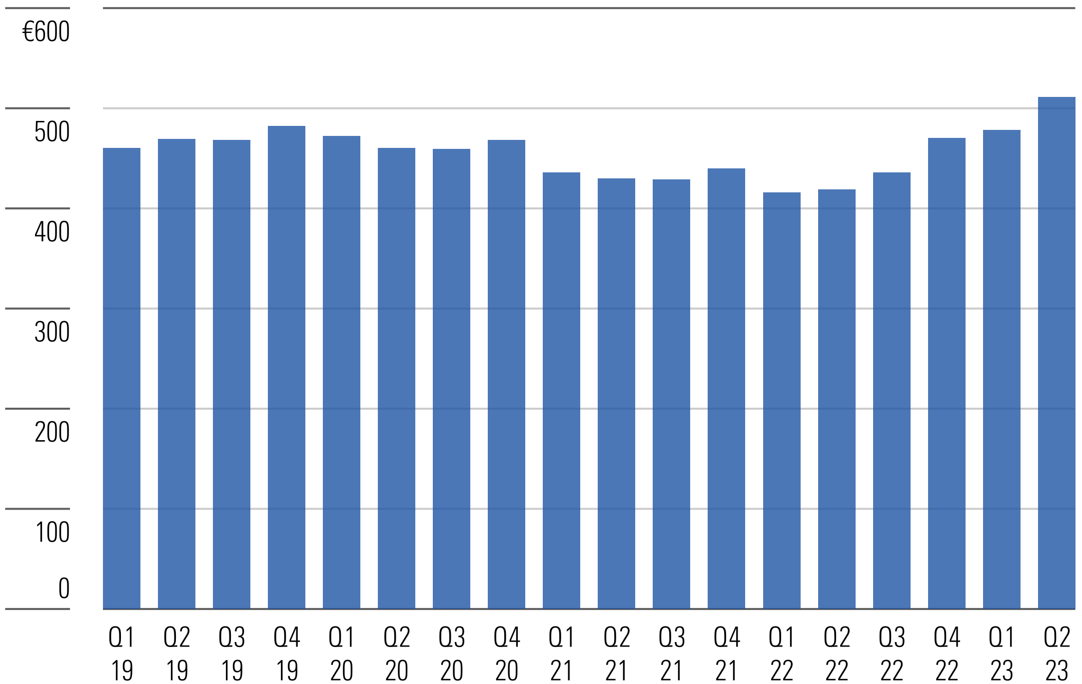
Source: Morningstar. Data as of Sept. 13, 2023.

Motor Insurance Pricing and Card Payments Continue to Rise

Motor insurance premiums within the U.K. continued to rise this year, growing by 9% year to date. We think the individual motor insurers we cover have raised prices by more than this.

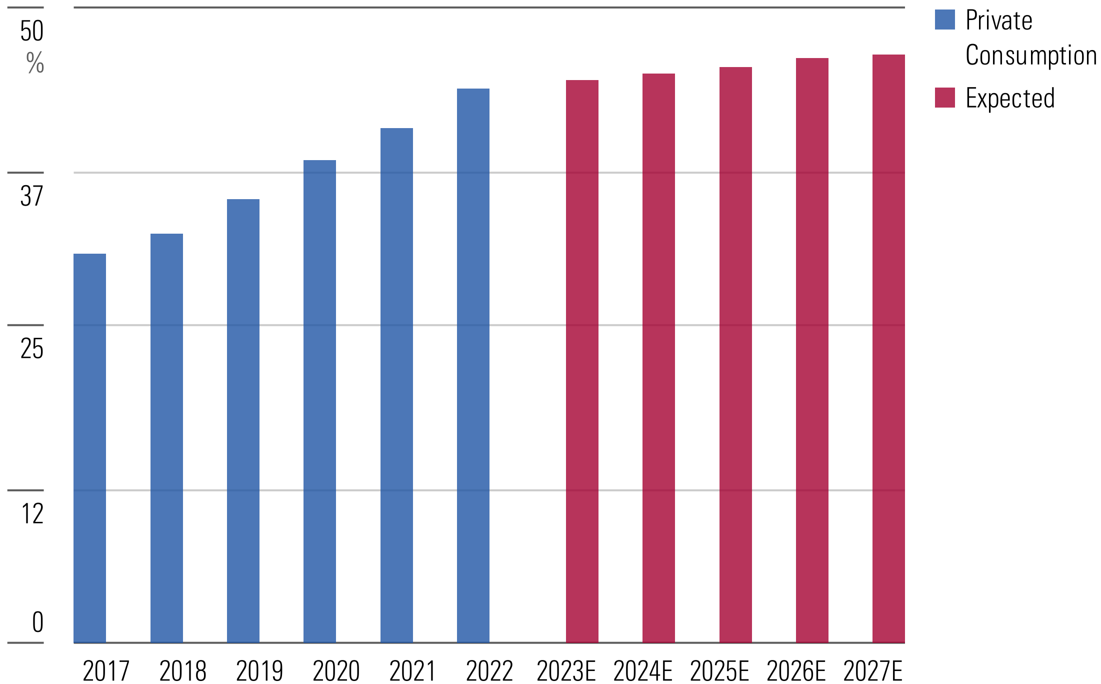
The shift from cash to cards is expected to continue in Europe, steadily expanding the addressable market for in-store acquirers such as Worldline.

Comprehensive Motor Insurance Premium Tracker



Source: Association of British Insurers. Data as of Aug. 11, 2023.

European Card Transaction Share



Source: Euromonitor. Data as of June 30, 2023.

Financial Services | Top Picks

Name/Ticker		Rating
Allianz (ALV)		★★★
Price	Fair Value Estimate	Uncertainty
EUR 232.50	EUR 250.00	Medium
Market Cap (B)	Economic Moat	Capital Allocation
EUR 93.95	None	Exemplary

Allianz is the largest European insurer we cover by market cap and we believe it is one of the most impressive of these businesses. Normally, we would attribute this sort of size to an inefficiently run business, with lots of waste and the potential for large underwriting losses. However, Allianz is a consistent performer. The geographies the business operates in tend not to be overly price-sensitive and in its exposure to personal lines insurance its revenue orientates around long-term relationships. While intangible assets help to keep pricing and claims in check, the company is exceptional at controlling expenses.

