November 2018

MORNINGSTAR®

Global Equity Best Ideas

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Company	Morningstar Rating	Fair Value Estimate	Discount / (Premium) to FV	Economic Moat	Uncertainty Rating
RECENT ADDITIONS					
Altaba Inc (AABA)	★★★★	98	41%	None	High
Vodafone Group PLC (VOD)	★★★★	250	41%	Narrow	High
Anheuser-Busch InBev SA/NV (BUD)	★★★★★	118	37%	Wide	Low
Applied Materials Inc (AMAT)	★★★★	49	34%	Wide	High
KLA-Tencor Corp (KLAC)	★★★★	128	28%	Wide	High
Lam Research Corp (LRCX)	★★★★	185	25%	Narrow	High
Link Administration Holdings Ltd (LNK)	★★★★	8.5	12%	Narrow	Medium
Macquarie Group Ltd (MQG)	★★★★	130	10%	Narrow	Medium
Orsted A/S (ORSTED)	★★★	450	8%	Narrow	Low
RECENT REMOVALS					
Synaptics Inc (SYNA)	★★★★	64	42%	None	Very High
Royal Philips NV (PHIA)	★★★★	42	24%	Narrow	Medium
Mitsubishi UFJ Financial Group Inc (8306)	★★★★	797	17%	None	Medium
Reckitt Benckiser Group PLC (RB.)	★★★★	7300	14%	Wide	Low
Ramsay Health Care Ltd (RHC)	★★★★	65	14%	Narrow	Medium
MYOB Group Ltd (MYO)	★★★	3.82	12%	Narrow	Medium

Data as of October 31, 2018 | UR = Under Review

Best Ideas

Sector	Company	Morningstar Rating	Economic Moat	Uncertainty Rating	Fair Value Estimate	Discount / (Premium) to FV	Market Cap (mil)	Currency
Americas								
Basic Materials	Cameco Corp (CCJ)	★★★★★	Narrow	High	19.5	46%	4,144	USD
Basic Materials	Compass Minerals International Inc (CMP)	★★★★★	Wide	High	81	42%	1,603	USD
Basic Materials	Martin Marietta Materials Inc (MLM)	★★★★	Narrow	High	260	36%	10,473	USD
Comm. Services	Comcast Corp (CMCSA)	★★★★	Wide	Medium	42	10%	163,737	USD
Consumer Cyclical	Norwegian Cruise Line Holdings Ltd (NCLH)	★★★★	Narrow	High	69	39%	9,390	USD
Consumer Cyclical	Hanesbrands Inc (HBI)	★★★★★	Narrow	Medium	27	35%	6,341	USD
Consumer Cyclical	Mattel Inc (MAT)	★★★★	Narrow	High	21	34%	4,604	USD
Consumer Cyclical	Expedia Group Inc (EXPE)	★★★★	Narrow	High	180	31%	18,546	USD
Consumer Cyclical	General Motors Co (GM)	★★★★	None	High	45	25%	46,743	USD
Consumer Cyclical	Walt Disney Co (DIS)	★★★★	Wide	Medium	130	12%	170,676	USD
Consumer Defensive	General Mills Inc (GIS)	★★★★★	Wide	Low	58	22%	27,128	USD
Consumer Defensive	Mondelez International Inc (MDLZ)	★★★★	Wide	Medium	52	19%	61,236	USD
Consumer Defensive	Procter & Gamble Co (PG)	★★★★	Wide	Low	97	8%	219,842	USD
Consumer Defensive	PepsiCo Inc (PEP)	★★★★	Wide	Low	122	7%	160,594	USD
Energy	Cenovus Energy Inc (CVE)	★★★★	None	Very High	21	47%	13,627	CAD
Energy	Enbridge Inc (ENB)	★★★★★	Wide	Medium	64	37%	69,026	CAD
Energy	Enterprise Products Partners LP (EPD)	★★★★★	Wide	Low	35.5	25%	57,663	USD
Financial Services	American International Group Inc (AIG)	★★★★★	None	Medium	76	46%	36,391	USD

	Sector	Company	Morningstar Rating	Economic Moat	Uncertainty Rating	Fair Value Estimate	Discount / (Premium) to FV	Market Cap (mil)	Currency
+	Financial Services	Altaba Inc (AABA)	★★★★	None	High	98	41%	35,071	USD
	Financial Services	Capital One Financial Corp (COF)	★★★★	Narrow	Medium	127	31%	41,610	USD
	Financial Services	BlackRock Inc (BLK)	★★★★★	Wide	Medium	580	30%	64,924	USD
	Healthcare	McKesson Corp (MCK)	★★★★★	Wide	Medium	210	41%	24,250	USD
	Healthcare	Allergan PLC (AGN)	★★★★★	Wide	Medium	263	39%	54,539	USD
	Healthcare	Medtronic PLC (MDT)	★★★★	Wide	Medium	110	18%	122,148	USD
	Industrials	Stericycle Inc (SRCL)	★★★★★	Narrow	High	86	43%	4,216	USD
	Industrials	Johnson Controls International PLC (JCI)	★★★★	Narrow	High	53	40%	29,422	USD
	Industrials	Anixter International Inc (AXE)	★★★★★	Narrow	Medium	107	38%	2,226	USD
	Industrials	Grupo Aeroportuario del Pacifico SAB de CV (GAP B)	★★★★	Wide	High	210	22%	112,134	MXN
	Industrials	General Dynamics Corp (GD)	★★★★	Wide	Medium	216	20%	50,905	USD
	Real Estate	Welltower Inc (WELL)	★★★	None	Medium	72	3%	26,104	USD
	Technology	Microchip Technology Inc (MCHP)	★★★★★	Wide	Medium	112	42%	14,673	USD
+	Technology	Applied Materials Inc (AMAT)	★★★★	Wide	High	49	34%	31,869	USD
+	Technology	KLA-Tencor Corp (KLAC)	★★★★	Wide	High	128	28%	13,181	USD
	Technology	Intel Corp (INTC)	★★★★	Wide	Medium	65	27%	217,977	USD
+	Technology	Lam Research Corp (LRCX)	★★★★	Narrow	High	185	25%	21,071	USD
	Utilities	SCANA Corp (SCG)	★★★★	Narrow	Medium	56	27%	5,832	USD
	Utilities	Dominion Energy Inc (D)	★★★★	Wide	Low	84	13%	47,620	USD
	Utilities	FirstEnergy Corp (FE)	★★★★	Narrow	Low	41	9%	19,041	USD

	Sector	Company	Morningstar Rating	Economic Moat	Uncertainty Rating	Fair Value Estimate	Discount / (Premium) to FV	Market Cap (mil)	Currency
	Asia								
	Comm. Services	China Mobile Ltd (00941)	★★★★	Narrow	Medium	97	24%	1,500,853	HKD
	Consumer Cyclical	Alibaba Group Holding Ltd (BABA)	★★★★★	Wide	High	240	43%	343,044	USD
	Consumer Defensive	Kao Corp (4452)	★★★★	Wide	Low	8800	17%	3,567,431	JPY
	Financial Services	Agricultural Bank of China Ltd (601288)	★★★	Narrow	High	4.2	8%	1,319,888	CNY
	Industrials	Guangshen Railway Co Ltd (00525)	★★★★★	None	High	6.3	53%	23,334	HKD
	Industrials	CK Hutchison Holdings Ltd (00001)	★★★★★	None	Medium	118	33%	304,450	HKD
	Industrials	Beijing Enterprises Holdings Ltd (00392)	★★★★	Narrow	Medium	58	27%	53,511	HKD
	Real Estate	Sun Hung Kai Properties Ltd (00016)	★★★★★	Narrow	Medium	153	33%	295,204	HKD
	Technology	Tencent Holdings Ltd (00700)	★★★★★	Wide	High	590	55%	2,541,902	HKD
	Technology	Murata Manufacturing Co Ltd (6981)	★★★★	Narrow	High	24000	33%	3,406,686	JPY
	Australia & New Zealand								
	Comm. Services	Telstra Corp Ltd (TLS)	★★★★	Narrow	Medium	4.4	30%	36,631	AUD
	Consumer Cyclical	InvoCare Ltd (IVC)	★★★★	Wide	Medium	16	24%	1,335	AUD
	Consumer Defensive	G8 Education Ltd (GEM)	★★★★★	None	High	3.5	41%	930	AUD
	Consumer Defensive	The a2 Milk Co Ltd (ATM)	★★★★	Narrow	High	14.6	29%	7,657	NZD
	Energy	Woodside Petroleum Ltd (WPL)	★★★★	None	High	46.5	25%	32,625	AUD
	Financial Services	Pendal Group Ltd (PDL)	★★★★	Narrow	Medium	11	26%	2,281	AUD
	Financial Services	Westpac Banking Corp (WBC)	★★★★	Wide	Medium	35	23%	90,918	AUD
+	Financial Services	Link Administration Holdings Ltd (LNK)	★★★★	Narrow	Medium	8.5	12%	3,972	AUD
+	Financial Services	Macquarie Group Ltd (MQG)	★★★★	Narrow	Medium	130	10%	40,232	AUD

	Sector	Company	Morningstar Rating	Economic Moat	Uncertainty Rating	Fair Value Estimate	Discount / (Premium) to FV	Market Cap (mil)	Currency
	Real Estate	AVEO Group (AOG)	★★★★★	None	Medium	2.8	34%	1,072	AUD
	Europe								
	Comm. Services	Telefonica SA (TEF)	★★★★★	Narrow	High	13	44%	37,638	EUR
+	Comm. Services	Vodafone Group PLC (VOD)	★★★★	Narrow	High	250	41%	39,289	GBX
	Comm. Services	BT Group PLC (BT.A)	★★★★	Narrow	High	360	32%	24,175	GBX
	Consumer Cyclical	WPP PLC (WPP)	★★★★★	Narrow	Medium	1450	39%	10,968	GBX
	Consumer Cyclical	Bayerische Motoren Werke AG (BMW)	★★★★	Narrow	High	117	35%	49,704	EUR
+	Consumer Defensive	Anheuser-Busch InBev SA/NV (BUD)	★★★★★	Wide	Low	118	37%	148,270	USD
	Consumer Defensive	Imperial Brands PLC (IMB)	★★★★★	Wide	Low	3700	28%	25,565	GBX
	Energy	Total SA (TOT)	★★★★	None	Medium	77	25%	151,474	USD
	Energy	Royal Dutch Shell PLC (RDS.B)	★★★★	Narrow	Medium	83	22%	260,235	USD
	Financial Services	Credit Suisse Group AG (CSGN)	★★★★★	Narrow	High	22	40%	33,712	CHF
	Healthcare	Roche Holding AG (ROG)	★★★★★	Wide	Low	333	27%	208,344	CHF
	Industrials	KION GROUP AG (KGX)	★★★★★	Narrow	Medium	90	44%	5,959	EUR
	Industrials	GEA Group AG (G1A)	★★★★★	Wide	Medium	45	43%	4,639	EUR
	Industrials	G4S PLC (GFS)	★★★★★	None	Medium	337	37%	3,308	GBX
	Industrials	Sodexo (SW)	★★★★	Narrow	Medium	110	19%	12,938	EUR
	Utilities	Enel SpA (ENEL)	★★★★	None	Medium	5.7	23%	44,733	EUR
+	Utilities	Orsted A/S (ORSTED)	★★★	Narrow	Low	450	8%	174,070	DKK

