# Chasing New Frontiers

## We see Anthropic as well placed to capture value in an AI world.

**Morningstar Equity Research**
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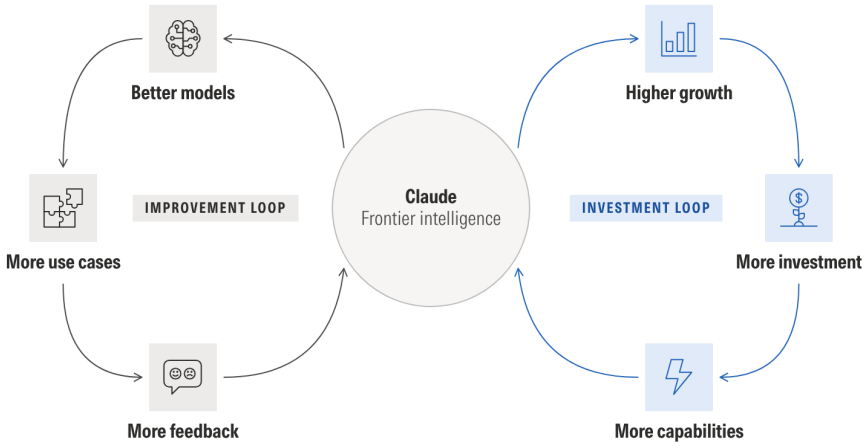
### Wait, What Does Anthropic Do, Again?

Anthropic is in the business of building and selling intelligence. As such, the firm's core strategy can be distilled into two equally important and reinforcing parts.

First, the firm devotes considerable resources to building, or training, large language models. Then, once these models are trained, Anthropic sells access to them using a combination of its application programming interface platform and first-party applications such as Claude Code and Cowork.

The mutual reinforcement of both training and subsequent monetization happens elegantly. By building new models that unlock new capabilities and workflows, Anthropic is able to drive adoption and monetization of these models. The dollar inflows from monetization are then channeled back into training the next series of models.

**Exhibit 1** How We See Anthropic's Training and Monetization Reinforce Each Other




Source: Morningstar.

The firm's monetization engine itself is pretty straightforward, with enterprise-heavy consumption-based revenue, which is governed by how many tokens enterprises consume, supplemented by consumer-leaning subscription revenue, which is priced at a flat monthly subscription fee.

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While we understand investor concerns around potential commodification of LLMs that could make Anthropic's business and financial outlook bleak, we view the future differently. We have a positive outlook on Anthropic's ability to remain at the frontier of artificial intelligence model research, demonstrate capability leadership in key domains, and monetize these capabilities by selling primarily to enterprise customers.

Three key factors underpin our view that Anthropic will continue to gain wallet share among enterprise customers:

First, we believe AI adoption across enterprises remains in early stages, with enterprises increasingly looking to adopt AI to improve efficiencies and drive revenue. In our view, this low-penetration, high-appetite dynamic creates a secular tailwind that will boost Anthropic's top line.

Second, we believe enterprises are willing to pay a premium for frontier-level intelligence. As model capabilities unlock new workflows, they expand Anthropic's total addressable market, with each new capability driving more dollars to frontier intelligence. This preference for "best in class" is not isolated to AI models; we have more than two decades of enterprises demonstrating this behavior across a variety of software domains.

Third, we see Anthropic increasingly creating industry applications in key domains, thereby attracting sticky software spending onto its platform. We have seen early evidence of this in software engineering with Claude Code, and we expect the firm to develop similar first-party applications in other highly monetized domains such as legal research, financial research, healthcare, cybersecurity, and design.