Name/Ticker		Rating
Admiral (ADM)		★★★★
Price	Fair Value Estimate	Uncertainty
GBX 2,425.00	GBX 3,070.00	Medium
Market Cap (B)	Economic Moat	Capital Allocation
GBP 7.35	Narrow	Exemplary

Narrow-moat Admiral is one of the most inflation-protected insurance businesses under our coverage. In personal lines insurance, pricing tends to lag claims, which has led to depressed results during the initial inflationary period. But because Admiral has been quicker to raise prices, it is so far showing some of the best underwriting improvements. Admiral has a history of focusing on specific policyholder strata where it has deeper and better data for pricing and claims. This helps it to price and underwrite risks more effectively. While U.K. motor growth is currently taking a back seat, Admiral is finding good growth in other lines of business. Within these lines we expect the company to continue building intangible asset data and proprietary technology expertise. We anticipate when underwriting conditions become more favorable, Admiral will return to profitable growth in U.K. motor.

Name/Ticker		Rating
Worldline (WLN)		★★★★★
Price	Fair Value	Uncertainty
EUR 27.75	EUR 91.00	High
Market Cap (B)	Economic Moat	Capital Allocation
EUR 7.85	Narrow	Standard

After exiting the pandemic, lower levels of long-distance travel remained a drag on Worldline's performance, hitting volume and revenue growth. As the market has adjusted to those lower growth numbers and the uncertain outlook, the share price has fallen. We think as travel activity has rebounded from the low 2020 and 2021 base, there is no real structural change in this payment provider's outlook. Our long-term view is that the shift from cash to cards will continue and investors should capitalize on the current share price weakness of this well-placed narrow-moat business.

Healthcare

Alex Morozov, CFA | alex.morozov@morningstar.com
Damien Conover, CFA | damien.conover@morningstar.com

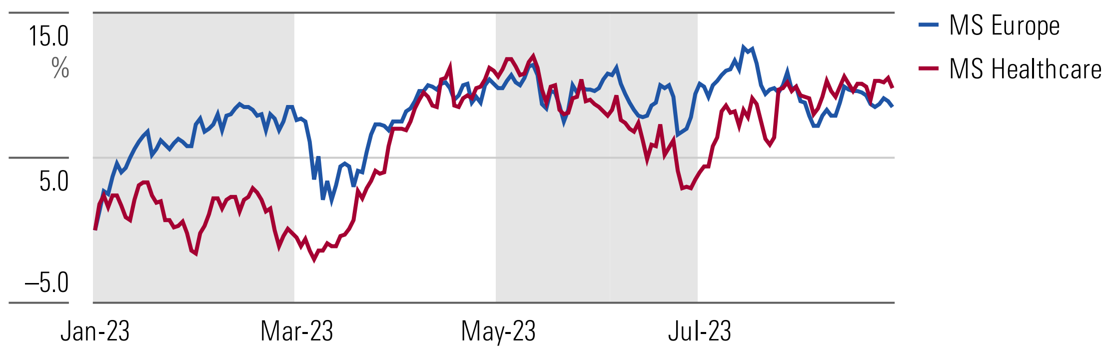
Healthcare Valuations Appear Attractive Across Most Industries

Healthcare's Fundamentals Remain Solid as Valuations Look Appealing
Over the past 12 months, Morningstar's Healthcare Index has lagged the overall market. With investors appearing less concerned about recessionary pressures, healthcare seems to have slightly fallen out of favor relative to the market. If recessionary concerns return, we believe that innovation within healthcare along with the defensive nature of the sector should support more stable demand relative to the rest of the market.

On valuation, we view the healthcare sector as undervalued. Our coverage trades below our overall estimate of intrinsic value with an aggregate price/fair value metric of 0.88. Aside from the medical distribution and device industries, the remaining healthcare industries look undervalued. We see the most 5-star stock calls in the biopharma and healthcare plan industries.

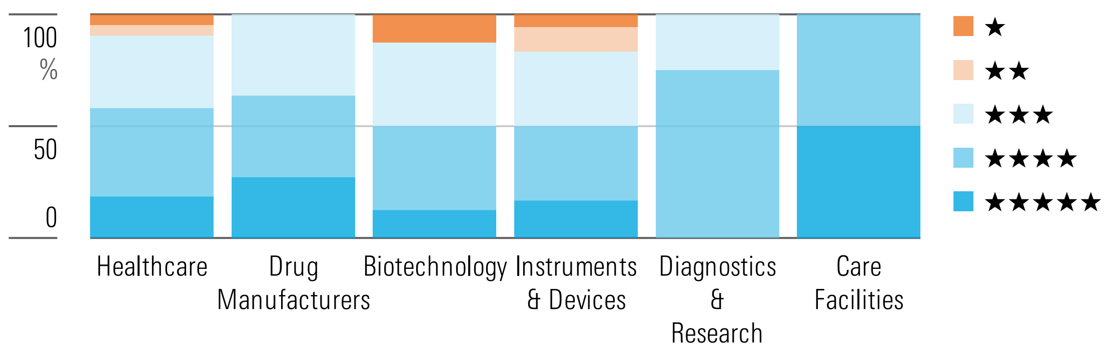
Within the largest healthcare industry by market capitalization, the biopharma group looks undervalued with the market not fully appreciating the innovation in several therapeutic areas, including oncology, immunology, and rare diseases. In the healthcare plan industry, we believe the short-term headwinds of potential pharmacy benefit reforms and falling support in Medicaid and Medicare Advantage are creating undervalued opportunities as the industry can offset these challenges over the long run. In the large devices industry, we see a mixed valuation picture with some stocks offering compelling valuations after falling from a bullish run during the COVID-19 pandemic.

Healthcare vs. the Morningstar European Index



Source: Morningstar. Data as of Sept. 13, 2023.

Healthcare Star Rating Distribution by Industry



Source: Morningstar. Data as of Sept. 13, 2023.

