

Morningstar™ Equity Qualitative Research Process

Key Benefits

- ▶ Provides clear recommendations and actionable commentary.
- ▶ Research is tailored to the needs of individual investors.
- ▶ Combines Aspect Huntley’s long stock-picking experience with Morningstar’s quantitative skills to provide a comprehensive, multi-factor approach to research.

Introduction

Morningstar’s Equity Research provides simple and easy to understand qualitative recommendations to individual investors. We aim to find good businesses that are appropriately priced so we can recommend undervalued stocks with a medium- to long-term investment horizon.

Our research focuses on finding companies that will deliver sustainable earnings per share growth based on strong cashflow generation and solid future dividend stream. We look for strong, experienced and disciplined management; Track cyclical stocks to look for trading opportunities over periods up to several years; Monitor companies with poor fundamentals to help clients avoid exposure to them.

Our research process consists of five steps that combine qualitative assessment with quantitative analysis derived from our extensive financial database. The five steps include industry research, business strategy analysis, accounting analysis, financial analysis and spreadsheet modelling.

Research Process – Industry Research

We assess the company in relation to its industry peers by asking such questions as: What is the nature of the company’s competitive environment? What is the degree of rivalry in the sector? What is the relative power of its customers and suppliers? What are the barriers to entry and what threat do substitutes carry? Research Process – Business Strategy Analysis We analyse the company’s response to its competitive environment; How has the company chosen to compete against its peers? How successful is this strategy likely to be? How are competitors likely to respond to the company’s strategies and innovations?

Research Process – Accounting Analysis

We scrutinise the company’s accounting policies and procedures by assessing questions such as: Are there any red flags? Are there any adjustments required to determine underlying earnings? Do the financial statements truly reflect the nature of the current business?

Research Process – Financial Analysis

We assess the company’s performance through changes in financial ratios: What does the historical financial data reveal? Is profitability improving? Are gearing levels in check?

Research Process – Spreadsheet Modelling

Comprehensive spreadsheet modelling is used to assess future cash flows and earnings: What is the present value of the company’s future cashflow (DCF)? What is a reasonable future price to earnings ratio (Forward P/E)? What risks need to be quantified?

Outputs

The end result of the research is a single Recommendation, a corresponding intrinsic valuation, qualitative business and pricing risk ratings, and an Investment Rating commentary. The Recommendation consists of one of five directives: ‘Buy’– suitable for purchase now; ‘Accumulate’– still undervalued with time to purchase; ‘Hold’– appropriately priced, neither buy nor sell; ‘Reduce’– sell part holding; ‘Sell’– sell all holdings now. The Recommendation is accompanied by a graphical Recommendation Trigger Guide which indicates the price at which our recommendation is likely to change.

The Recommendation is also accompanied by an Investment Rating commentary—a concise one to two paragraph opinion on the quality of the business. The

How Does It Work?