Data as of October 31, 2018 | + = Recent Addition

Best Ideas Rationale

Company	Rationale
Agricultural Bank of China Ltd (601288)	Narrow-moat Agricultural Bank of China, or ABC, is our preferred name among Chinese financials. Thanks to its strong deposit base and presence in the underserved rural market, the bank is less affected by intensifying deposit competition from joint-stock banks and Internet banks. We expect ABC to continue its net interest margin expansion amid tight liquidity. Also, we believe the market has yet to factor in gradual fundamentals improvement at ABC, including industry-leading provision level, improving credit quality, and a stronger capital position following the upcoming private placement in 2018. We believe these factors will help ABC to achieve faster earning growth and to narrow the valuation gap with leading SOE banks, including ICBC and CCB. ABC's H shares are trading at a three-year low of 0.67 times 2018 price/book ratio, implying a 5.9% dividend yield. This was attributable to the market's renewed credit quality concerns amid climbing default risks and trade war fears. We expect the bank to face lower-than-peers' ROE compression during our forecast period, resulting in an average of ROE at 13.3%, thanks to its cheap funding costs and strong potential for efficiency improvement.
Alibaba Group Holding Ltd (BABA)	Wide-moat Alibaba has successfully made the transition from a traditional e-commerce marketplace to a Big Data-centric conglomerate, with transaction data from its marketplaces, financial services, and logistics businesses allowing it to move into cloud computing, media and entertainment, delivery, and online-to-offline services. We've long thought that a strong network effect can allow e-commerce players to extend into other growth avenues, and nowhere is that more evident than Alibaba. While we view Taobao and Tmall marketplaces Cainiao and Alipay/Ant Financial as Alibaba's core cash flow drivers, we also believe AliCloud, globalization and digital entertainment offer long-term potential. While AliCloud will remain in investment mode in the near term, accelerating revenue per customer trends suggests a migration to value-added content delivery and database services that can drive margin expansion over time. On globalization, third-party merchants are having success reaching Lazada's active users across Southeast Asia, something that should persist in the years to come as the company rolls out incremental personalized mobile marketing and content opportunities in this region. While early, we share management's views that digital entertainment is an important user acquisition and retention tool. Alibaba's recent accelerating growth trends support our belief that trade war concerns will have a minimal impact on consumption patterns, which have unfairly weighed on shares.
Allergan PLC (AGN)	Unlike its most of its peers in specialty pharma, Allergan retains an attractive product portfolio and innovative pipeline, particularly in its core markets of aesthetics, ophthalmology, gastro, and central nervous system. Despite concerns about generic competition on Restasis and new entrants in the aesthetics market, Allergan's diverse portfolio, key durable products, including Botox, and healthy pipeline support a wide economic moat and mid-single-digit organic growth over the next five years, in our view. The firm's decisions to sell its generics division to Teva in 2016 and reinvest capital in pipeline assets have also improved the company's moat and outlook.

Company	Rationale
+ Altaba Inc (AABA)	Altaba is a closed-end management investment company with its main holding in wide-moat Alibaba. Our valuation of Altaba is based on the discounted fair value estimate of the firm’s holdings in Alibaba, plus net cash. While Altaba’s valuation is based on its holding in Alibaba, we expect it to be discounted, as the risk of a non-tax-efficient liquidation of that holding remains. However, at current levels, Alibaba is meaningfully undervalued, supporting our bullish view on Altaba. Alibaba has transitioned from a traditional e-commerce marketplace to a Big Data-centric conglomerate, with transaction data from its marketplaces, financial services, and logistics businesses allowing it to move into cloud computing, media and entertainment, delivery, and online-to-offline services. We've long thought that a strong network effect can allow e-commerce players to extend into other growth avenues, and nowhere is that more evident than Alibaba. While we view Taobao and Tmall marketplaces Cainiao and Alipay/Ant Financial as Alibaba's core cash flow drivers, we also believe AliCloud, globalization and digital entertainment offer long-term potential. While AliCloud will remain in investment mode in the near term, accelerating revenue per customer trends suggests a migration to value-added content delivery and database services that can drive margin expansion over time. On globalization, third-party merchants are having success reaching Lazada's active users across Southeast Asia, something that should persist in the years to come as the company rolls out incremental personalized mobile marketing and content opportunities in this region. While early, we share management's views that digital entertainment is an important user acquisition and retention tool. Alibaba's recent accelerating growth trends support our belief that trade war concerns will have a minimal impact on consumption patterns, which have unfairly weighed on shares.
American International Group Inc (AIG)	We believe previous management's focus on growth and a lack of discipline are the root causes of American International Group's poor historical performance, and now the company has set a course in the opposite direction. When AIG announced that it would take a $5.6 billion reserve development charge in the fourth quarter of 2016, the market's confidence in management dimmed and the stock now trades at a significant discount to book value. CEO Peter Hancock departed in light of this disappointment. We see Brian Duperreault as a strong choice to replace Hancock. His extensive background in commercial property-casualty lines contrasts with Hancock's lack of experience on the underwriting side and inspires confidence that Duperreault can resolve the one issue on which Hancock failed to make progress. Given the potential for improvement, we think the market valuation is overly skeptical and this creates an opportunity, especially as the recent reinsurance deal with Berkshire Hathaway helps to mitigate reserve development risk going forward. We think a valuation close to book value is appropriate, as our view is that AIG will improve returns to a level on par with our estimate of the cost of equity within the next two years. In essence, our assumptions are that AIG is able to bring results in line with other no-moat insurers, a fairly low bar to clear. For more details, please see our Select presentations "Duperreault Already Built a Better AIG; He Can Do It Again" and"Outlining AIG's Path to Mediocrity".
+ Anheuser-Busch InBev SA/NV (BUD)	We are adding AB InBev to the Best Ideas list because we think the stock is now too cheap to ignore. With the announcement of a dividend cut, to a yield of around 2.5%, management has removed an overhang that has concerned investors for months. We estimate that the incremental $4 billion to $5 billion in free cash flow that will be used to pay down debt will help deleverage the balance sheet to 3 times net debt/EBITDA by 2022. AB InBev has a wide economic moat, driven by a cost advantage in Africa and Latin America. Its dominant position in those markets, most of which are monopolistic competition markets, should ensure that AB InBev benefits from the growth these geographies offer. Africa is likely to grow volumes in the medium to long term, while Latin America offers a large mix opportunity. Developed markets remain a drag, however, as industry volumes are being pressured from consumer migration to wine and higher-quality beer. Any slowdown in craft growth could stabilize volumes in mainstream price segments and act as a catalyst for the stock.

Company	Rationale
Anixter International Inc (AXE)	We think Anixter's shares are currently deeply undervalued. As the company's end markets strengthen, we think shareholders will be rewarded with consistent earnings growth and the resumption of special dividends and/or share repurchases over at least the next few years. Over the past three years, Anixter has completed three transactions that have bolstered its market presence, growth potential, and operating flexibility. After acquiring Tri-Ed, selling its capital-intensive OEM supply fasteners business, and purchasing HD Supply's utility distribution business (Power Solutions), Anixter is now the global leader in network and security distribution, a major player in electrical distribution, and the leading utility power solutions distributor in North America. Anixter's focus on value-added technical and supply chain services across a global platform differentiates the firm from many of its competitors. In many cases, Anixter is not the low-cost leader, but its value-added services can provide its customers with the lowest cost of ownership. We see key growth drivers for each of Anixter's segments over the next five years. With the addition of Tri-Ed, Anixter's network and security solutions segment is set to gain share with midsize system integrators and in residential end markets. This segment should also benefit from cross-selling security products to utilities customers as they invest in security solutions to comply with regulatory standards. Growth in wireless and cloud-related products should augment network and security growth. Anixter's electrical and electronic solutions business has suffered from industrial end-market weakness and has been generating depressed margins. As industrial end markets recover, we expect this segment to return to growth and normalized profitability. After the acquisition of HD Supply's power solutions business, the utility power solutions segment was created, which has industry-leading scale and should benefit from market share gains and improving utility capital spending. Anixter's capital-allocation strategy has favored returning cash to shareholders through special dividends and share repurchases. Once Anixter achieves its targeted leverage ratio of 2.5-3 times EBITDA, which we think could happen by 2019, we expect it to resume returning cash to shareholders.

Company	Rationale
+ Applied Materials Inc (AMAT)	We are adding wide-moat Applied Materials to the Best Ideas list because we remain positive on the wafer fabrication equipment, or WFE, market heading into 2019. Applied has benefited greatly from the sharp rise in spending by memory and display customers over the past few years, though recent customer commentary suggests a near-term pullback in spending for each subsegment (especially in 3D NAND and OLED). Although we think total WFE spending will be modestly lower in 2019, we foresee Applied leveraging the breadth of its product portfolio and services business to navigate softer WFE demand. Shares of Applied offer a compelling margin of safety versus our fair value estimate of $49, as we think the recent sell-off was overdone. Applied is the leading vendor of semiconductor fabrication tools. While competitors tend to specialize in a single core competency, Applied competes in almost every key equipment segment with the exception of photolithography. As a result, all major chipmakers develop strong relationships with Applied that span multiple process steps of their chip production. The firm is the dominant player in the material deposition and removal areas, among others, and boasts an impressive global presence with an installed base of more than 30,000 tools and customer engineers stationed in nearly every chip-manufacturing facility in the world. With semiconductor fabrication becoming increasingly complex, resulting in more process steps and new manufacturing technologies, collaboration between chipmakers and equipment providers is set to reach unprecedented levels. Applied has also expanded its global services business fairly significantly, which provides a stable revenue stream distinct from tool purchases. What began as simply a corrective maintenance and spares provider has evolved into the on-site presence of roughly 3,000 customer engineers that collaborate with chipmakers to troubleshoot high-value problems to improve yields and output, ultimately driving productivity and reducing cost. As traversing the path prescribed by Moore's law becomes increasingly difficult, we believe this part of the firm will help entrench Applied's installed base of tools in customers' chip-manufacturing facilities. We attribute the recent weakness in semiconductor stocks to an assortment of factors, including macro-related concerns such as tariffs, the escalating trade war between the U.S. and China, inventory builds, and memory price declines. However, the end-market diversity beyond PC and smartphones for semis, which includes the shift to the public cloud, rise in automotive chip content, investments in 5G, and artificial intelligence should collectively allow for less-cyclical behavior for overall WFE patterns, in our view. We think memory customers are better equipped to navigate downturns with greater cash cushions and profitability levels from the recent memory upswing, thanks to more rational behavior from a supply/demand standpoint. As such, short-term delays in equipment spending by Samsung and Micron shouldn't last nearly as long as past downturns, which bodes well for Applied and its peers.

Company	Rationale
AVEO Group (AOG)	Aveo's share price fell after negative media attention in June 2017, and we view the stock as undervalued, trading at a meaningful discount to our fair value estimate. Accusations raised by the media focused on legacy resident freehold contracts in villages that Aveo acquired in August 2016 and have no bearing on the remaining villages where residents stay under leasehold contracts. The long-term fundamentals of Aveo's business have been impacted as the firm in mid 2018 reduced its activity in new development from 500 annually to 400, which is most likely a result of a longer sales process. That said, long-term industry drivers are positive, with the firm well positioned to benefit from the aging Australian population, driving demand for retirement living units and serviced apartments. Compared with 2017, the number of people turning 75 will be up 14% in 2019 and up 49% in 2022. Aveo continues its high-growth strategy of upgrading legacy units and adding to resident amenities. The firm estimates it can deliver at least AUD 0.70 per share accretion to the portfolio from these initiatives over the next three years. Aveo's reputation has been tarnished, but by no means as much as the share price would imply, in our view. Around 60% of Aveo's annual earnings are unaffected, representing accrued earnings on resident deferred fee contracts entered into roughly 10 years prior. As such, near-term earnings risk centers on a slower sales rate for units being turned over or newly developed units. Aveo is tackling this risk head-on by significantly increasing buying protection on its standard leasehold contracts. Standard contracts now incorporate a try-before-you-buy option, enabling residents to stay for six months before committing to purchase. We believe this increased buyer protection plus guaranteed buyback when a resident departs, simplified contract terms, and enhanced disclosure will significantly allay residual concerns of prospective buyers without significant long-term cost to Aveo.