Biopharma Industry Well Positioned for Steady Long-Term Gains, Buoyed by Continued Innovation

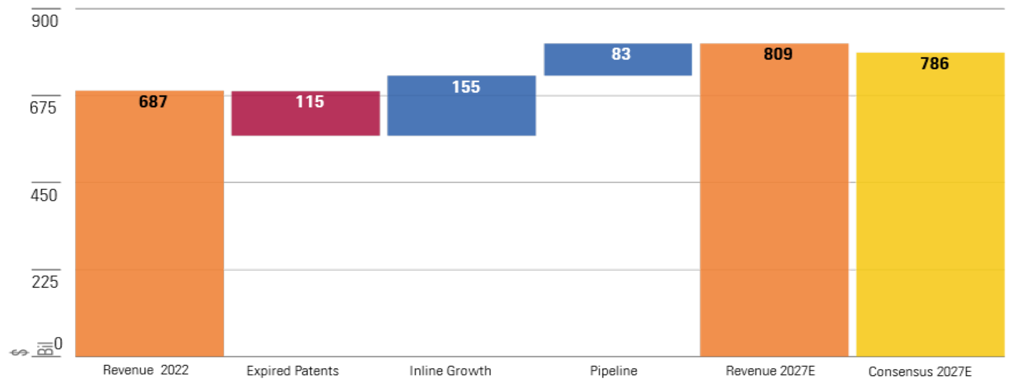
We believe the market is underappreciating pipeline innovation that should support 4.5% compound annual earnings growth over the next five years (excluding COVID-19 products) for the large-cap biopharma industry (see top-right exhibit).

The market appears overly concerned by U.S. drug policy changes in the Inflation Reduction Act, a drag on acquisitions from Federal Trade Commission scrutiny, and patent losses. COVID-19 vaccines and treatments also create tough comparables in 2023 that mask strong underlying industry growth. However, we expect these headwinds are manageable and the industry will continue to post steady growth despite the challenges.

The obesity drug market has shown excellent recent innovations and is poised to grow to $65 billion by 2031 (see bottom-right exhibit), led by Novo Nordisk and Eli Lilly. While we view the biopharma industry as undervalued, we believe the leading weight loss drugmakers are slightly overvalued with the market getting overly excited about the stocks.

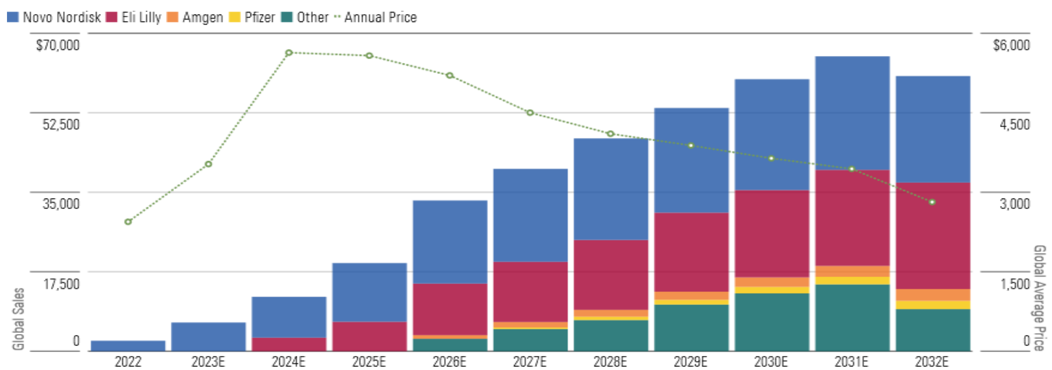
Beyond the obesity market, we are seeing the most drug innovations in the oncology, rare disease, and immunology settings, all areas that have shown excellent pricing power.

Biopharma Firms to Grow at 4.5% 5-Year CAGR Excluding Pfizer's COVID-19 Sales



Source: Morningstar. Includes branded drug sales at AbbVie, Amgen, AstraZeneca, Bayer, Biogen, BioMarin, Bristol, Gilead, GSK, J&J, Eli Lilly, Merck, Novartis, Novo Nordisk, Pfizer, Regeneron, Roche, and Sanofi as of Sept. 8, 2023.

In Likely $65 Billion Global Obesity Market, Eli Lilly and Novo Nordisk To Dominate



Source: Morningstar.

Healthcare | Top Picks

Name/Ticker
Elekta (EKTA B)

Price	Fair Value Estimate	Rating
SEK 75.26	SEK 127.00	★★★★★
Market Cap (B)	**Economic Moat**	**Uncertainty**
SEK 28.75	Wide	Medium
		Capital Allocation
		Standard

Buoyed by growing demand for radiotherapy, wide-moat Elekta should enjoy strong sales momentum over the next decade. The radiotherapy industry has consolidated substantially over the past decade and the two main players are in a prime position to benefit from a market that we believe will grow in midsingle digits. Elekta has several things going for it in the near term, with the main catalyst being adoption of its magnetic resonance/radiation therapy Unity technology. The company has sunk immense amounts of capital and time into the platform and should now start seeing steady order upticks as clinical data highlighting its advantages starts trickling in. The company hasn't executed well historically, but with a strong product portfolio, it can finally make inroads into the lucrative North American market while continuing to see strong demand from emerging markets. Elekta trades at a material discount to its key rival as well as other medical technology firms.

Name/Ticker
Fresenius (FRE)

Price	Fair Value Estimate	Rating
EUR 29.83	EUR 52.00	★★★★★
Market Cap (B)	**Economic Moat**	**Uncertainty**
EUR 16.8	Narrow	High
		Capital Allocation
		Standard

Fresenius SE shares appear significantly undervalued because of the unprecedented challenges that the company's dialysis segment (Fresenius Medical Care) has been facing since 2021. Even with these concerns, we see a solid intermediate and long-term outlook for Fresenius SE, especially if the new management teams at Fresenius SE and Fresenius Medical Care can turn things around and if external factors such as labor pressures ease. The company's injectable therapies business (Fresenius Kabi) is gearing up for potentially large biosimilar launches in 2023 and beyond. The company's other segments appear solid. So, even with some near-term weakness, we think high-single-digit earnings growth compounded annually through 2027 remains possible at Fresenius SE. The shares appear to be discounting a much weaker scenario than that and overall, we still view Fresenius SE shares as some of the cheapest in our healthcare coverage.

Name/Ticker
Roche (ROG)

Price	Fair Value	Rating
CHF 261.35	CHF 387.00	★★★★★
Market Cap (B)	**Economic Moat**	**Uncertainty**
CHF 210.8	Wide	Low
		Capital Allocation
		Exemplary

We don’t think the market fully appreciates Roche's drug portfolio and industry-leading diagnostics, which combined create maintainable competitive advantages. As the market leader in biotech and diagnostics, this Swiss healthcare giant is in a unique position to guide global healthcare into a safer, more personalized, and more cost-effective endeavor. The collaboration between its diagnostics and drug development groups gives Roche a unique in-house angle on personalized medicine. While COVID-19 and biosimilar-related headwinds will likely drive Roche’s growth into negative territory in 2023, we believe the fundamentals are strong, and expect a recovery in 2024 as core blockbuster drugs continue to grow and pipeline drugs are launched.