**Key Takeaways**

- We assign Anthropic a Morningstar Economic Moat Rating of narrow, owing to its intangible assets and cost advantage, with switching costs and an indirect network effect flagged as emerging moat sources.
- We believe the firm's intangible assets consist of frontier research know-how, its capability leadership in key domains including cybersecurity and coding, and the firm's increasing ability to leverage its AI models to improve upcoming models.
- We attribute Anthropic's cost advantage to its multi-chip hardware stack, which allows it to efficiently route AI workloads and lower its costs, its multi-year compute agreements that enable it to lower its compute costs, and its continued work on driving algorithmic improvements in its training and inference methods that let it serve models more efficiently.
- Our fair value estimate of $92 per share values Anthropic's equity at $1.7 trillion, or about 13 times 2027 sales, on a 47% five-year revenue compound annual growth rate. Our bull and bear cases are $188 per share and $25 per share.
- In our bull case, our fair value for Anthropic is $188 per share, or roughly $3.4 trillion in equity value. Our bull case assumes five-year revenue growth north of 60% as rapid enterprise adoption and share gains against OpenAI, Google, and open-weight providers push Anthropic's sales to 12% of enterprise software and IT services budgets, supporting a 2027 price/sales multiple of 26 times.

- Our bear-case fair value is $25 per share, or roughly $500 billion in equity value. The bear case assumes five-year revenue growth of 22% on gradual enterprise adoption, scaling laws that stop holding, and compute capacity that fails to come online as planned, implying a 2027 price/sales multiple of 6 times.
- We assign a Very High Morningstar Uncertainty Rating. Whether scaling laws hold, and how quickly enterprises adopt AI, will drive the range of outcomes.

**Companies Mentioned**

| Name/Ticker | Economic Moat | Currency | Fair Value Estimate | Current Price | Uncertainty Rating | Morningstar Rating | Market Cap (Bil) |
|---|---|---|---|---|---|---|---|
| Anthropic (Private) | Narrow | USD | 92 | 74 | Very High | NA | NA |
| Alphabet (GOOGL) | Wide | USD | 450 | 287.38 | Medium | 5 | 3,519 |
| Amazon.com (AMZN) | Wide | USD | 280 | 270.87 | High | 3 | 2,929 |
| Nvidia (NVDA) | Wide | USD | 310 | 168.89 | Very High | 4 | 4,078 |
| Advanced Micro Devices | Narrow | USD | 570 | 515.21 | Very High | 3 | 845 |
| OpenAI (Private) | NA | USD | NA | NA | NA | NA | NA |

## Has Anthropic Built an Economic Moat?

We assign Anthropic a Morningstar Economic Moat Rating of narrow, primarily owing to the firm's intangible assets and cost advantage. We also see emerging customer switching costs and an indirect network effect further bolstering the firm's competitive advantage.

While building large language models is compute and resource-intensive, the firm's research velocity, enterprise pricing power as well as penetration, and signed multiyear compute deals give us confidence that Anthropic will be able to generate excess returns on invested capital over the next 10 years.

### Intangible Assets

We view Anthropic's intangible assets—frontier research know-how, recursive model development, and safety alignment training—as its primary moat source. On the firm's AI model research, we have seen Anthropic sustain capability leadership in key domains, especially in agentic coding and cybersecurity. This leadership has translated directly into pricing power, with Anthropic's models priced at a premium to other frontier labs, while rapidly scaling the number of enterprise customers.

The firm's edge in model research is also aided by recursive model development, a process in which training and testing of new models is aided by Claude, with Claude assisting in running experiments, generating and processing training data, and creating evaluations and safety audits for the upcoming models.

Finally, while the firm has been investing aggressively in model development, it has made safety and alignment a key attribute of its model development strategy. This messaging resonates well with companies in a heavily regulated industry such as financial services and healthcare. The firm's model capability, as well as its focus on safety, has allowed it to gain adoption within these regulated industries, with the firm's customers including nine of the 10 largest pharmaceutical companies, the 10 largest banks, nine of the 10, and eight of the 10 largest healthcare companies.