Company	Rationale
Bayerische Motoren Werke AG (BMW)	Shares of narrow-moat BMW, maker of premium Mini cars, BMW luxury passenger vehicles, and premium motorcycles as well as ultraluxury Rolls-Royce cars, have been discounted after recent 2018 guidance was reduced as a result of several items affecting revenue and margin, including negative currency effect, up-front investment in future mobility technologies, Europe market distortions on new emissions testing regulations, higher warranty reserves, and international trade conflicts. We had already been using assumptions at the low end of management guidance, which resulted in only a slight change to our estimates. The market has reacted harshly to the guidance cut. BMW does not provide specific numbers, but management had previously said it expects "slight" increases in automotive units and revenue, with EBIT margin of 8%-10%. Automotive segment revenue is now forecast to be "slightly lower than the previous year," owing to negative currency effect and the price pressure experienced in Europe and in China (tariffs). EBIT margin guidance is now "at least 7%" on higher spending for electrification and autonomous technologies, plus significantly higher additions to goodwill and warranty provisions. We had been forecasting 3.8% revenue growth on a 5% currency headwind and an 8% EBIT margin. We now forecast a 0.9% decline in revenue on the same 4.9% currency headwind, with an EBIT margin of 7.7%. However, we had already been forecasting sub-8% EBIT margins in years two to five of our Stage I forecast. Consequently, there is no change to our EUR 117 fair value estimate. Investors should view any additional sell-off of the 4-star-rated BMW shares as a window of opportunity to own an attractively valued narrow-moat company. BMW shares were already unduly discounted before the guidance cut owing to a litany of headwinds, including U.S.-China tariffs (exports SUVs from the U.S. to China), fears that the company will be fined for collusion on diesel equipment, margin degradation on higher spending to develop industry-disruptive technologies including electrified powertrain and autonomous driving technologies, as well as concerns regarding its diesel exposure in Europe. Even so, BMW has been able to consistently produce vehicles that command superior pricing and margin as well as generate volume increases above global light-vehicle growth rates. The company's focus on ultraluxury, luxury, and premium segments, with an obsessive attention to detail that impresses its target clientele, supports BMW's substantial excess returns over its weighted average cost of capital. Since 2002, the company's returns exceeded its cost of capital 14 times out of the past 16 years. During the same time frame, average return on invested capital was 16.1% on an 8.5% weighted average cost of capital for an average economic profit of 7.6%, an outstanding performance for an automotive manufacturer. Our fair value estimate represents a 35% discount to the current market valuation and 14% upside potential over the current sell-side consensus price target. During the past 10 years, BMW's group EBIT margin has had a high, low, and median of 11.6%, negative 0.6%, and 9.0%, respectively. We assume a 7.7% normalized sustainable midcycle group EBIT margin, 30 basis points below management's long-term 8%-10% guidance and 130 basis points below the 10-year median. For our model to generate an EUR 88 fair value, equivalent to the sell-side consensus price target, investors would have to believe that BMW's normalized sustainable mid-cycle EBIT margin would be 5.6%. At the current market valuation of EUR 76.40, our normalized sustainable mid-cycle assumption would have to be 4.2% for our model to generate an equivalent fair value. In our view, the market has unfairly valued BMW as though fundamentals will only deteriorate, never to recover from the current transitory pricing and confrontational trade environment as well as temporarily increased spending on industry disruptive technologies.

Company	Rationale
Beijing Enterprises Holdings Ltd (00392)	We think China's long-term promotion of natural gas over coal as a cleaner fuel source remains a positive driver for Beijing Enterprises, given that the firm derives about 75% of group net income from natural gas transmission and distribution. The firm has a monopoly on Beijing's natural gas distribution and also owns the Shaanxi-Beijing gas transmission pipeline, the main artery for the natural gas supply to Beijing and northern China. We think these high-quality well-located assets, coupled with the firm's unique customer mix with gas-fired power and heating plants in the most prominent demand segment, are the key strengths that allow the company to benefit from supportive policies promoting clean air in Beijing. While the 18% tariff cut on Shaanxi-Beijing gas transmission pipelines in August 2017 weighs on BEH's profitability and returns, we expect robust industrial usage and strong demand from the coal-to-gas conversion projects in northern China to more than offset the negative impact. In addition, with the key uncertainty removed, we expect the market to refocus on the company's core fundamentals, which are characterized by healthy and predictable cash flows and relatively decent high-single-digit earnings growth.
BlackRock Inc (BLK)	We are adding wide-moat-rated BlackRock to the Best Ideas list. While the firm is currently trading at a premium to the group of 12 U.S.-based asset managers we cover, the shares are undervalued relative to our $570 per share fair value estimate. The market tends to reward both organic growth and operating profits in the U.S.-based asset managers, which explains why BlackRock (generating a 3.3% compound annual growth rate for organic growth, with a 3.3% standard deviation, during 2008-17 with operating margins averaging 36.2% annually and reaching 38.6% during 2017) and wide-moat-rated T. Rowe Price (with a 2.6% CAGR for organic growth, with a 3.3% standard deviation, the past 10 years and annual operating margins of 43.6% on average, with the firm closing out 2017 with margins at 44.2%) have tended to trade at premiums to the group. As a reference point, the group of 12 U.S.-based asset managers we cover had an average annual organic growth rate of 0.7% during 2008-17, with a standard deviation of 6.2%, and operating margins of 27.4% on average the past ten years). Going forward, our expectation is that BlackRock will continue to generate above average organic growth (of 3.6% annually during 2018-22, with a standard deviation of 1.9%), with operating margins of 39.3% on average the next five years (a period that includes a 20% decline in equity market values midway through our projection period). Our fair value estimate implies a price/earnings multiple of 20.5 times our 2018 earnings estimate and 18.7 times our 2019 earnings estimate. For some perspective, during the past five (ten) calendar years, the company's shares have traded at an average of 20.0 (20.8) times trailing earnings. BlackRock is at its core a passive investor. Through its iShares exchange-traded fund platform and institutional index fund offerings, the wide-moat firm sources close to two thirds of its managed assets (and nearly half its annual revenue) from passive products. In an environment where investors and the advisors that serve them are expected to seek out providers of passive products, as well as active asset managers that have greater scale, established brands, solid long-term performance, and reasonable fees, BlackRock is well-positioned. The biggest differentiators for the firm are its scale, ability to offer both passive and active products, greater focus on institutional investors, strong brands, and reasonable fees. We believe that the iShares ETF platform as well as technology that provides risk management and product/portfolio construction tools directly to end users, which makes them stickier in the long run, should allow BlackRock to generate higher and more stable levels of organic growth, operating profitability and free cash flows than its publicly traded peers the next five years.

Company	Rationale
BT Group PLC (BT.A)	While narrow-moat BT Group has had some issues in the past two years that caused its stock to decline, we believe the sell-off is overdone. BT is the incumbent telecom operator in the United Kingdom. In 2016, it acquired EE, the largest wireless telecom operator in the country. The company now has the largest fixed-line telephone, broadband, and wireless telephone subscriber bases in the country. Additionally, it is the only operator in the U.K. that owns both a retail fixed-line and wireless network. We believe this provides BT with an advantage in selling a converged package of these services plus pay TV. The company has been slow to market its converged services, but we believe now that it has reached an agreement with telecom regulator Ofcom regarding Openreach, its U.K. business that owns its fixed-line network and wholesales access to it to other operators, we expect a more aggressive marketing push into converged services during calendar 2018. BT has been hurt by the widening underfunding of its pension plan as interest rates have declined in the U.K. We think interest rates have bottomed and are more likely to increase from here. We believe the benefit on the pension will be greater than the hit on higher interest on its bonds, the reverse of what happened as interest rates declined. We also think the company has dealt with its problems in Italy and will be able to improve its revenue in its global services division. The market appears to believe that BT's problems will continue, and possibly worsen, whereas we believe business can improve over the next few years. In the meantime, the stock yields 6.3% and the company has increased its dividend for each of the past seven years. Additionally, because it is a U.K.-domiciled company, there is no foreign tax withholding on the dividend.
Cameco Corp (CCJ)	We think the market is mispricing narrow-moat uranium miner Cameco. Uranium offers a rare growth opportunity in metals and mining. China's structural slowdown portends the end of a decadelong boom for most commodities, but not for uranium. China's modest nuclear reactor fleet uses little uranium today. That's set to change in a major way. Beijing is pivoting to nuclear to reduce the country's heavy reliance on coal. We believe the market overemphasizes the current supply glut caused by delayed Japanese reactor restarts. This situation won't last much longer. We expect global uranium demand to grow about 40% over the next 10 years, a staggering amount for a commodity that saw next to zero demand growth in the past 10 years. Supply will struggle to keep pace. We believe uranium prices will rise from nearly $28 a pound currently to $65 a pound (constant dollars) by 2021, as higher prices are required to spur new mine investment. Early contracting by utilities means we see significant price increases beginning in 2019. As one of the largest and lowest-cost producers globally with expansion potential, Cameco should benefit meaningfully from higher uranium prices.
Capital One Financial Corp (COF)	We believe rising charge-offs have created another opportunity to invest in narrow-moat Capital One, which we regard as one of the best-managed banks in our coverage universe. Investors shouldn't be surprised that charge-offs are rising from historically low levels. After the 2008 crisis, credit card issuers experienced abnormally low credit losses because consumers were leery of most forms of credit. As consumers have returned to borrowing, credit losses have started to normalize. However, investors have concluded that rising charge-offs are attributable to either lower underwriting standards or declining consumer health. We believe it's more likely the result of Capital One's recent growth. Unlike many other forms of credit, charge-offs on credit cards typically happen within the first three years. This growth has put upward pressure on credit losses. We regard this up-front cost as an investment in creating a high-quality credit card portfolio. 2018 now appears to be a year of improving credit quality for Capital One. We believe this provides a significant benefit to Capital One's margin, resulting in significant earnings growth for the year.
Cenovus Energy Inc (CVE)	Cenovus Energy represents our Best Idea for investors in the Canadian energy sector. The stock is currently trading around a 50% discount to our fair value estimate, while on average the industry looks fairly valued. We believe the market is overlooking the immense growth potential in the company's oil sands reserves that can be brought on line with low-cost solvent-aided process technology. Consequently, we believe that the stock presents an attractive opportunity for long-term investors. Investors appear to be skeptical that the company can improve its balance sheet and undertake economic growth. As detailed in our October 2017 Select presentation "The King in the North: Cenovus Energy," we believe the company can bring on its production at under $50 per barrel West Texas Intermediate with its solvent-assisted technology.