Industrials

Michael Field, CFA | michael.field@morningstar.com

Healthy Order Backlogs and Spillover Pricing Support Rising Profit Margins

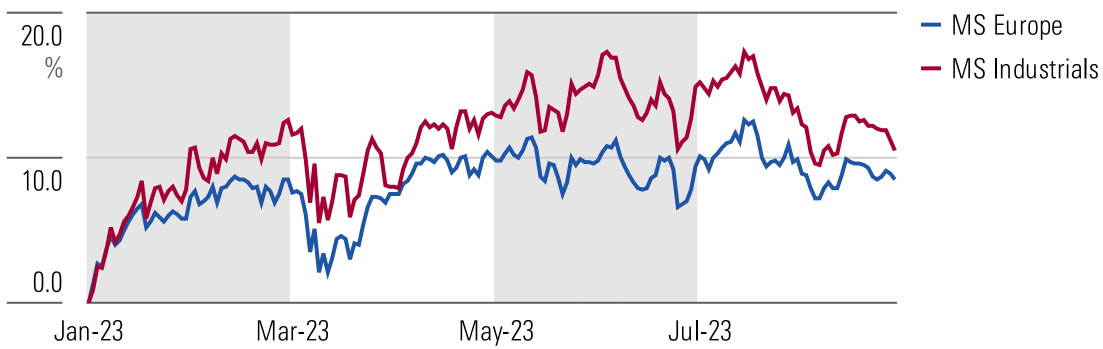
The industrials sector has lagged behind the wider Morningstar European Index so far in 2023 as concerns over a potential recession hit investors' willingness to invest in a sector with strong cyclical exposures.

Falling raw material costs and the spillover of price increases implemented during the previous year have supported rising operating margins across many industrial businesses, despite declining volumes. Destocking at wholesalers, who had overbought inventories due to supply chain constraints in the prior year, is contributing even more to lower volumes. Meanwhile, deteriorating macroeconomic conditions are most noticeable for businesses with end-market exposure to residential construction.

Within the construction sector, the reshoring of production and accelerating spending on infrastructure supports demand. This is in contrast to residential construction, where the number of new building permits is falling in many European countries due to rising interest rates.

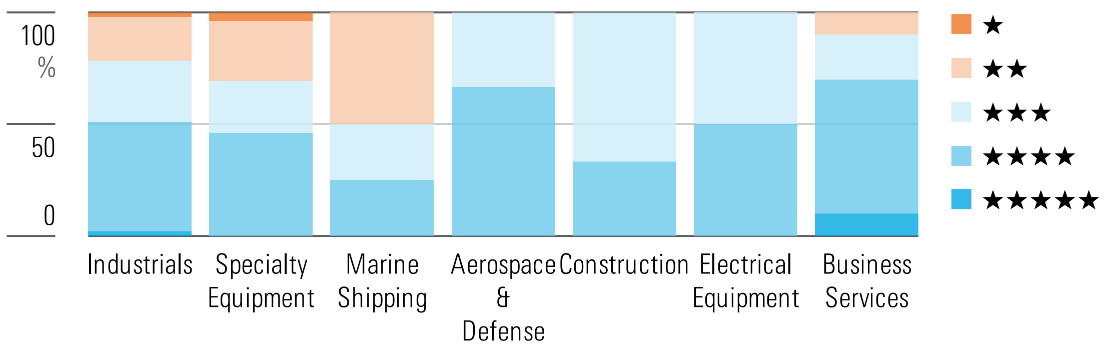
Valuations across the industrials sector are mixed, with areas like specialty equipment highly valued, while opportunities still exist in areas like business services. In the latter, we highlight the testing, inspection, and certification companies. These companies are moaty by nature and highly resilient with flexible cost bases and have the ability to pivot to areas of structural growth during tough economic conditions.

Industrials vs. the Morningstar European Index



Source: Morningstar. Data as of Sept. 13, 2023.

Industrials Star Rating Distribution by Industry

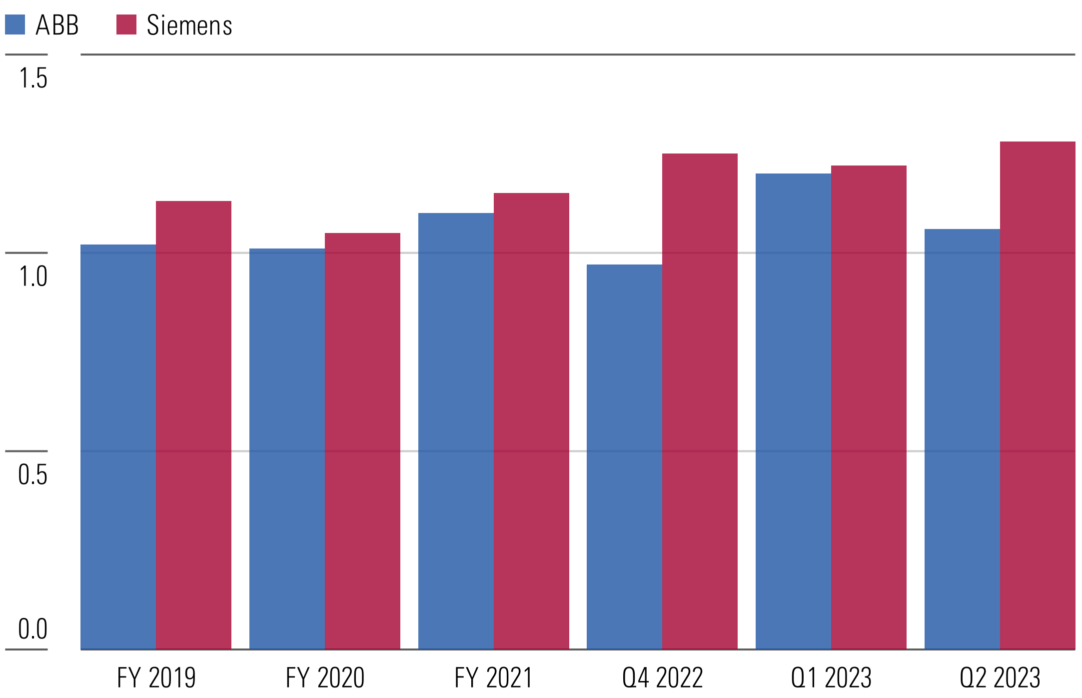


Source: Morningstar. Data as of Sept. 13, 2023.