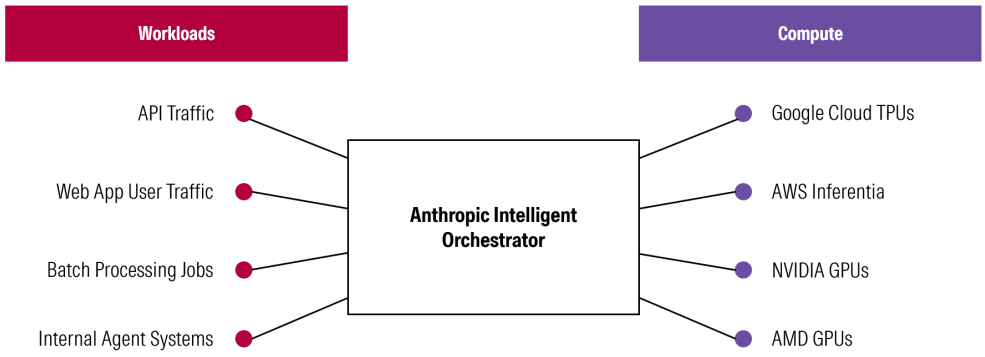
### Cost Advantage

We believe that Anthropic holds a structural cost advantage relative to other model providers as well as enterprises seeking to self-host open-weight models. We view this cost advantage as being driven by four mechanisms.

First, training costs increase materially with each generation. As a result, a challenger entering today must not merely match the leaders' current spending but also have some novel method to "catch up" on all the accumulated learnings these model companies have made by iterating through various model architectures and methodologies. We see these high training costs and the growing gulf between existing AI labs and new entrants as contributing factors to the whittling down of the model field—from many dozens of model companies claiming to be leading-edge back in 2023 to just a handful at the frontier in 2026.

Second, Anthropic's multi-chip hardware portfolio allows it to dynamically route workloads to the lowest-cost silicon. This orchestration layer, which Anthropic has built in-house, is incredibly hard to replicate, with Anthropic as the only frontier AI lab that has a fungible compute fleet across four hardware configurations (AWS Trainium, Google TPUs, Nvidia GPUs, and AMD GPUs).

**Exhibit 2** Anthropic's Hardware Abstraction Allows It To Improve Its Compute Efficiency




Source: Morningstar.

Third, the firm's emphasis on algorithmic and methodological improvements across training and inference has allowed it to grow its effective output of a given amount of compute. These "compute multipliers," which are increasingly being discovered with the help of Claude, enable the firm to both train more capable models and also be able to serve existing models more efficiently.

Fourth, due to Anthropic's scale, it can procure compute from cloud infrastructure and hardware providers at attractive prices, not available to smaller peers. Anthropic can commit to multiyear terms and offer to buy gigawatt-scale capacity from infrastructure providers, so it can capture better unit economics than smaller peers that can only commit to smaller deals.

### Switching Costs

While we do not see switching costs as a fully formed moat source for Anthropic as of yet, we are seeing increased evidence that Anthropic is entrenching itself in enterprise workflows that are hard to replace. We see two key ways in which Anthropic is building switching costs for its model ecosystem. One, the firm is pushing for multi-product adoption, with more than half of its large customers—defined as those spending more than $100,000 annually—using both the Claude platform and a first-party app such as Claude Code or Cowork. Across our software coverage, we see multiproduct adoption as stickier than adoption of a single product.

Two, as enterprises increasingly shift to agentic workflows, we will see a rise in long-running, persistent agents. When deploying these long-running agents, enterprises need to set up intricate system prompts, tool-use definitions, and error-handling processes, all of which allow the agent to work autonomously for extended periods of time. This additional tooling is calibrated to specific models, with Anthropic's forward-deployed engineers also playing a key role in building this tooling around Claude. Swapping a model out requires building the tooling again, which is both time- and cost-intensive.

Despite the above points, we do not attribute a switching cost moat source to Anthropic as more than 80% of the firm's revenue is consumption-based, with customers able to reduce consumption in relatively short order. Also, for customers not leveraging more than a single product and building long-running agents, switching away from an existing model provider is relatively simple.

### Network Effect

Finally, we see early signs of a network effect forming for Anthropic in two distinct ways. One, when prosumers/free users use products such as Claude Code, they generate multistep agentic workflows that are tracked and monitored by Anthropic. This includes tool calls, which code edits they accept, failure modes, as well as user feedback. All this data can then enable Anthropic to improve/fine-tune its upcoming models.

Two, by looking at usage patterns and telemetry data, Anthropic can gauge which workflows end-users are building on top of its existing models. This data can allow Anthropic to build first-party products in key areas, with Claude Code and Claude Design as two good early examples. As Anthropic expands the roster of pre-built tools, with product discovery being aided by usage of its models, it can expand its target market by unlocking new personas, thereby attracting more users to its platforms.