Company	Rationale
China Mobile Ltd (00941)	We expect narrow-moat China Mobile to generate underlying EPS growth in the high-single digits annually over the next five years, putting it toward the upper end of Asia-Pacific telecom companies in terms of growth. We expect China Mobile's strong market share gains in broadband and moving to 4G mobile technology to drive this growth. Also driving growth are the upgrading of around 25% of its customer base to phones supporting mobile data, cost savings from the tower company, and a potential re-rating in its stake in the tower company when it lists.
CK Hutchison Holdings Ltd (00001)	CK Hutchison Holdings is relatively undervalued, with a current price that more than reflects a business outlook facing currency headwinds and worries over escalating global trade impediments. However, with the stock trading near our bear case, we think most concerns are reflected. More important, we expect CK Hutchison Holdings' cash flow to benefit with reduced dividend risks from its subsidiaries and associates. The forecast five-year operating income compound annual growth rate of 6% is driven by the company's telecommunication segment with a boost from the 100% ownership of Wind Tre, the largest Italian mobile network operator by market share. Infrastructure contribution will grow at around 4% organically but is likely to be boosted by acquisitions. The company is developing an Internet strategy to help strengthen its retail operations. Although we think Wind Tre will see market share erode with the entry of Iliad's Italian mobile services, expected by mid-2018, and we incorporate profit flattening in the midterm, CK Hutchison Holdings' emerging Asian telco operations should see rising profits from a low base. The group's sizable war chest, with net gearing at just 0.32 times, half of its pre-financial crisis historical level, means that it is still able to hunt for acquisitions that will improve its efficiency and returns.
Comcast Corp (CMCSA)	Like its traditional pay-TV distributor peers, Comcast has suffered from the growth in "cord-nevers" and cord-shaving, particularly as over-the-top offerings like Sling TV, DirecTV Now, and YouTube TV gain traction. This ongoing deterioration in pay-TV economics has weighed on the share price of Comcast and its peers. However, the combination of the hostile bid for Sky and the hostile counterbid for the Fox assets has had a larger impact as shares are down notably since the Feb. 27 announcement of the Sky offer. We believe that a shift in focus toward mergers and acquisitions from returning capital to shareholders has spooked some investors. While Comcast walked away from the Fox assets, we expect the firm to remain in the fight for control of Sky. After the M&A headlines disappear, we believe Comcast is the best-positioned U.S. communications firm. Irrespective of the challenges faced by traditional pay TV, broadband demand continues to accelerate. We believe Comcast is better situated to benefit from this trend because of its faster Internet speeds than many of its telco peers. The current regulatory environment is favorable because of the reversal of Title II and net neutrality rules. With the threat of pricing regulation diminished, Comcast could offset deteriorating pay-TV economics with higher broadband prices.
Compass Minerals International Inc (CMP)	Wide-moat Compass Minerals remains undervalued, as investors are concerned that its near-term operational issues might represent a new normal for the company's earnings power. The Goderich mine has continued to experience near-term operational hiccups, most recently, a slower-than-expected production volume ramp-up using the new low-cost continuous miners. However, our long-term thesis is intact. Based on our analysis of more than 120 years of weather history, winter weather exhibits mean reversion tendencies over a multiyear period. While the number of snow days in 2015 and 2016 were around 15% below trend, the 2017-18 winter bounced back with above-average snowfall and higher deicing salt demand. Historically, harsher winters have led to increased deicing salt prices as local governments need to replenish inventories, and this trend will continue as Compass reported deicing salt price increases of roughly 15% for the upcoming winter. Higher prices should provide a much-needed profit boost for Compass, although roughly half of the price increase is due to higher transportation costs. We ultimately expect a rebound in Compass' profits as the mine is fully restored and the company's cost-reduction plan comes to fruition.

Company	Rationale
Credit Suisse Group AG (CSGN)	The profitability of Credit Suisse's core businesses comfortably exceeds its cost of capital; we estimate a midcycle return on equity of 13% compared with our cost of capital estimate of 10%. A few issues have concealed the company's true profitability. As part of the process of derisking the business away from volatile sales and trading, Credit Suisse has run down a massive noncore book of EUR 126 billion to EUR 45 billion over the past four years, incurring cumulative before-tax losses of EUR 16 billion in the process. To add insult to injury, Credit Suisse has incurred legal expenses of CHF 7 billion over the past four years. Credit Suisse has often been criticized that it was behind UBS in adapting its strategy to the new requirements for Swiss private banks. The market has hounded Credit Suisse to reduce its exposure to risky sales and trading and replicate UBS' business mix, where wealth management dominates. However, there are many more similarities between Credit Suisse and UBS than there are differences. We believe that losses booked out of the noncore portfolio have led investors to overestimate the importance of sales and trading to Credit Suisse. Sales and trading contributed 27% to Credit Suisse's revenue in 2017, compared with 23% of UBS' revenue generated by sales and trading.
Dominion Energy Inc (D)	Dominion Energy's investments in energy infrastructure projects in the Eastern United States should result in wide-moat businesses generating over 50% of operating earnings by 2019, up from less than 40% in 2017. The remaining earnings are primarily from narrow-moat regulated gas and electric utilities in states with long histories of constructive regulatory frameworks, industry-leading sales growth, and high-return investment opportunities. Also, the 2016 Questar acquisition added a 2,700-mile pipeline network in Utah, Wyoming, and Colorado that we believe will offer wide-moat investment opportunities into the next decade. These opportunities and the earnings power of its core businesses should allow Dominion to increase its dividend at roughly 3%-4% annually. Dominion's wide moat, secure and growing dividend, and long-term earnings growth outlook have the potential to deliver high-single-digit annual returns for conservative investors during the next five years.
Enbridge Inc (ENB)	Wide-moat Enbridge represents our Best Idea for investors in the Canadian midstream sector. We see 60% upside in the stock, while on average the Canadian midstream sector looks fairly valued. We believe the market doesn't realize the full potential of the company's growth portfolio, which is highlighted by the Line 3 replacement project (Canadian Mainline pipeline expansion). Line 3 received its final approval in June, which we expected and discussed in our January Select presentation, "Best Idea Enbridge Is a Triple Threat." Accordingly, we expect Enbridge to generate significant free cash flow, allowing the company to increase its dividend at approximately 10% annually over the next three years. The company is currently yielding approximately 6.7%.
Enel SpA (ENEL)	This is a value-driven call. The share price has been under pressure since the formation of the Italian populist government. There are market concerns about Italian stocks and bonds ahead of the 2019 budget to be unveiled this fall. We think concerns are overdone and overshadow Enel's solid fundamentals. There is no particular measure in the coalition manifesto against utilities. Enel is the cheapest utility we cover in terms of estimated 2018 P/E, despite boasting 10% average annual EPS growth through 2022, which is the second-highest growth rate. Dividend growth of 10% per year, which we expect through 2022, is also one of the highest and will be largely covered by organic free cash flow. Our fair value estimate implies 20% upside, making Enel the most undervalued utility we cover. That drives an appealing risk/reward profile.

Company	Rationale
Enterprise Products Partners LP (EPD)	Enterprise Product Partners is one of the cheapest wide-moat partnerships in our midstream coverage. It has an Exemplary stewardship rating, and we view it as one of the industry's highest-quality names. With the removal of the overhang from the Federal Energy Regulatory Commission's rulemaking effort related to the disallowance of a recovery of income taxes, we think investor perception toward master limited partnerships is improving. To be clear, we don't believe the FERC ruling had any material impact on Enterprise because the partnership primarily uses negotiated rates for its pipelines. However, we think the focus has now shifted back toward Enterprise's fundamentals, and particularly natural gas liquids. The volume growth outlook for U.S. hydrocarbons remains very healthy, as does Enterprise's leading position as the exporter of the incremental hydrocarbon, whether it be liquefied petroleum gas, oil, or ethane. Further, we continue to believe Enterprise Product Partners is well positioned for the master limited partnership investor base transition, as the industry shifts toward a total-return-based approach versus focusing solely on dividend/distribution growth. Enterprise eliminated its incentive distribution rights years ago and has consistently maintained a healthy coverage ratio above 1.2 times. The partnership is now seeking to fully self-fund \$1.5 billion of its \$3.0 billion 2019 capital spending program, which has historically been funded with equity. By using its retained cash flows, we believe this is achievable, further differentiating it from peers. For more on why we think several midstream entities are deeply undervalued and our take on industry moats, please see our recent report, "Midstream Energy Offers Efficient Scale Moats at a Discount." For more details on our NGL forecast, please see our July report, "The Natural Gas Liquids Rubik's Cube Solved."
Expedia Group Inc (EXPE)	Expedia's shares have underperformed since late 2017 because of the market's ill-advised concern about increasing competition and investment; this provides a sufficient margin of safety for investors looking to take a position in this narrow-moat company. In our view, Expedia's market position shows no signs of cracks, supported by solid trends in its international and vacation rental segments. This reinforces our stance that the company's incremental spending in these divisions is justified and being done from a position of strength versus weakness. Despite this spending damping Expedia's near-term profits (we model 11% EBITDA growth in 2018; around a high-single-digit percentage lift is typical in years of investment), we see it as a strong use of capital, supporting out-year performance (we expect a return to midteens EBITDA growth in 2020, typical in noninvestment years). We also believe these investments could buoy Expedia's leading network of 600 million monthly visits and 2 million plus properties, which is the source of the narrow moat rating we award the company.
FirstEnergy Corp (FE)	FirstEnergy eliminated its merchant generation exposure by separating from its unregulated unit, FirstEnergy Solutions, earlier this year. Without the support of its parent, FES immediately filed for bankruptcy. To avoid years of litigation, FirstEnergy settled with FES creditors with guarantees and payments totaling roughly \$2.7 billion. The market applauded the move and the shares have been one of the best-performing utilities in 2018. Even after this year-to-date performance, we think the shares remain undervalued. We believe the market fails to fully appreciate the company's ability to invest over \$2.5 billion per year in its wide-moat transmission businesses and narrow-moat utilities in constructive state regulatory environments, which together will account for 90% of earnings. We believe solid earnings growth and a growing dividend will be the catalysts for the market valuing FirstEnergy shares more in line with its regulated utility peers with economic moats.
G4S PLC (GFS)	Global security leader G4S has fallen more than 25% from its 2017 peak on the back of concerns about its India and Middle East business and resultant cuts to full-year revenue growth guidance. However, this division generates just 11% of group revenue and 15% of EBITA, and we believe many of the issues highlighted by investors in this business are short term in nature and do not pose a significant structural risk. Longer term, we believe the ongoing restructuring program can further simplify the business and remove costs, and structural improvements as the largest players in the industry shift toward higher-value activities should go some way to improving revenue growth and operating margins for G4S. We see material upside to our fair value estimate.

Company	Rationale
G8 Education Ltd (GEM)	G8 Education shares are trading significantly below our AUD 3.50 fair value estimate. A short-term oversupply of childcare centers in Australia has driven a share price slump; however, we believe the current share price reflects a market overreaction and that supply challenges are a cyclical rather than a structural problem. Population growth and growing female workforce participation underpin demand for childcare, an essential service, and we expect the July introduction of the childcare subsidy to boost demand further. Although G8 is experiencing weakening occupancy rates currently, and its lack of an economic moat means the company is vulnerable to competitive pressures, we expect the demand tailwind to boost occupancy rates over the next two years. G8's balance sheet is in reasonable shape following the debt refinancing in mid-2018, with the net debt/EBITDA ratio at a manageable 2.0 as of June 30. G8 is a relatively capital-light business that enables regular fully franked dividend payments at a high payout ratio. In early 2017, listed Chinese investor China First Capital Group invested AUD 96 million in G8 Equity at AUD 3.88 per share; the recent weakness in G8's share price and CFCG's share price strength may encourage the Chinese childcare group to invest more in the company and provide a catalyst to narrowing the price/fair value discount.
GEA Group AG (G1A)	We believe management's clumsy handling of its restructuring program has clouded the market's view of wide-moat GEA's long-term value. At issue is a disappointing margin performance and guidance combined with a top line that has suffered in the past two years from overcapacity in dairy processing equipment as well as an extraordinarily weak milk price hurting dairy farming orders. We continue to expect margin expansion over the next several years but believe the market has overlooked the nearer-term opportunity for earnings growth to return in 2018 from orders outside of dairy. Our analysis of the company's order intake shows that while dairy processing orders have been declining 8% per year for the past three years, the rest of the order intake has grown 3%. Food (bakery, ingredients, and pasta) is now the largest category and grew at 5% organically over the same period. GEA supplies food and dairy processing equipment, specializing in decanters and separators that determine a product's texture and consistency, which are essential to a company's brand and, along with food safety standards, create high switching costs for its customers. Nearly one third of its equipment is used in food processing to make products such as edible oils, instant coffee, and baked goods. Because GEA is a leading global supplier and number-one or -two player in nearly all its markets, it will benefit over the long term from increasing food production demand to feed the world's growing population as well as increasing urbanization demand for convenience food.