Capital Goods Manufacturers Have Growing Order Backlogs

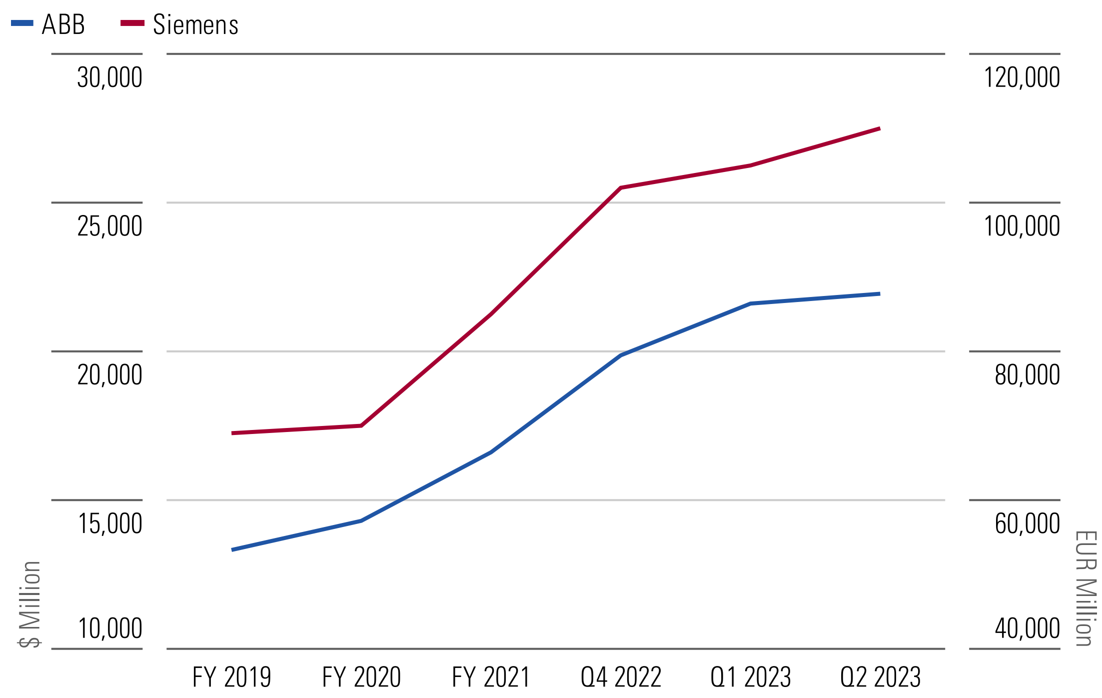
Businesses exposed to secular growth themes such as electrification and automation continue to fare well and see their order books grow. Capital goods manufacturers ABB, Schneider Electric, and Siemens have all grown their order backlogs since the start of 2023, despite weakness in their short-cycle segments. During the past two quarters, each of the above-mentioned businesses has raised their full-year revenue guidance, underpinned by strong pricing and healthy backlogs.

Book/Bill Ratios Above 1 Times, Supporting Future Revenue Growth



Source: Company statements.

Order Backlogs Continue to Rise Even With Double-Digit Revenue Growth



Source: Company statements.

Industrials | Top Picks

Name/Ticker		Rating	
Sodexo (SW)		★★★★	The number-two caterer in the world, Sodexo's narrow moat is underpinned by strong switching costs, with client retention north of 95%. The stock's current valuation is back to prepandemic levels. However, investors are missing the potential for supernormal revenue growth for the next couple of years, combined with a greater ceiling for operating margin growth, following a complete overall of the company's cost base during the pandemic years.
Price	Fair Value Estimate	Uncertainty	
EUR 102.05	EUR 118.00	Medium	
Market Cap (B)	Economic Moat	Capital Allocation	
EUR 14.92	Narrow	Standard	

Name/Ticker		Rating	
Intertek (ITRK)		★★★★★	Currently, Intertek is the most attractive stock in the testing, inspection, and certification sector, and trading at a rare discount to our fair value estimate. Although the company is still recovering from the pandemic and Chinese industrial disruptions, due to COVID-19 lockdowns in the first half of 2022, the company is already showing positive signs of recovery in 2023.
Price	Fair Value Estimate	Uncertainty	
GBX 4,233.00	GBX 5,700.00	Low	
Market Cap (B)	Economic Moat	Capital Allocation	
GBP 6.76	Narrow	Standard	

Industrials | Top Picks

Name/Ticker		Rating	
Siemens (SIE)		★★★★	The spinoff of Siemens' cyclical energy and wind turbine divisions in 2020, combined with an increasing mix of revenue generated from its formidable industrial software offerings have improved the quality of the group and provides more durable returns than in the past. Shares are trading in undervalued territory and at a larger discount than its European capital goods peers despite its superior market outlook, underpinned by secular growth themes such as the energy transition, digitalization, and industrial automation. We believe the market is overstating the perceived cyclicality of its strongly competitively advantaged business units, which warrant a higher multiple than its current 14 times forward P/E ratio.
Price	**Fair Value Estimate**	**Uncertainty**	
EUR138.10	EUR 166.00	Medium	
Market Cap (B)	**Economic Moat**	**Capital Allocation**	
EUR 109.40	Wide	Exemplary	

Name/Ticker		Rating	
Assa Abloy (ASSA B)		★★★★	Investors are currently underappreciating the long-term growth opportunity of Assa Abloy, the clear leader in the global locking and physical access industry. Specifically, we are positive about the transition to electromechanical locking systems. Electromechanical lock adoption rates are presently low—we estimate adoption rates of 8% and 15%, respectively, for the residential and nonresidential segments of the North American and European markets. With the global locking systems profit pool set to expand considerably, we expect robust earnings growth for Assa Abloy over the coming decade and forecast a 10-year EBIT CAGR of about 8%. We expect organic revenue growth of approximately 5.5% annually as adoption rates for electromechanical locking systems rise in North America and Europe over the coming decade. We expect bolt-on acquisitions to deliver a further approximate 2% top-line growth annually as Assa Abloy continues to roll up fragmented physical access systems.
Price	**Fair Value Estimate**	**Uncertainty**	
SEK 237.50	SEK 320	Medium	
Market Cap (B)	**Economic Moat**	**Capital Allocation**	
SEK 261.48	Wide	Standard	