## What Are the Key Risks and Uncertainties Facing Anthropic?

We assign Anthropic a Morningstar Uncertainty Rating of Very High. This rating reflects our view on the wide range of financial outcomes for a business investing heavily in large language models, a nascent technology. We see three clear drivers of financial uncertainty for Anthropic.

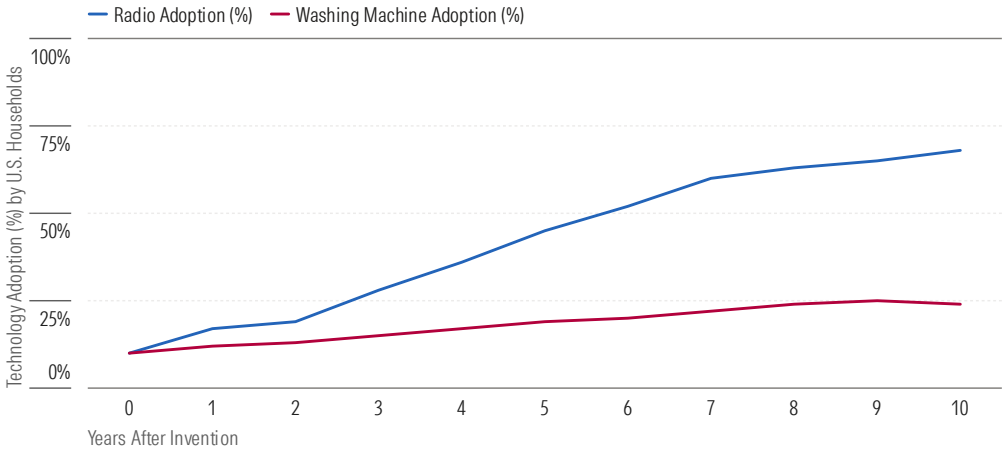
One, we assume that training larger, more-complex models continues to expand their respective capabilities, especially in domains that are monetizable. While this assumption makes sense to many,

including us, there is uncertainty worth unpacking here. For the better part of the past five years, model improvements have operated under a framework known as "scaling laws." Put simply, the framework posits that an AI model's intelligence scales predictably as you increase the volume of its training data, its post-training alignment, and the time it spends pondering over a specific problem.

We have seen these scaling laws work elegantly over the past few years, enabling models to get better and more economically useful as AI labs, such as Anthropic, worked to improve each scaling axis. We'd note, however, that the scaling laws framework is an observation, not an actual physical law, that could stop holding true at any point in the future. If scaling laws do stop "working," model improvements may become incremental, not transformational, thereby potentially shrinking Anthropic's total addressable market and giving competitors the opportunity to catch up with Anthropic.

Two, there are myriad ways in which enterprise adoption curves could inflect in the coming years. A good historical analogy is the difference in adoption of radios, swift and widespread, versus washing machines, slow and gradual.

**Exhibit 3** Adoption Curves of Radios and Washing Machines From Years Zero to 10




Source: Our World in Data; Comin and Hobijn (2004). Data as of Nov. 11, 2026.

If AI adoption is fast across enterprises, Anthropic's revenue, along with its margin profile, will likely inflect upward well faster than our base case forecast. AI bulls will point to the adoption of cloud computing, social media, and mobile as evidence that the AI adoption curve will be rapid, enabling AI labs that are building the LLMs to rapidly expand their top lines and profit pools.

On the flip side, AI adoption could be slow. Proponents of the slow adoption thesis point to the redesign that any enterprise needs to commit to in order to deploy AI at scale, as well as the friction created by incumbent vendors that won't be displaced by AI labs without putting up a fight. All these factors, bears argue, will lead to a much more gradual adoption of AI, still enabling AI labs to increase revenue and

even achieve profitability, albeit on a much longer timeline.

The gulf between the two states of this future world—one where AI adoption is fast and one where it is slow—is substantial. According to our own estimates, the 2031 revenue differential between the two future states is loosely $500 billion for the frontier model labs.