Company	Rationale
General Dynamics Corp (GD)	General Dynamics remains the most undervalued name across the major U.S. aerospace and defense names we cover. We think wide-moat General Dynamics' monopolylike position in shipbuilding, its large backlog in ground combat vehicles, and its industry-leading business jet brand, Gulfstream, will generate top-line growth. Despite margins coming under pressure in 2018 and 2019, we anticipate operating margin expansion in 2020. Operating cash flow should follow suit, breaching $5 billion by 2020 in our model, up from about $4 billion in 2018. General Dynamics' shares continue to trade at a discount to our fair value estimate. While the company operates a business jet unit (aerospace systems), its CSRA acquisition will boost defense and government-related revenue to roughly 75% of revenue. We think investors continue to underappreciate the recovery taking hold in business jets (who can blame them, after scraping the bottom of the market for several years?) and some investors are also applying a generic conglomerate discount to General Dynamics, despite management's proven ability to create value for shareholders. General Dynamics' ground vehicle business, combat systems, is poised for significant revenue increases thanks to international work. In addition, the U.S. defense budget is returning to growth, and we believe that the U.S. Army will begin a long-delayed vehicle modernization and recapitalization program. Marine systems operates in a duopoly for large U.S. Navy shipbuilding and enjoys a monopolylike position in submarines. Due to increasing cost-plus type work, we don't think the shipbuilding business will hit double-digit margins over the next few years, but we do think the Columbia program, which is a key growth driver, is secure due to the pressing need to replace the U.S. Navy's existing Ohio-class ballistic missile submarines. The company's recent focus on expanding the scale of its defense IT services business, which is growing via the $9.7 billion acquisition of CSRA, is a necessary move, in our view given the need to gain scale in the services market to better control overhead costs embedded on contracts. The new General Dynamics information technology business will also have an attractive position in intelligence services work (roughly one third of revenue in the business), which we believe possesses a wide moat due to its classified nature compared with the narrow moat for most services work. Turning to the business jet unit, aerospace systems, we think jet deliveries have found a bottom and that the aerospace segment will begin growing again. Its 2,000-plus fleet of aircraft will also provide recurring services revenue, and the 2018 acquisition of Hawker Pacific is further building out services capabilities. Although aerospace systems margins will contract over the near term, we're convinced that General Dynamics can maintain industry-leading business jet margins even as it transitions to the new G500 and G600 aircraft.
General Mills Inc (GIS)	We think the market's confidence in wide-moat General Mills' ability to restore top-line growth has faltered, considering continued softness in volume across the packaged food space as well as skepticism around the acquisition of natural pet food company Blue Buffalo. While the deal carries some inherent risk as General Mills enters a category in which it has limited experience, we remain confident in the firm's ability to efficiently integrate Blue Buffalo and extract cost synergies from combining these operations. We believe General Mills will rely on the same strategy used for its previous acquisitions of niche players, enabling its pet food unit to benefit from its supply chain and distribution capabilities while largely leaving the acquired firm's operating model intact, which we think ensures these niche brands stay in touch with the preferences of their core customer base. We think this approach has proved successful in the past, as exemplified by Annie's, which has increased distribution around 80% since being acquired in 2014. Further, we expect General Mills' stringent cost-management focus will facilitate additional reinvestment in its brands through research and development and advertising; we expect brand-related spending as a percentage of sales to tick up over the long term, totaling around 7% of sales over our forecast (versus a five-year historical average slightly below 6%), which should support top-line gains as General Mills expands the distribution of Blue Buffalo's fare in mass-market channels. Given its discounted price (we see at least 20% upside to our current valuation) and a 4%-plus dividend yield, we think the stock provides an attractive entry point for long-term investors.

Company	Rationale
General Motors Co (GM)	General Motors is starting to see the upside to high operating leverage, thanks to lower fleet sales and smarter manufacturing than in the past, including a reduction in its vehicle platforms. It also is starting to be recognized as a leader in autonomous vehicle technology and expects to launch AV ride-hailing at scale in 2019. A $3.35 billion investment in Cruise by GM and Japan's SoftBank, as well as a $750 million investment from Honda, should enable GM to meet this timing goal and at times has given GM's stock some tech luster. We believe many investors are focused on the large pension/other postemployment benefits underfunding, the overhang of VEBA ownership, and the ignition recall. However, the pension won't be due all at once and is closed to new participants. The U.S. plan's 92% funding percentage is still slightly better than the 83% ratio at the end of 2012, when many feared low rates' impact on pensions. GM also has cash that it could use for share buybacks or discretionary pension funding, and we like the announcement of a significant initial dividend in January 2014 of $0.30 a quarter, followed by a 20% increase in 2015 and another 6% increase in 2016, equivalent to a yield approaching 5%. In March 2015, GM announced a clear capital-allocation policy that in January 2017 was amended to expect the company to buy back $9 billion of its stock through 2017. Subsequent amendments have led to GM buying back $10.5 billion of stock across 2015-17, with $3.5 billion of authorization remaining at year-end. It also reduced its cash target in March 2015 to $20 billion from $20 billion-$25 billion and in March 2017 lowered its cash target to $18 billion upon completion of the Opel sale in August 2017. We like that GM is focusing only on markets where it can be profitable long term, even if that means exiting a huge market, such as Europe, or markets like India, where its share was minuscule. An aggressive GM Korea restructuring plan set up in 2018 is expected to bring $400 million-$500 million in annualized savings, which, along with the GEM platforms for the GMI segment in 2019, should help GMI, excluding Chinese equity income, finally be profitable in 2019. In the long term, we expect Chinese auto demand to grow and GM to remain a market leader there. GM China's retail volume grew 4.4% year over year in 2017 to 4.0 million units. GM sold nearly 1.2 million Buicks in China in 2017 and has a long growth runway for Cadillac there as well. China was Cadillac's largest market in 2017 and Cadillac increased its 2017 Chinese sales by 51% to 175,489. The brand's Chinese sales are up 20% in the first nine months of 2018. The industry's mix shift toward highly profitable SUVs over sedans also eases some of the pain of slower industry growth than recent years as well as pricing pressures from a crowded market. Key holes in the U.S. product lineup (full-size sedans, full-size trucks, and SUVs) are now filled and 2018 starts the launch of new generations of the firm's most profitable vehicles. Old GM broke even with 25% U.S. share and a U.S. industry sales level of 15.5 million units, while New GM breaks even depending on mix at just 18%-19% share of 10.5 million-11 million U.S. industry units. The ignition switch recall increases headline risk and litigation risk, but we think GM can pay any fines or judgments that come its way thanks to $32.1 billion of automotive liquidity as of June 30, including $18.0 billion of automotive cash and securities, including $2 billion of cash at GM Cruise. In October 2017, we reduced our reserve for fines and legal settlements around the ignition recall to $5 billion from $7 billion, currently about a $3 hit to our fair value estimate. We still think our reserve is conservative, but some issues, such as Department of Justice fines, are resolved, and we don't see GM settling the class-action lawsuit for economic loss for a large, multi-billion-dollar figure. The victims compensation fund announced a final settlement in December 2015 of about $594.5 million, but many uncertainties on personal injury lawsuits, a Securities and Exchange Commission investigation, state lawsuits, and economic loss lawsuits remain. GM could be liable for economic loss class-action claims on ignition recall vehicles made under Old GM.

Company	Rationale
Grupo Aeroportuario del Pacifico SAB de CV (GAP B)	We believe wide-moat airport operator Grupo Aeroportuario del Pacifico is the best positioned of the three Mexican airport companies we cover. Over the next several years, we think Pacifico can take advantage of multiple tailwinds, including a demographic boom in Mexico and an aging U.S. population, that will increase both domestic and international traffic moving through its airports. A healthy balance between domestic and international passengers and a lack of reliance on a particular airport also put Pacifico in a unique position compared with its domestic peers. We think the Mexican air travel market sits at the edge of a decadelong demographic tailwind and growth in Mexico's working-age population will drive airport traffic. While air travel remains quite cyclical, a growing Mexican working-age population coupled with this group's higher propensity to travel generates a secular demand driver for domestic and cross-border air travel to the U.S. For international travel, the weakened peso compared with historical levels and a growing retirement population in the U.S. will continue to support tourism flows to Pacifico's Puerto Vallarta and Los Cabos airports. In fact, we believe Los Cabos will be one of the fastest-growing airports in Mexico over the next several years. We expect Pacifico's total passenger traffic to grow at an average annual rate of 6% over the next three years and revenue to increase roughly 10% annually over the same time frame. We believe revenue growth will continue to outpace traffic growth due to the operator's significant pricing power on the nonaeronautical side of its business. Specifically, we think vendors' strong desire to reach the captive audience inside Pacifico's terminals provides the company with significant leverage in pricing negotiations. In addition, the airport business model's inherent operating leverage should enable Pacifico to keep operating margins elevated. As expected, Andrés Manuel López Obrador won the Mexican presidential election. Despite all the rhetoric, we don't envision a significant impact on the airport operators because of AMLO policies. Instead, we think he would look to reform higher-profile sectors of the Mexican economy, and with the exception of the Mexico City airport, which is not owned by the operators we cover, he won't meddle with the operators' airports or their concessions. It does look as if AMLO is moving toward a popular referendum on the Mexico City airport, asking citizens to choose either the current location where the new airport's construction is well underway or scrapping this plan in favor of an expansion of the Santa Lucia military airbase. The latter choice would curb air traffic growth modestly for Pacifico because of connecting traffic congestion in and out of the old Mexico City airport continuing well past 2020, which is when the new Mexico City airport under the existing plan begins operations. We've already fully modeled this risk into our air traffic growth estimates, and despite the rally on the back of positive NAFTA renegotiation news, shares still look a bit cheap, recently trading at around a 8% discount to our fair value estimate.
Guangshen Railway Co Ltd (00525)	We recently raised our fair value estimate to reflect a stronger growth outlook and robust cash flows driven by China's railway reform, with the latest government actions indicating more comprehensive policies in 2018. We expect concrete actions to be taken over the next 12-24 months, including a one-off 25% tariff hike on conventional passenger lines, further progress in railway land development and utilization, railway asset securitization, and further deregulation in the sector. We expect these to boost Guangshen's profitability and returns over the next five years, and we forecast the company's net income to grow at a decent 16% during 2017-20, with return on invested capital improving to 9.2% in 2021 from 4.6% in 2016. We remain optimistic on Guangshen's long-term investment value, supported by China's high-speed network expansion and the industry's reforms. Pending potential high-speed rail acquisitions, we retain our no-moat rating on Guangshen. However, we see potential improvements in network efficiency that could enable Guangshen to develop a moat in the future.

Company	Rationale
Hanesbrands Inc (HBI)	We view narrow-moat Hanesbrands as attractive as it trades well below our fair value estimate. We think the market has been overly focused on short-term issues (inventory reductions at retail and its excessive leverage) and overlooks longer-term opportunities within the business that arise from its intangible asset-sourced narrow moat. We believe Hanesbrands has been innovative in product development, which has enabled some of its basic innerwear brands to outsell competing brands by a wide margin. While the stock fell on the announcement earlier this year that Target would cease selling the firm's C9 brand in 2020, we don't view this as detrimental to the business or evidence of an eroding competitive position. Rather, we think Hanesbrands' Champion brand has benefited from a trend toward throwback apparel and is being supported by new retail stores. We expect worldwide sales of $2 billion for Champion in 2022, up from $1.4 billion in 2017. Much of this growth is expected to come from international sales as the brand grew 22% in Europe and 23% in Asia in 2017, and we think there is an untapped opportunity to expand further in each of these regions. Based on this view, we expect consolidated sales growth to resume to a low- to mid-single-digit clip over the course of our explicit forecast. We also think the market fails to appreciate that Hanesbrands has significant potential for margin improvement. We estimate its overall adjusted operating margins will gradually improve from 13.8% in 2018 to 16.4% in 2027, as the firm works to extract inefficiencies from its operations, which we view as prudent, and instills best practices within its recently acquired businesses. Further, despite its current debt load (3.5 times EBITDA), we view efforts to lower leverage as favorable. Management targets leverage between 2 and 3 times, and we think that upon reaching this range it will direct its robust free cash flows (which we forecast will average more than 12% of sales over the next decade) to shareholders. We expect it will maintain a dividend payout ratio of about 30% and resume repurchase activity by 2020 (averaging more than 5% of shares outstanding between fiscal 2020 and fiscal 2027).
Imperial Brands PLC (IMB)	Imperial is the unloved stock in a sector that is very much in favor. The market is valuing tobacco stocks based on their exposure to heated tobacco, the emerging category that is achieving impressive growth in Japan and select markets around the world. We are bullish on heated tobacco, and we think a valuation premium for those leading and developing the category is appropriate. However, we think the market is overestimating the value of the first-mover advantage, and if heated tobacco gains traction in other markets, particularly the U.S. and Europe, we expect Imperial to leverage its wide moat and follow Philip Morris, British American, and Japan Tobacco into the space with its own technology. Imperial's current multiple discount of 9 times P/E is much larger than the historical discount, and we think this is unjustified.