Utilities

Tancrede Fulop, CFA | tancrede.fulop@morningstar.com

Rising Interest Rates Overshadow Strong First-Half Results Leaving Utilities Undervalued

Higher Rates and Higher Costs Act as Headwinds

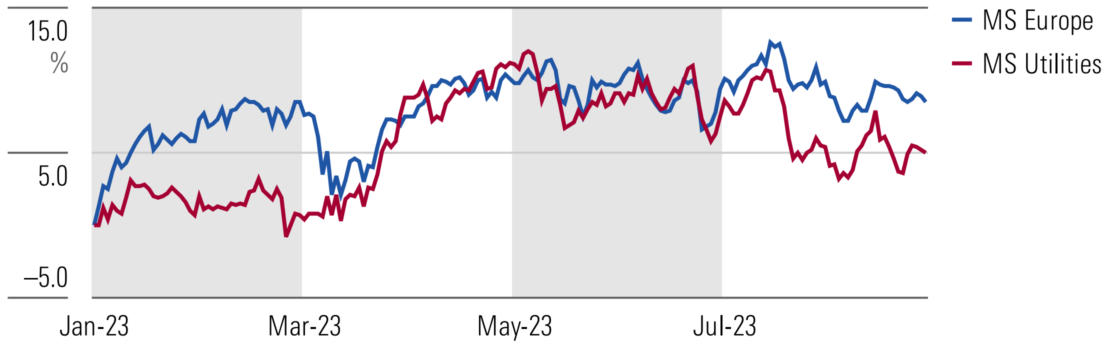
European utilities have underperformed the broad European market by 4% year to date with most of the underperformance occurring in the third quarter because of the rise in interest rates. This overshadowed strong second-quarter results, driven by the easing energy crisis, persistent commodity price volatility, and hedging improvements. These drivers have persisted in the third quarter, which should continue to support earnings. Moreover, some power price clawbacks will expire by the end of 2023 or have expired at the end of June, such as in Germany and Belgium. On the flip side, the comparison basis will be tougher as of the third quarter.

Renewables unit construction costs have increased by around 20% since 2021. The cost of capital continues to rise, but has been offset by rising power-purchase agreement prices. Projects awarded before the rise in interest rates, and not yet sanctioned, are the ones feeling the pinch. This chiefly concerns offshore wind, evidenced by the upcoming massive impairment of U.S. projects by Orsted in the third quarter. Solar is gaining momentum thanks to the drop in polysilicon prices in the first half of 2023 and the easing of supply chain issues.

Shares Trading Near Five-Year Lows

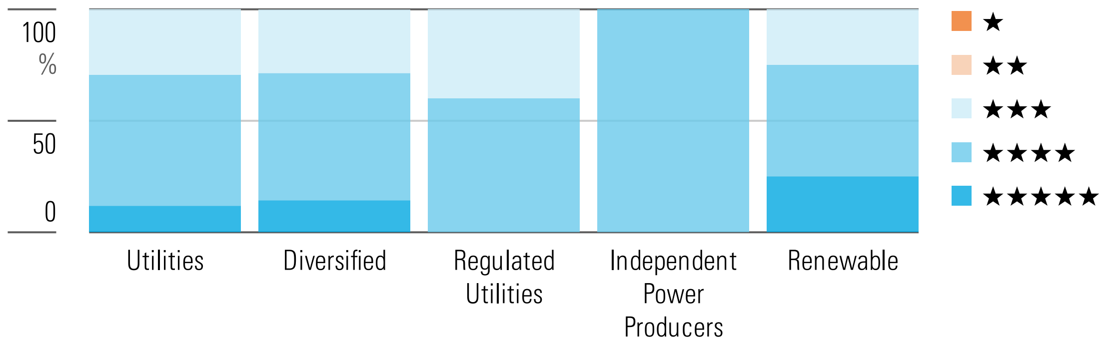
Overall, we view the sector as significantly undervalued with a median price/fair value estimate ratio of 0.89, close to the lowest since the beginning of the year. Two thirds of companies we cover are in buying territory. Integrated utilities have an attractive risk/reward profile.

Utilities vs. the Morningstar European Index



Source: Morningstar. Data as of Sept. 13, 2023.

Utilities Star Rating Distribution by Industry

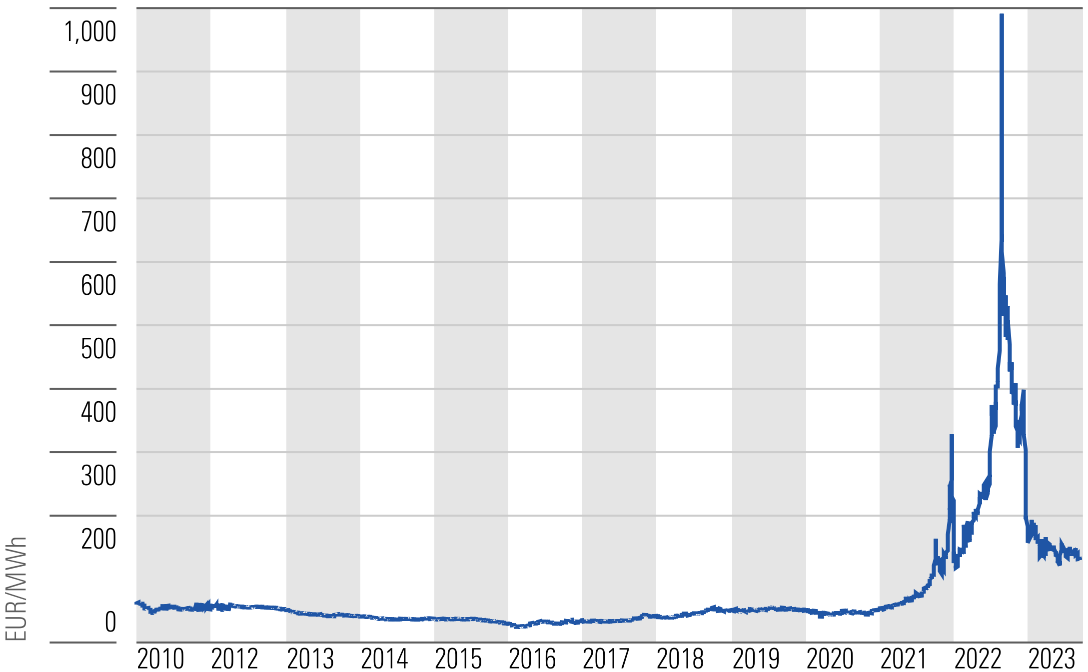


Source: Morningstar. Data as of Sept. 13, 2023.