Three, as part of its IPO documentation, Anthropic has made the developing capabilities of its AI models to improve themselves, a process known as recursive self-improvement, a clear part of the investment case for the firm.

We are seeing clear progress on this front for the firm. First, Claude, Anthropic's AI model, now writes more than 90% of contributions to the firm's codebase. Second, Claude now leads around a quarter of its model research tasks, up from around 1% in March of this year. Third, Anthropic's amended prospectus claims that the firm's internal estimates indicate that the firm may soon meet its own threshold for accelerated, AI-driven progress. We have some corroboration of this acceleration, with METR, a safety-focused third-party group that reviewed Anthropic's internal data, estimating this month that Anthropic's pace of AI progress has roughly doubled over the last year, with METR attributing loosely 80% of this acceleration to AI itself.

While investors may dismiss these claims as dubious or overblown, we are seeing outside AI researchers take them seriously, and we do believe that they merit further attention. Outside AI researchers now see an increasing likelihood that AI can begin outperforming Anthropic's best human researchers sometime in 2027, which would dramatically accelerate the firm's product capability unlock and budget capture among enterprises.

We flag this "fast takeoff" scenario, as it further widens the range of outcomes in both directions. On the upside, if the claims made by outside researchers as well as METR prove accurate and model improvements generalize beyond certain domains including coding, then our base case will likely prove far too conservative. We could see an argument that even our bull case, which values the firm's equity at $3.4 trillion, would be too conservative under a true RSI loop scenario.

On the downside, however, a misaligned "super AI researcher" may justify an industrywide pause, leading to slowdowns in both model capability improvements as well as enterprise AI adoption while raising the odds of regulation aimed at slowing frontier AI progress.

**How Is Anthropic's Financial Condition?**

We view Anthropic's financial position as healthy. The firm has more than $130 billion in cash and marketable securities, having burned through less than $10 billion in cash since 2023.

While the business does have more than $850 billion in compute commitments, we'd remind investors that these commitments are structured over more than 10 years. With the firm's existing cash balance, along with around $100 billion in expected IPO proceeds, it can cover its noncancelable compute

commitments for around three years, even if revenue growth stalls out in 2027.

This balance sheet strength is a key reason why Anthropic, instead of throwing more compute toward revenue-generating inference demand, has dedicated the majority of its compute toward training better models.

Longer term, we see these frontier AI labs building robust, free cash flow-generating businesses, with continued model progress unlocking new pockets of demand and allowing them to increase revenue even as compute bills continue to expand.

**Bulls Say**

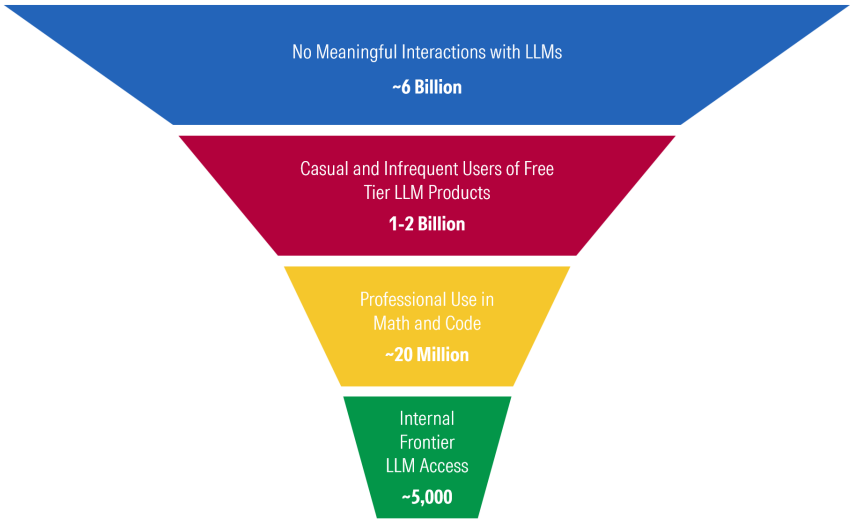
Anthropic is at the forefront of technological innovation arguably as big as the Industrial Revolution, with knowledge work accounting for more than $20 trillion annually. This is orders of magnitude greater than the markets software firms operate in, with revenue set to ramp dramatically in 2027 and beyond.