Company	Rationale
Intel Corp (INTC)	Wide-moat Intel trades at an attractive discount to our fair value estimate of $65 per share. The chip titan's comprehensive product portfolio tailored to computers from the data center to the edge gives us confidence in the firm's long-term growth prospects, despite a declining PC market. We applaud Intel's scattershot approach to address challenges in computing (artificial intelligence and cloud), connectivity (5G), and memory (3D NAND and 3D XPoint). This data-centric strategy is rooted in Intel's swath of products that attempt to support data creation, transfer, storage, and analysis. Its string of acquisitions (Altera, Mobileye, Nervana, and Movidius) have unlocked new growth vectors for Intel to tackle while augmenting the capabilities of its old guard in client computing and data center. Our fair value estimate implies a forward GAAP P/E ratio of 15 times, while shares currently trade at 11 times. Beyond our explicit five-year forecast, we foresee the automotive and artificial intelligence-related segments spearheading revenue growth for Intel. By 2021, we project the artificial intelligence accelerator chip market will be $20 billion, with Intel a significant beneficiary. One of the chipmaker's most recent large acquisitions, Mobileye, benefits from incumbency in countless advanced driver-assistance systems programs and a robust pipeline of design wins. Now coupled with Intel's technological and financial resources, the combination will be a formidable player in the race to self-driving cars, in our opinion. Additionally, we view Mobileye's approach to autonomous driving very favorably, as it looks to incrementally build upon existing products to enable full autonomy. We estimate a $7 billion 2025 opportunity for Intel's autonomous platform solution, with Intel capturing a meaningful portion of this addressable market.
InvoCare Ltd (IVC)	InvoCare is amid a major reinvestment cycle that has resulted in the temporary closure of a significant number of its stores and a temporary dip in sales. However, this disruption is short-term, and the medium- to long-term outlook remains positive. After completing its reinvestment program, the firm should be in a much stronger position to continue increasing its share of the steadily growing funeral services market. We view the recent sell-off as an opportunity to invest in a high-quality stock at a significant discount to our fair value estimate. After the company reopens the refurbished facilities, we expect high-single-digit earnings per share growth to resume and for the pace to continue over the medium term. The key earnings drivers are 1%-2% growth in the annual death rate, incremental market share gains, and around 3% per year in price growth, slightly ahead of inflation. We forecast EBITDA margins averaging 28% during the next five years, compared with 25% during the past three years, which is mainly an outcome of operating leverage, favorable mix shift, and most notably the cost-cutting initiatives as part of the Protect and Grow project. The firm's competitive advantages stem from its intangible brand assets as well as cost advantage. We believe the strong branding, reputation, and in many cases regional monopolies will allow InvoCare to continue raising prices ahead of inflation while building on its leading one third share of the Australian market. We also believe the market underappreciates the highly attractive prepaid funeral business. These funds are invested in a diversified portfolio, which over the long term we expect to comfortably outperform cost inflation. The benefit is retained by the company, essentially providing a low-cost source of funding.

Company	Rationale
Johnson Controls International PLC (JCI)	Narrow-moat Johnson Controls was long viewed as an auto-parts supplier, given that it historically generated about two thirds of its annual revenue from automakers. However, over the past few years, Johnson Controls has been on a mission to transform itself by selling noncore assets and acquiring businesses that complement the buildings segment. The most transformative transactions came in 2016, when the company merged with Tyco International in September and spun off its automotive seating business (now called Adient) to shareholders in October. As a result of these transactions, Johnson Controls is a more profitable and less cyclical business with much lower exposure to the automakers (now only 6% of sales) and more exposure to higher-margin recurring service and aftermarket revenue, which now represents over 40% of sales. Tyco, the global leader in security and fire-protection products and services, nicely complements Johnson Controls' legacy building efficiency business, which is a global leader in HVAC systems and building automation and controls. The combination should result in meaningful synergies and enhanced market penetration as the company eliminates redundant costs, streamlines operations, leverages research and development capabilities, and goes to market with a more comprehensive portfolio of products and services. Johnson Controls is targeting $1.2 billion (about $1.10 in earnings per share) of cost and revenue synergies by fiscal 2020. Johnson Controls should also benefit from secular growth trends. We expect global urbanization, increased demand for smart building technology, and growing aftermarket and retrofitting activity to act as tailwinds for Johnson Controls' enhanced building technologies and solutions business. Johnson Controls' power solutions segment is the largest producer of lead-acid automotive batteries in the world, manufacturing approximately 154 million annually. The company has 36% global market share; it is the leading supplier in the Americas and Europe and the third-largest in China, with aspirations to become the second largest by 2020. Power solutions' significant exposure to the inelastic aftermarket business (76% of segment sales) yields stability, while the segment's participation in emerging markets and start-stop vehicle technology provide substantial growth opportunities. In September 2017, former Tyco CEO and Johnson Controls COO George Oliver succeeded Alex Molinaroli as chairman and CEO. With Oliver at the helm, we commented that we saw an increased probability of the company selling its power solutions segment. On March 12, Johnson Controls announced that it is exploring strategic alternatives for the power solutions business. Management expects to make a decision by Johnson Controls' fiscal fourth-quarter earnings release. Media outlets have reported that Johnson Controls will likely sell the business. While it's true that the power solutions business has limited synergies with Johnson Controls' building technologies and solutions segment, power solutions is growing faster and is more profitable than the firm's buildings business. That said, we certainly see how a favorable selling price could create shareholder value.
Kao Corp (4452)	As the largest consumer product manufacturer in Japan with around 30% share in the home detergent and disposable baby diaper space, wide-moat Kao can leverage its huge research and development resources in Japan and expand its premium products to further attract higher-income consumers in emerging Asia. We expect Kao's detergent business to enjoy stable growth rates in Japan and overseas and its human healthcare segment to grow at a high-teens rate in Asia thanks to the premiumization trend in baby diapers. While the stock performance in 2017 lagged cosmetics peers by 20% due to the slow ramp-up of Kao's cosmetics sales, we think the aforementioned cash-cow segments can more than offset its struggling cosmetics business, leading to slight margin expansion over the next five years. Trading at a discount to our fair value estimate, Kao's stock price is still attractive, in our view.

Company	Rationale
KION GROUP AG (KGX)	As a market leader in forklift manufacturing, Kion is already well positioned to benefit from growing e-commerce. Given this combined with its recent Dematic acquisition, we think the company will offer attractive long-term revenue growth and increasing returns. Despite rapid growth, e-commerce still accounts for only a small portion of global retail sales, just 8% in the United States and near 14% in China. While warehouse equipment orders can be lumpy from one quarter to the next because of their size and the long lead time to signing contracts, low e-commerce penetration levels suggest a long runway for Kion's revenue growth as warehouse equipment demand grows with the increasing automation and expansion of warehouse space needed to support an e-commerce supply chain. Kion's and Dematic's respective leading market share positions in forklifts and warehouse automation secure dominance in a complementary product set, enabling the company to cross-sell the products to each division's client base. We think Kion and Dematic will be able to offer a one-stop software-driven solution that combines the management of forklifts with automation systems, starting in 2018. An impressive book of past reference projects gives Dematic an advantage over competitors as customers in major warehouse automation projects tend to give new business only to suppliers with specifically similar project experience. With its list of clients including Amazon, JD.Com, Zara, Tesco, and FedEx, we expect Dematic to continue to be a favored supplier for new business and gain share.
+ KLA-Tencor Corp (KLAC)	We are adding KLA-Tencor to the Best Ideas list as we remain positive on the wafer fabrication equipment market heading into 2019. Investments by major foundry and logic customers such as TSMC and Intel for their respective 7- and 10-nanometer-related process technologies will require more complex tools from KLA in process diagnostic and control. We believe domestic Chinese chipmakers typically do not possess the intellectual property and engineering talent found at cutting-edge chipmakers, implying that the capital intensity of PDC tools will be higher, as domestic Chinese chipmakers must perform more troubleshooting and use greater process control feedback loops to ramp their production to high volume. We believe wide-moat KLA's shares are trading at an attractive discount to our $128 fair value estimate. KLA-Tencor dominates the PDC segment of the semiconductor equipment industry. During the fabrication process, wafers must be inspected for defects and proper critical dimensions to identify and correct problem sources. As customers pursue Moore's Law, smaller chips must meet more precise specifications, which increases the need for advanced PDC tools. These tools help customers improve semiconductor die yields, accelerate development and product ramps, and ultimately maximize profitability. Overall, we expect inspection and metrology requirements to continue rising, which bodes well for PDC leader KLA. Historically, logic and foundry have ranged from 15% to 17% in PDC capital intensity, and with EUV lithography soon to be adopted, we think KLA will operate at the high end of this range, if not exceeding it. Capital intensity in memory is also set to rise, particularly as cutting-edge 3D NAND technologies move from 64 layers to 96 layers, which we think KLA will be able to aggressively target over the coming years as dedicated tools come to market.

Company	Rationale
+ Lam Research Corp (LRCX)	We are adding Lam Research to the Best Ideas list, as we remain positive on the wafer fabrication equipment market heading into 2019. Lam has benefited greatly from the sharp rise in spending by memory customers, though recent customer commentary suggests a near-term pullback in spending for the end market (especially in 3D NAND). Although total WFE spending will probably be modestly lower in 2019, with softer memory investments mostly offset by strength in logic and foundry, we foresee firms such as Lam being able to achieve solid levels of profitability by effectively controlling costs. Furthermore, we anticipate share gains for Lam in key multiple patterning steps at logic and foundry customers such as Intel and TSMC at advanced process nodes. We view the shares of narrow-moat, positive-trend Lam as attractive versus our $185 fair value estimate. Chipmakers that have continued along the trajectory prescribed by Moore's law have endured significant challenges in terms of cost and complexity. Equipment providers are vital to making the pursuit more economical via advanced chip manufacturing tools. Lam has benefited from the sharp rise in etch, deposition, and clean steps required as a result of major inflections, including FinFET and 3D NAND flash storage, that feature multiple patterning and vertical layers well suited for Lam's advanced etch and deposition offerings. We attribute the recent sell-off across semiconductor stocks to an assortment of factors, including macro-related concerns such as tariffs, the escalating trade war between the U.S. and China, inventory builds, and memory price declines. However, the end-market diversity beyond PC and smartphones for semis, which includes the shift to the public cloud, rise in automotive chip content, investments in 5G, and artificial intelligence, should collectively allow for less cyclical behavior for overall WFE patterns, in our view. We think memory customers are better equipped to navigate downturns with greater cash cushions and profitability levels from the recent memory upswing, thanks to more rational behavior from a supply/demand standpoint. As such, short-term delays in equipment spending by Samsung and Micron shouldn't last nearly as long as past downturns, which bodes well for Lam and its peers.
+ Link Administration Holdings Ltd (LNK)	Link's share price has been weak since the release of the federal budget in May, which included changes to superannuation rules that will negatively affect the company's superannuation business. However, this business constitutes around one third of group EBITDA, and we believe the market has overreacted to the changes, which we expect to reduce divisional EBITDA by around 10%. We also expect the Australian superannuation sector to be increasingly dependent upon Link's relatively low-cost administration services and the likely consolidation of superannuation funds will benefit the company. The impact of superannuation sector uncertainty has been amplified by Link's acquisition of U.K.-based Capita Asset Services in late 2017, which leveraged the balance sheet and created integration risk in the short to medium term. However, we believe the market is being overly cautious in this regard also, as Link bought CAS from a distressed seller, has expertise in the sector, and has an excellent record of integrating acquisitions. Early signs are that the CAS integration is progressing well, and further good news in this regard is likely to be a catalyst to close the share price discount to fair value. Link also owns a 20% stake in electronic conveyancing platform PEXA, which has a first-mover advantage and looks likely to build a network effect in the large Australian real estate conveyancing market. Link's consortium of investors, which includes Commonwealth Bank and Morgan Stanley Infrastructure, is the only bidder remaining in PEXA's dual-track sale process following the failure of the initial public offering due to stock market volatility. We believe Link has a low risk of overpaying for PEXA, considering it's a long-term shareholder with board representation and it's likely that an acquisition will be value-accretive. Although many of Link's businesses are likely to deliver only low-single-digit organic revenue growth, PEXA will add a strong top-line growth element to the stock, and we expect synergies from CAS and other previous acquisitions to boost EPS growth in the short to medium term. We believe Link's midteens fiscal 2019 price/earnings ratio fails to reflect its earnings growth outlook and the quality of the highly experienced executive team.