Relative Dividend Yield at a Decade-Low, but Remains an Attractive Source of Income

The sector's 4.5% median trailing dividend yield is in line with the historical average. On the flip side, the 80-basis-point premium to the median of the main European government bond yields is way below the 270-basis-point historical average.

German Power Prices Have Decreased From Extreme 2022 Levels



Source: Morningstar commodities. Data as of Sept. 15, 2023.

European Utilities' Yield Premium to Government Bond Is at a Decade-Low

Source: Morningstar. Data as of Aug. 1, 2023.

Utilities | Top Picks

Name/Ticker		Rating	
SSE (SSE)		★★★★	SSE has an attractive business mix. It boasts an appealing pipeline of renewables projects in the U.K. that will boost medium-term earnings. Its U.K. offshore wind projects under construction are protected against construction cost inflation since the procurement costs are locked. Therefore, the read-across from Orsted's U.S. issues is unjustified. Its CCGTs are a good hedge against poor renewables conditions and benefit from capacity payments, which have materially increased at the latest auctions. Its transmission and distribution networks are indexed to inflation. Moreover, rising interest rates imply higher returns in future regulatory periods, which offset the negative impact on renewables projects.
Price	Fair Value Estimate	Uncertainty	
GBX 1,668.50	GBP 2,200	Medium	
Market Cap (B)	Economic Moat	Capital Allocation	
GBP 18.19	None	Standard	

Name/Ticker		Rating	
ENGIE (ENGI)		★★★★	The 2023 P/E and dividend yield of 7 and 9.5%, respectively, reflect record expected profits and undervaluation of the shares that is unjustified given the company's strong fundamentals and the derisking of the equity story since the nuclear deal with the Belgian government in June 2023. Engie has limited sensitivity to rising interest rates thanks to its leverage, which is well below its peers. Its large fleet of CCGTs provides a good hedge against poor renewables conditions while its trading division provides favorable exposure to commodity price volatility.
Price	Fair Value Estimate	Uncertainty	
EUR 15.20	EUR 17.00	Medium	
Market Cap (B)	Economic Moat	Capital Allocation	
EUR 36.66	None	Standard	

Name/Ticker		Rating	
RWE (RWE)		★★★★★	With the acquisition of ConEd's clean energy business, RWE became the fourth-largest renewable player in the U.S., a very attractive market since the adoption of the Inflation Reduction Act. The advance of the coal exit in Germany to 2030 could help reduce the discount of RWE's renewable operations versus peers. RWE has one of the highest exposures to European power prices and clean-spark spreads thanks to the high liberalized share of its renewables volumes and combined-cycle gas turbine plants. Additionally, the group typically benefits from commodity price volatility thanks to its trading business. Its average 2023-24 P/E of 10 reflects the material undervaluation of the shares, partly driven by the read-across from Orsted's issues with its U.S. projects. RWE is the second-biggest offshore wind company behind Orsted, but the read-across is unjustified since RWE has not been awarded any U.S. offshore wind projects.
Price	Fair Value	Uncertainty	
EUR 36.69	EUR 55.00	Medium	
Market Cap (B)	Economic Moat	Capital Allocation	
EUR 27.29	None	Exemplary	

Upcoming Webinar

Register Here

Watch live or on-demand

General Disclosure

Unless otherwise provided in a separate agreement, recipients accessing this report may only use it in the country in which the Morningstar distributor is based. Unless stated otherwise, the original distributor of the report is Morningstar Research Services LLC, a U.S.A. domiciled financial institution.

This report is for informational purposes only and has no regard to the specific investment objectives, financial situation, or particular needs of any specific recipient. This publication is intended to provide information to assist investors in making their own investment decisions, not to provide investment advice to any specific investor. Therefore, investments discussed and recommendations made herein may not be suitable for all investors; recipients must exercise their own independent judgment as to the suitability of such investments and recommendations in the light of their own investment objectives, experience, taxation status, and financial position.

The information, data, analyses, and opinions presented herein are not warranted to be accurate, correct, complete, or timely. Unless otherwise provided in a separate agreement, neither Morningstar, Inc. nor the Equity Research Group represents that the report contents meet all of the presentation and/or disclosure standards applicable in the jurisdiction the recipient is located.

Except as otherwise required by law or provided for in a separate agreement, the analyst, Morningstar, Inc. and the Equity Research Group and their officers, directors and employees shall not be responsible or liable for any trading decisions, damages or other losses resulting from, or related to, the information, data, analyses or opinions within the report. The Equity Research Group encourages recipients of this report to read all relevant issue documents for example, prospectus) pertaining to the security concerned, including without limitation, information relevant to its investment objectives, risks, and costs before making an investment decision and when deemed necessary, to seek the advice of a legal, tax, and/or accounting professional.

The Report and its contents are not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country, or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Morningstar, Inc. or its affiliates to any registration or licensing requirements in such jurisdiction.

Where this report is made available in a language other than English and in the case of inconsistencies between the English and translated versions of the report, the English version will control and supersede any ambiguities associated with any part or section of a report that has been issued in a foreign language. Neither the analyst, Morningstar, Inc., nor the Equity Research Group guarantees the accuracy of the translations.

This report may be distributed in certain localities, countries and/or jurisdictions ("Territories") by independent third parties or independent intermediaries and/or distributors ("Distributors"). Such Distributors are not acting as agents or representatives of the analyst, Morningstar, Inc. or the Equity Research Group. In Territories where a Distributor distributes our report, the Distributor is solely responsible for complying with all applicable regulations, laws, rules, circulars, codes, and guidelines established by local and/or regional regulatory bodies, including laws in connection with the distribution third-party research reports.