The firm's focus on key domains including software engineering, cybersecurity, and natural sciences allows it to embed itself in high-volume, price-insensitive workflows. Growing token volumes have been paired with price increases, demonstrating legitimate pricing power for frontier models at each launch.

As we highlighted above, bulls will also point to recursive self-improvement as a potential accelerant. With Claude already writing the bulk of Anthropic's code and taking on a growing share of its model research, bulls see a path to AI-driven progress compounding on itself, which could unlock capabilities and enterprise budget capture well ahead of our base-case forecast.

As AI becomes embedded across enterprise workflows, it may soon compete with labor budgets in addition to enterprise software and IT services budgets. Given the size of global labor budgets, even a modest shift of entry-level work toward AI could create a massive market opportunity for Anthropic.

**Exhibit 4** AI Adoption Remains in Early Stages




Source: Alex Karpathy, Morningstar estimates. Data as of Nov. 11, 2026.

### Bears Say

Frontier labs may not capture the bulk share of the AI market opportunity if non-frontier intelligence models become "good enough" for many enterprise customers, who may switch to cheaper open-weight and in-house model alternatives.

While cloud providers, or CSPs, serve as key Anthropic suppliers, they are also competitors, with every interest in commodifying the intelligence layer to capture value in the cloud infrastructure layer. In the past, Anthropic has sought more compute capacity than its CSPs were willing to provide, and further constraints, or planned capacity that fails to come online on schedule, could limit Anthropic's ability to scale and maintain its position at the frontier.

While the vast majority of Anthropic's revenue is based on consumption, which can be variable, the firm's costs are mostly fixed. Put another way, if variable revenue doesn't scale to cover fixed costs, the company could face financial distress.

### Is the Firm a Good Steward of Capital?

We assign Anthropic an Exemplary Capital Allocation Rating based on its sound balance sheet, exceptional investments, and appropriate shareholder distributions.

We view Anthropic's financial position as healthy. The firm carries more than $130 billion in cash and marketable securities on its balance sheet, with the upcoming IPO likely adding another $100 billion to the firm's cash pile.

While the firm does carry off-balance-sheet liabilities in the form of compute commitments, we see its cash pile, along with strong revenue generation, as more than strong enough to pay for the growing compute bills.

The firm's investment strategy has been simple. Nearly all of the firm's reinvestment over the past few years has been dedicated to compute. The return on this investment has been not only capability leadership in key domains such as software engineering and cybersecurity, but also a rapidly expanding top line that is driven by enterprises leveraging its models.

We expect the firm's investments to be geared mostly toward compute, as the firm continues to train larger, more complex models that unlock more economically useful tasks, thereby driving further adoption and enterprise penetration.

Finally, on shareholder distributions, the firm has not returned capital to shareholders through share buybacks or dividends. We won't hold our breath for either capital return method to begin anytime soon, with Anthropic seeking to leverage every incremental dollar toward either building newer models or securing compute to serve them to customers. We see the firm's focus on growth as appropriate given its stage in the company lifecycle.

**How Much Is Anthropic Worth?**

Our fair value estimate of $92 per share for Anthropic values its equity at $1.7 trillion, implying a 2027 price/sales multiple of around 13 times.

We believe Anthropic is well positioned to increase revenue rapidly, with our base-case forecast calling for a top-line compound annual growth rate of 47% over the next five years. We see three key drivers of this revenue growth.

One, we expect the firm to drive deeper into existing accounts. The firm has almost 12,000 customers spending more than $100,000 a year, more than 1,900 customers spending $1 million annually, and more than 250 accounts spending more than $10 million each year. We see Anthropic expanding deeper into all of these accounts by moving enterprises from using simple, low-volume applications like Claude chat to integrating Claude into agentic infrastructure that all large enterprises are trying to build. As Claude takes over more automated, long-running tasks, we see a natural inflection upward in total spending on Claude by enterprise customers.