Company	Rationale
+ Macquarie Group Ltd (MQG)	Diversification and interlinking are key to generating long-term revenue growth for narrow-moat-rated global diversified financial services firm Macquarie Group. The extent of interconnectivity among the five groups and operating leverage provides attractive earnings upside that we think the market underappreciates. We like the firm's growth profile, long-standing senior management, long-term investment approach, and upside from exposure to infrastructure, energy, and technology sectors. We see the interconnectedness of Macquarie's adjacent businesses as a real competitive advantage and key to continued strong growth in shareholder returns. Macquarie is a world-leading infrastructure fund manager and has increasing exposure to renewable energy, putting it in a good position to benefit from huge growth in global infrastructure and energy investment in the next decade. We recently updated our moat rating to narrow, based on the competitive advantages of Macquarie's underlying businesses. The asset management and corporate finance businesses benefit from customer switching costs and brand strength, while the investment banking businesses benefit from network effects and brand strength. The banking business is the only business we don't consider moatworthy. We forecast attractive annual average EPS growth of 8% for fiscal 2019-23, based on growing global need for investment in infrastructure and energy markets, robust global capital markets, and ongoing institutional demand for Macquarie's mainly unlisted alternative infrastructure funds. The stock is currently trading 10% below our AUD 130 fair value estimate. Macquarie provides a reasonable exposure point to the long-term growth opportunities in global infrastructure and energy sectors. The stock currently trades at a P/E of 14.5 and offers a 5% yield, comparing favorably with global peers.
Martin Marietta Materials Inc (MLM)	Shares of narrow-moat Martin Marietta Materials are trading roughly 40% below our fair value estimate of $260 per share. Year to date, Martin Marietta's shares have traded with volatility that we believe doesn't reflect a solid long-term outlook for residential, nonresidential, and road construction. Waning optimism for a Trump infrastructure plan, worries on weakening end-market demand, general equity market declines, and misidentifying weather challenges as permanent slowdowns in demand have weighed on the stock. Nevertheless, we expect Martin Marietta's EBITDA to surge nearly 150% by 2022 from 2017 as strong demand drives higher volume. A combination of robust price increases and the benefits of operating leverage as production volume rises should drive materially higher profits. Martin Marietta wields meaningful pricing power in each of its local markets, representative of its narrow moat based on cost advantage and intangible assets. The low value/weight ratio of cement and aggregates establishes Martin Marietta's cost advantage against out-of-market competition. In addition, the company benefits from intangible assets stemming from high barriers to entry, as "not in my backyard" tendencies make opening new quarries near populated areas incredibly difficult. A recovery in construction remains in the early stages, as U.S. aggregates consumption is still below prerecession levels. Moreover, current demand doesn't even include the backlog of projects created from the recession and from years of underspending on infrastructure. Historically, limited funding has prevented this demand from being unleashed but, based on two key factors, we think the money will be there. First, though federal funding has weakened over the years, the FAST Act provides some stability for infrastructure planning over the next few years. Furthermore, states have increasingly relied on their own funding mechanisms to pay for needed road work. Second, better infrastructure is a goal that should inspire bipartisan support. Therefore, we think it's only a matter of time until more stable long-term funding emerges. For more details on why we think Martin Marietta is undervalued, please see our November 2017 report, "Martin Marietta Has a Solid Foundation for Massive Profit Growth."

Company	Rationale
Mattel Inc (MAT)	The 2016-17 holiday seasons along with the Toys 'R' Us bankruptcy proved difficult for Mattel to navigate, leading to revenue declines and margin pressure from promotions that were greater than anticipated; this hindered performance at the end of fiscal 2016 and ongoing through 2018. This has left the shares at a significant discount to our intrinsic value, providing a wide margin of safety for long-term investors. We expect current company headwinds to be transitory, which shouldn't negate Mattel's long-term competitive advantages, and we think changes implemented under prior CEO Margo Georgiadis' strategy have begun to bear fruit during the second half of 2018. Additionally, with new CEO Ynon Kreiz at the helm, further brand stabilization should occur across power brands like Barbie and Hot Wheels, which have delivered robust recent results. We believe Kreiz will still focus on improving Mattel's brand equity by capitalizing on the firm's restored creative bent, but will also drive IP exposure to the next level to improve Mattel's profitability.
McKesson Corp (MCK)	Despite major near-term headwinds, McKesson should remain an essential link in the pharmaceutical supply chain. Several headwinds have pressured the firm's operations and stock. The loss of material volume as a result of customer consolidation, slowing branded drug price inflation, a mix shift toward specialty drug products that are costlier to distribute, and increased competition for small/independent pharmacy market share have formed a confluence of negative variables that have built in significant near-term uncertainty for the drug distributor. However, we believe these are near-term issues, and McKesson will be able to power through the recent volatility as it is a critical partner to both retail pharmacy clients and drug suppliers. This has given investors an opportunity to acquire shares of a wide-moat company at a material discount. While there are some remaining headwinds associated with a changing pharmaceutical supply chain, we believe McKesson will be able to effectively offset this issue, win its share of contracts in the future, and thrive long term. McKesson is in the process of better positioning itself as a critical player in the lucrative specialty pharmaceutical market niche, which will eventually bolster its wide economic moat.
Medtronic PLC (MDT)	As the market-leading pure play in medical technology, Medtronic has an unmatched, extensive product portfolio, stretching from surgical consumables to implantable devices for cardiac conditions. We think the market is overly focused on the waning of some of Medtronic's product cycles in key cardiac device markets and underappreciates how the firm has shifted the dynamics of competition away from innovation exclusively. Medtronic has pioneered ways to benefit from the shift to value-based reimbursement through risk-based contracting, which has gained a foothold with providers and payers. We expect Medtronic's efforts to solidify preference at that level should better insulate its products from competition, even when the firm is in an unfavorable product cycle.
Microchip Technology Inc (MCHP)	We view wide-moat Microchip Technology as one of the highest-quality firms under our semiconductor coverage. We maintain our $112 fair value estimate and see an attractive margin of safety for investors after a recent pullback across our broad-based semiconductor coverage. Microchip remains a leading supplier of the "brains" needed for a variety of smart devices categorized as the "Internet of Things." We find Microchip under the hood (figuratively and often literally) of the latest cars with the most advanced electronics and think it is poised to profit from rising chip content per vehicle. We're confident in Microchip's wide moat rating, thanks to high customer switching costs associated with electronics redesigns, intangible assets associated with the firm's proprietary chip designs, and decades of expertise and reliability. In the near term, business conditions in the analog space appear to be slowing down due to tariffs and trade wars. However, Microchip is adept at navigating the various industry cycles and, at this point, we see no reason this latest potential industry slowdown will be an exception. We think that longer-term patient investors will be rewarded once demand rebounds. Further, Microchip's exemplary management team has made shrewd mergers in the past and believes its recent acquisition of Microsemi will be another hit. We think that Microchip's profitability targets with Microsemi announced at its investor day are mildly conservative, and we can foresee even greater upside, even with a near-term slowdown. With this and the firm hitting its long-term target of 7%-9% organic revenue growth, we see a healthy amount of upside for investors.

Company	Rationale
Mondelez International Inc (MDLZ)	Former CEO Irene Rosenfeld orchestrated significant change during her nearly decadelong reign at wide-moat Mondelez. However, after announcing last year that she would step down, the shares have languished. We attribute a portion of the demise to competitive angst and lackluster top-line gains (like its peer set). But we think this was compounded as her external successor, Dirk Van de Put, delayed articulating his strategic road map. After being at the helm for nearly a year, though, he has finally provided clarity as to the direction the company will embark upon and the gains he believes are likely to ensue from these plans. We've never believed that righting the ship at Mondelez would necessitate seismic shifts in operations, but rather more tactical initiatives to facilitate sustainable improvement. As we expected, reigniting sales is at the forefront of its plans, which the firm aims to do by extending the distribution of its fare, reinvesting in product innovation aligned with consumer trends, and selectively pursuing inorganic growth opportunities. While much attention has centered on opportunities to bolster sales, we never expected the pendulum would shift entirely to sales gains under Van de Put's direction; rather, based on his tenure at privately held McCain Foods and his recent rhetoric, we suspected he would put the firm on a path to drive sustained, profitable growth. Management has been reluctant to quantify its cost-saving objectives, but we see an additional $1 billion in excess costs that it could remove (on top of the $1.5 billion realized over the past several years), primarily by extracting further complexity from its operations (including rationalizing its suppliers, parting ways with unprofitable brands, and continuing to upgrade its manufacturing facilities). We don't think the entirety of its potential savings will boost profitability; rather, we think a portion will fuel additional spending behind its brand mix (in the form of research and development as well as marketing), supporting the intangible asset that underlies its wide economic moat. We forecast 3%-4% average annual top-line growth through fiscal 2027 and another 300 basis points of operating margin expansion to around 20% by the end of the decade (versus consensus forecast for low-single-digit sales growth and high teens margins). With the shares trading about 20% below our fair value estimate, we suggest investors consider Mondelez.
Murata Manufacturing Co Ltd (6981)	Narrow-moat Murata Manufacturing is the global top supplier of passive components, such as multilayer ceramic capacitors (40% market share) and sound acoustic wave filters (45% market share). Murata's revenue doubled over the past five years, as approximately half of its revenue is from handsets. Smartphones use a larger number of passive components than feature phones, and in addition, progress of 4G communication requires more content per smartphone, becoming the driver of Murata's revenue growth. Even though the yearly shipment of smartphones seems to have hit a ceiling, diffusion of 5G communication and auto digitalization will drive Murata's revenue growth in the long run. We believe RF content for wireless devices will continue to increase in 5G, and Murata's broad product portfolio will provide even larger business opportunities to the company than in 4G. Safety and environmental regulations require autos to equip more electronic devices, and as a result, we forecast MLCCs for autos to increase at a midteens percentage per year. Accordingly, we expect a tight supply/demand balance of MLCCs will continue in the midterm, which will be favorable for suppliers. We assign a narrow economic moat rating to Murata based on intangible assets for passive components, especially for handsets. Being the top global supplier of passive components for more than two decades, Murata has market share and operating margins for MLCC and SAW filters that are at least twice as great as other players, and which has enabled Murata to establish a close relationship with key players in the industry. Murata is able to obtain future product roadmaps from its clients and thus can help design circuits, as the quality of passive components is critical to remove magnetic noise from the circuit and enable better telecommunication quality. Our fair value estimate is JPY 24,000, which implies enterprise value/EBITDA of 10 times. We believe that margin expansion of MLCCs, recovery of the profitability of its substrate business, and robust revenue growth of its communication module business are not fully priced in.