Risk Warning

Please note that investments in securities are subject to market and other risks and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost.

A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's Uncertainty Rating serves as a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

Conflicts of Interest

- No interests are held by the analyst with respect to the security subject of this investment research report.
- Morningstar, Inc. may hold a long position in the security subject of this investment research report that exceeds 0.5% of the total issued share capital of the security.
- To determine if such is the case, please click http://msi.morningstar.com and http://mdi.morningstar.com.
- Analysts' compensation is derived from Morningstar, Inc.'s overall earnings and consists of salary, bonus and in some cases restricted stock.
- Neither Morningstar, Inc. nor the Equity Research Group receives commissions for providing research nor do they charge companies to be rated.
- Neither Morningstar, Inc. nor the Equity Research Group is a market maker or a liquidity provider of the security noted within this report.
- Neither Morningstar, Inc. nor the Equity Research Group has been a lead manager or co-lead manager over the previous 12 months of any publicly disclosed offer of financial instruments of the issuer.
- Morningstar, Inc.'s investment management group does have arrangements with financial institutions to provide portfolio management/investment advice some of which an analyst may issue investment research reports on. However, analysts do not have authority over Morningstar's investment management group's business arrangements nor allow employees from the investment management group to participate or influence the analysis or opinion prepared by them.
- Morningstar, Inc. is a publicly traded company (Ticker Symbol: MORN) and thus a financial institution the security of which is the subject of this report may own more than 5% of Morningstar, Inc.'s total outstanding shares. Please access Morningstar, Inc.'s proxy statement, "Security Ownership of Certain Beneficial Owners and Management" section http://investorrelations.morningstar.com/sec.cfm?doctype=Proxy&year=&x=12

Morningstar, Inc. may provide the product issuer or its related entities with services or products for a fee and on an arms' length basis including software products and licenses, research and consulting services, data services, licenses to republish our ratings and research in their promotional material, event sponsorship and website advertising.

Further information on Morningstar, Inc.'s conflict of interest policies is available from http://global.morningstar.com/equitydisclosures. Also, please note analysts are subject to the CFA Institute's Code of Ethics and Standards of Professional Conduct.

For a list of securities which the Equity Research Group currently covers and provides written analysis on please contact your local Morningstar office. In addition, for historical analysis of securities covered, including their fair value estimate, please contact your local office.

For Recipients in Australia: This Report has been issued and distributed in Australia by Morningstar Australasia Pty. Ltd. (ABN: 95 090 665 544; ASFL: 240892). Morningstar Australasia Pty. Ltd. is the provider of the general advice ("the Service") and takes responsibility for the production of this report. The Service is provided through the research of investment products. To the extent the Report contains general advice it has been prepared without reference to an investor's objectives, financial situation or needs. Investors should consider the advice in light of these matters and, if applicable, the relevant Product Disclosure Statement before making any decision to invest. Refer to our Financial Services Guide, or FSG, for more information at http://www.morningstar.com.au/fsg.pdf.

For Recipients in New Zealand: This report has been issued and distributed by Morningstar Australasia Pty Ltd and/or Morningstar Research Ltd (together 'Morningstar'). Morningstar is the provider of the regulated financial advice and takes responsibility for the production of this report. To the extent the report contains regulated financial advice it has been prepared without reference to an investor's objectives, financial situation or needs. Investors should consider the advice in light of these matters and, if applicable, the relevant Product Disclosure Statement before making any decision to invest. Refer to our Financial Advice Provider Disclosure Statement at www.morningstar.com.au/s/fapds.pdf for more information.

For Recipients in Hong Kong: The Report is distributed by Morningstar Investment Management Asia Limited, which is regulated by the Hong Kong Securities and Futures Commission to provide services to professional investors only. Neither Morningstar Investment Management Asia Limited, nor its representatives, are acting or will be deemed to be acting as an investment advisor to any recipients of this information unless expressly agreed to by Morningstar Investment Management Asia Limited. For enquiries regarding this research, please contact a Morningstar Investment Management Asia Limited Licensed Representative at http://global.morningstar.com/equitydisclosures.

For Recipients in India: This Investment Research is issued by Morningstar Investment Adviser India Private Limited. Morningstar Investment Adviser India Private Limited is registered with SEBI as an Investment Adviser (Registration number INA000001357), as a Portfolio Manager (Registration number INP000006156) and as a Research Entity (Registration Number INH000008686). Morningstar Investment Adviser India Private Limited has not been the subject of any disciplinary action by SEBI or any other legal/ regulatory body. Morningstar Investment Adviser India Private Limited is a wholly owned subsidiary of Morningstar Investment Management LLC. In India, Morningstar Investment Adviser India Private Limited has one associate, Morningstar India Private Limited, which provides data related services, financial data analysis and software development. The Research Analyst has not served as an officer, director or employee of the fund company within the last 12 months, nor has it or its associates engaged in market making activity for the fund company.

*The Conflicts of Interest disclosure above also applies to relatives and associates of Manager Research Analysts in India. The Conflicts of Interest disclosure above also applies to associates of Manager Research Analysts in India. The terms and conditions on which Morningstar Investment Adviser India Private Limited offers Investment Research to clients, varies from client to client, and are detailed in the respective client agreement.

For recipients in Japan: The Report is distributed by Ibbotson Associates Japan, Inc., which is regulated by Financial Services Agency, for informational purposes only. Neither Ibbotson Associates Japan, Inc., nor its representatives, are acting or will be deemed to be acting as an investment advisor to any recipients of this information.

For recipients in Korea: The Report is distributed by Morningstar Korea Limited, which is regulated by Financial Supervisory Service, for informational purposes only. Neither Morningstar Korea Limited, nor its representatives, are acting or will be deemed to be acting as an investment advisor to any recipients of this information.

For recipients in Singapore: For Institutional Investor audiences only. Recipients of this report should contact their financial adviser in Singapore in relation to this report. Morningstar, Inc., and its affiliates, relies on certain exemptions (Financial Advisers Regulations, Section 32B and 32C) to provide its investment research to recipients in Singapore.

22 West Washington Street
Chicago, IL 60602 USA

About Morningstar® Equity Research™
Morningstar Equity Research provides independent, fundamental equity research differentiated by a consistent focus on sustainable competitive advantages, or Economic Moats.

Information on Morningstar's Equity Research methodology is available from https://www.morningstar.com/research/signature.