To give some perspective on penetration, we'd note that out of Fortune 500 customers spending more than $100,000 on Anthropic's models, their spending on Claude as a percent of their total expenditures was less than 0.1%. In other words, for every $1,000 a Fortune 500 client spends, only $1 currently goes to Anthropic. We see Anthropic being able to materially expand this number over time.

Two, while the firm has impressive enterprise penetration, we'd note that new logo additions are far from over. The firm has more than 50% of the Fortune 500 as active customers. Put another way, there is

still almost 50% of the Fortune 500 that are not spending much, if at all, on Anthropic's products. We'd imagine the penetration for Fortune 1000 and so forth is likely even lower. We view these customers, many of whom are still in early innings of broader AI adoption, as greenfield opportunities for Anthropic to target.

Three, instead of trying to build an enterprise sales team directly, the firm's strategic distribution agreements with AWS and Google Cloud allow it to scale its revenue without linearly adding more sales reps. By incorporating its models within managed AI platforms such as AWS Bedrock and Google Vertex AI, Anthropic can attract net new dollars toward its products.

While we feel fairly confident in Anthropic's ability to execute across these three verticals and drive sales growth, we think it is appropriate to also consider both bull and bear cases for the firm.

### Bull Case

In our bull case, we estimate Anthropic's five-year revenue growth rate to be north of 60%, with a 2027 price/sales multiple of 26 times. Furthermore, we estimate Anthropic's equity value would be slightly north of $3 trillion, or $188 per share—more than twice our $1.7 trillion, or $92 per share, base-case estimate.

Our bull case forecast is driven primarily by rapid adoption of AI in large enterprises, as well as Anthropic gaining significant market share against other frontier labs, namely OpenAI and Google, as well as open-weight model providers.

Our bull case captures rapid adoption, with Anthropic's sales capturing 14% of total software and IT services budgets in five years. Layered on top of this rapid adoption is also an increase in Anthropic's monetization of available compute capacity, with compute efficiency also increasing rapidly.

**Exhibit 5** Rapid Adoption: The Bull Case for Anthropic's Capture of Enterprise Software and IT Services Budgets

| | | Consumption-Based Revenue ($USD Billions) Enterprise Software & IT Services Budgets ($USD Billions) | | | | |
|---|---|---|---|---|---|---|
| | | 2027E | 2028E | 2029E | 2030E | 2031E |
| | | $3,640 | $4,020 | $4,420 | $4,850 | $5,310 |
| ANT Capture% | 2% | $73 | $80 | $88 | $97 | $106 |
| | 3% | $109 | $121 | $133 | $146 | $159 |
| | 4% | $146 | $161 | $177 | $194 | $212 |
| | 5% | $182 | $201 | $221 | $243 | $266 |
| | 6% | $218 | $241 | $265 | $291 | $319 |
| | 7% | $255 | $281 | $309 | $340 | $372 |
| | 8% | $291 | $322 | $354 | $388 | $425 |
| | 9% | $328 | $362 | $398 | $437 | $478 |
| | 10% | $364 | $402 | $442 | $485 | $531 |
| | 11% | $400 | $442 | $486 | $534 | $584 |
| | 12% | $437 | $482 | $530 | $582 | $637 |
| | 13% | $473 | $523 | $575 | $631 | $690 |
| | 14% | $510 | $563 | $619 | $679 | $743 |
| | 15% | $546 | $603 | $663 | $728 | $797 |

Source: Morningstar estimates. Data as of Nov. 10, 2026.

### Bear Case

On the other hand, our bear case calls for a much more gradual adoption curve, with Anthropic's five-year revenue growth rate coming in at 22%. Our bear-case equity value for Anthropic is $500 billion, or $25 per share, with the implied price/sales multiple of 6 times. The bear case also assumes compute capacity fails to come online as planned, whether from regulatory delays, cloud provider competition, or neocloud failures, which would constrain Anthropic's ability to scale.

Our bear case's gradual adoption curve has two implied assumptions baked into it. One, we see revenue scaling more gradually due to slow enterprise adoption, as existing switching costs and the risks associated with replacing traditional workflows with AI ones outweigh the potential AI-related benefits in a typical enterprise's strategic calculus.

Two, alongside slow enterprise adoption, scaling laws stop holding as model capabilities also scale more gradually. As a result, fewer target markets open up for Anthropic, and the pace of adoption of its models slows.

**Exhibit 6** Gradual Adoption: The Bear Case for Anthropic's Capture of Enterprise Software and IT Services Budgets

| | | Consumption-Based Revenue ($USD Billions) | | | | |
|---|---|---|---|---|---|---|
| | | Enterprise Software & IT Services Budgets ($USD Billions) | | | | |
| | | 2027E | 2028E | 2029E | 2030E | 2031E |
| | | $3,640 | $4,020 | $4,420 | $4,850 | $5,310 |
| ANT Capture% | 0.5% | $18 | $20 | $22 | $24 | $27 |
| | 1.0% | $36 | $40 | $44 | $49 | $53 |
| | 1.5% | $55 | $60 | $66 | $73 | $80 |
| | 2.0% | $73 | $80 | $88 | $97 | $106 |
| | 2.5% | $91 | $101 | $111 | $121 | $133 |
| | 3.0% | $109 | $121 | $133 | $146 | $159 |
| | 3.5% | $127 | $141 | $155 | $170 | $186 |
| | 4.0% | $146 | $161 | $177 | $194 | $212 |
| | 4.5% | $164 | $181 | $199 | $218 | $239 |
| | 5.0% | $182 | $201 | $221 | $243 | $266 |
| | 5.5% | $200 | $221 | $243 | $267 | $292 |
| | 6.0% | $218 | $241 | $265 | $291 | $319 |
| | 6.5% | $237 | $261 | $287 | $315 | $345 |
| | 7.0% | $255 | $281 | $309 | $340 | $372 |

Source: Morningstar estimates. Data as of Nov. 10, 2026.

## Research Methodology for Valuing Companies

### Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. We think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (mines, for example), 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 short-term market-price movements), but we believe these negatives are mitigated by deep analysis and our long-term 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:

- our assessment of the firm's economic moat.
- our estimate of the stock's fair value.
- our uncertainty around that fair value estimate.
- the current market price.

This process ultimately culminates in our single-point star rating.

### Economic Moat

The Morningstar Economic Moat Rating is a structural feature that Morningstar believes positions a firm to earn durable excess profits over a long period of time, with excess profits defined as returns on invested capital above our estimate of a firm's cost of capital. The economic moat rating is not an indicator of the investment performance of the investment highlighted in this report. Narrow-moat companies are those that Morningstar believes are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those that Morningstar believes will earn excess returns for 10 years, with excess returns more likely than not to remain for at least 20 years. Firms without a moat, including those that have a substantial threat of value destruction-related risks related to environmental, social, and governance; industry disruption; financial health; or other idiosyncratic issues, are more susceptible to competition. Morningstar has identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

### Fair Value Estimate

Each stock's fair value is estimated by using a proprietary discounted cash flow model, which assumes that the stock's value is equal to the total of the free cash flows of the company is expected to generate in the future, discounted back to the present at the rate commensurate with the riskiness of the cash flows. As with any DCF model, the ending value is highly sensitive to Morningstar's projections of future growth.

### Fair Value Uncertainty

The Morningstar Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the fair value estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, exposure to material ESG risks, and other company-specific factors. Based on these factors, analysts classify the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. 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.

### Market Price

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

**Morningstar Rating for Stocks**
The Morningstar Rating for Stocks is a forward-looking, analyst-driven measure of a stock's current price relative to the analyst's estimate of what the shares are worth. Stock star ratings indicate whether a stock, in the equity analyst's educated opinion, is cheap, expensive, or fairly priced. To rate a stock, analysts estimate what they think it is worth (its "fair value"), using a detailed, long-term cash flow forecast for the company. A stock's star rating depends on whether its current market price is above or below the fair value estimate. Those stocks trading at large discounts to their fair values receive the highest ratings (4 or 5 stars). Stocks trading at large premiums to their fair values receive lower ratings (1 or 2 stars). A 3-star rating means the current stock price is close to the analyst's fair value estimate.

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