Company	Rationale
Norwegian Cruise Line Holdings Ltd (NCLH)	Narrow-moat Norwegian Cruise Line Holdings is on the Best Ideas list, given its wide margin of safety (about 38%) to our $69 fair value estimate. Oversupply concerns have echoed through the marketplace in recent periods, weighing on cruise operator shares, with rising fuel prices and foreign exchange headwinds providing incremental pressure. However, we think plenty of global demand remains untapped to support industry growth, and cruise companies are expanding the aggregate demand pie by tapping into new geographies and demographics via wider market segmentation than in the past. With Norwegian's compelling value-added bundling and market-to-fill strategies, we think it's poised to pivot nimbly to capitalize on evolving consumer trends and increase average sales by 8% annually and EBITDA margins by 110 basis points by 2022.
+ Orsted A/S (ORSTED)	Our fair value estimate of DKK 450 per share implies a 12% total shareholder return, and with our low uncertainty rating, Orsted offers an appealing risk/reward ratio for a European utilities firm. Orsted is the only European utilities firm with an Exemplary stewardship rating underpinned by best-in-class capital allocation. The group has a narrow moat as strong visibility provided by highly subsidized wind power activity gives us certainty that Orsted will earn more than its cost of capital 10 years from now. Our estimates point to underlying EBITDA and net income average annual growth of 9% and 21%, respectively, through 2027. Key growth drivers will be the commissioning of 5.7 gigawatts of new capacity by 2025 and reduction in unit operating costs driven by increasing average turbine size. On the Nov. 28 capital market day, we anticipate the company will provide more details about the new projects' economics, which will help the market better value them, in our view.
Pendal Group Ltd (PDL)	Narrow-moat-rated Pendal Group is our preferred asset manager at current prices. A pure-play active fund manager with a strong investment performance record, Pendal should continue to benefit from the key tailwind of compulsory superannuation contributions and favorable demographic trends. Furthermore, it displays greater diversification across revenue sources, geography, and investment classes relative to its peers domestically. Although the acquisition of JO Hambro Capital Management in the United Kingdom has provided larger growth opportunities from offshore markets, disappointing recent performance by this division has seen Pendal's share price fall into 4-star territory. The share price has also come under pressure because of the sale of Westpac’s remaining 10% ownership stake in the group, valued at approximately AUD 380 million. This is a near-term negative driver that we believe should be seized upon by investors, who should be reassured by reasons already mentioned, as well as a strong balance sheet, attractive return on equity, and a healthy dividend yield.

Company	Rationale
PepsiCo Inc (PEP)	We think the shares of wide-moat PepsiCo offer a compelling opportunity for long-term investors, given the discount to our fair value estimate combined with a 3%-plus dividend yield. While soft performance in the North American beverage business has pressured the shares (segment volume declined for the last three quarters, driven by share losses in the cola category), we expect these challenges to subside over the longer term as the firm better allocates resources to its carbonated soft drink brands, which we estimate contribute less than one fourth of consolidated volume, and we reiterate our view of the firm's attractive positioning. Further, performance in the higher-margin snack business, where Pepsi enjoys a leading position with seven billion-dollar brands, remains solid. Frito-Lay North America, which generated one fourth of sales and more than 40% of operating profit in 2017, has averaged around 3% sales growth over the past five years, outpacing the recent flat to negative results across the U.S. packaged food industry. We expect performance in this business to remain robust as consumers' penchant for more convenient foods fuels snacking growth. Pepsi's formidable portfolio of leading beverage and snack brands, entrenched retail relationships, and economies of scale constitute meaningful competitive advantages, in our view. We believe management's renewed focus on protecting its share in the domestic carbonated soft drink space and driving innovation in the snack and noncarbonated beverage categories should help the firm defend its brand intangible assets and adapt to evolving consumer preferences. We expect the firm will maintain steady investments behind its brands, with annual advertising and research and development expenditures above 7% of sales annually, in line with its five-year historical average. Our long-term forecast incorporates 3% sales growth, with more than half of these gains driven by price/mix, and average operating margin in the high teens.
Procter & Gamble Co (PG)	We think the market is reluctant to believe Procter & Gamble can see sales growth of around 3%-4% annually over the next several years. However, we believe the benefits from the firm's enhanced focus (after culling more than 100 brands from its mix since 2014) will lead to increasing sales and volume growth and aid the brand intangible asset source underpinning its wide moat in the longer term. Now that its proxy battle with activist investor Nelson Peltz is in the rearview mirror, we believe management is poised to focus on ensuring the sustainability of its top-line improvement. Further, P&G is working to extract efficiency gains with its current $10 billion cost-saving initiative (which equates to a high teens percentage of its cost of goods sold and operating expenses, excluding depreciation and amortization) by reducing overhead, lowering material costs from product design and formulation efficiencies, and increasing manufacturing and marketing productivity. We think the combination of these initiatives will enable P&G to benefit from more targeted brand spending, enabling it to more effectively tap into and respond to evolving consumer trends, which we view as key in light of the ultracompetitive landscape and tepid growth prospects around the world. Overall, we think P&G's stock is attractively valued, trading at around a 10% discount to our valuation. Given this and an approximate 4% dividend yield, we think long-term investors would be wise to stock up on this wide-moat name.
Roche Holding AG (ROG)	We think the market underappreciates Roche's drug portfolio and industry-leading diagnostics that conspire to create sustainable competitive advantages. As the market leader in both 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. Also, Roche's biologics constitute three fourths of its pharmaceutical sales; biosimilar competitors have seen development setbacks while Roche's innovative pipeline could make these products less relevant by their launch.
Royal Dutch Shell PLC (RDS.B)	Shares of Best Idea Shell have performed well, as uncertainty around the safety of the dividend, integration of BG Group, and ability to achieve its 2020 free cash flow and return targets have faded. While the last few quarters have disappointed on cash flow, we do not see them as indicative of its long-term potential and think Shell is well on its way to achieving 2020 targets. Meanwhile, there remains further room for cost-cutting, upstream margin improvement, and reduced capital intensity that should ultimately improve free cash flow generation and drive the shares higher from here.

Company	Rationale
SCANA Corp (SCG)	Scana's decision to abandon its new nuclear plant construction in mid-2017 created political and regulatory headaches, but we think it has also created a favorable risk/reward trade-off for value investors. Dominion's acquisition offer provides more than 20% upside for Scana as of late September. We think the deal has a 75% chance of closing. On a stand-alone basis, Scana's core business is strong. Resolving the nuclear overhang should result in a revaluation of the stock in line with peers and our fair value estimate. With the market already pricing in a worst-case scenario, we think there's much more upside than downside.
Sodexo (SW)	We see Sodexo's March 29 profit warning and subsequent sell-off as an opportunity to build a position in this high-quality food-service giant. As one of only two global food-service providers in a highly fragmented market, Sodexo is well positioned to benefit from the outsourcing trend in developed markets in recent years. The company boasts client retention rates averaging 94% and has achieved positive organic revenue growth every year for the past decade.
Stericycle Inc (SRCL)	Stericycle had enjoyed a long history of high-single-digit organic growth and solid profitability, but by late 2016 it saw the emergence of headwinds that have plagued operating performance and investor sentiment. PSC and Shred-it were large acquisitions requiring significant and costly integration efforts, while making the firm a more complex organization. Shred-it added valuable ancillary services to the mix and is growing nicely, but PSC's industrial hazardous waste operations have weighed heavily on margins and returns on invested capital. Additionally, the firm is amid a painful pricing-reset period among small-quantity medical waste accounts. The consolidation of independent healthcare practices into larger hospital groups over the past decade has boosted these customers' bargaining power, and these blended accounts are now pushing back heavily on price as they grapple with their own budget constraints. Furthermore, visibility surrounding the class-action SQ customer lawsuit (settled last year) sparked pricing concession among independent doctor and dental practice accounts, as well. We still expect 30%-35% pricing headwinds among hospital-owned SQ customers and 10%-15% affecting independent doctor offices to progress through 2019 as contract renegotiations amortize in. Additionally, the firm will see heightened operating costs and capital outlays associated with its recently implemented multiyear business transformation, which includes a sizable ERP implementation. On the positive side, we expect the pricing concessions to abate as 2019 progresses and restructuring efforts should yield material network efficiency and sales-related benefits. We believe Stericycle's new internal investments, especially those focused on creating a cohesive IT infrastructure, are overdue and will help support our assumptions for midcycle organic revenue growth near 4% and 19.5% EBIT margins. Secular growth of patient admissions due to an aging population, a recurring revenue base subject to price escalators, and the ability to seamlessly offer healthcare customers cost-saving bundled service solutions are also key drivers of our midcycle revenue outlook. Admittedly, uncertainty surrounding our model assumptions is high and visibility is low, but the shares are trading at a healthy 20% discount to our fair value estimate. In our view, this offers an attractive margin of safety to patient investors willing to stomach near-term volatility.

Company	Rationale
Sun Hung Kai Properties Ltd (00016)	As the bellwether of the Hong Kong property sector, the shares of Sun Hung Kai Properties are affected by the city's residential market. As residential property buyers continued to move from the secondary market into the primary market, SHKP has been the main beneficiary of a very strong primary market recovery in 2017, driving the share price up more than 30%. During the first quarter of 2018, the share price retreated a bit along with the overall market. However, the primary market has remained steady with the company continuing to see strong demand for its residential projects. There is considerable market risk to the city's property market, especially considering higher interest rates, lower liquidity, and increasing supplies ahead. After multiple rounds of prudent measures, including higher risk weighing and lower loan/value ratios for new mortgages, the government is now turning to supply-side measures to tame a stubbornly high housing market. A new government task force has been formed to find ways to increase land supplies for residential housing development in the city. This opens the door for SHKP to replenish its land bank by the way of farmland conversion, which is subject to far less market risk. We continue to see value in the developer as its shares are trading at a 16% discount to our fair value estimate. We believe concerns about a potential decline in the Hong Kong residential market are priced into the stock as SHKP's exposure to the Hong Kong residential market will gradually decrease in the coming years. The percentage of earnings from Hong Kong residential property sales is expected to fall to 20% after fiscal 2018, while earnings from investment properties will account for 60% of the total. The investment property portfolio is underpinned by quality office and retail assets in Hong Kong. The office market in Hong Kong is very robust, due to strong demand from mainland firms setting up a presence in the city. On the retail side, the city's retail sales have continued to recover, up 2.2% over 2016. We expect the company's well-managed retail assets near larger catchments to see faster-than-average growth rates in retail sales. As the company scales back its capital expenditures in the Hong Kong residential sector, it will probably increase dividends or initiate share buybacks.
Telefonica SA (TEF)	Telefonica is leading the European communications market into converged services. Additionally, it is laying extensive amounts of fiber to better compete with cable operators in providing fixed broadband services. It acquired E-Plus in Germany and GVT in Brazil, which strengthens its position in both countries and provides lots of opportunities for cost savings. We don't believe the market appreciates how well the firm is positioned or its margin expansion opportunities, which have caused its stock to trade at a wide discount to our fair value estimate.
Telstra Corp Ltd (TLS)	Shares in narrow-moat Telstra are trading at an attractive discount to our fair value estimate, with investors preoccupied with a number of risks facing the group. First, competition is intensifying in Australian telecom across all segments. However, we believe Telstra boasts the strength to compete, given a sustainable cost advantage from unrivaled scale, infrastructure footprint, and consistent capital spending to maintain this competitive edge. Second, at the current price, the market is assuming that Telstra fails to plug the AUD 3 billion EBITDA hole from the National Broadband Network. This is an excessively bearish view, given the group's competitive position, its solid record of replacing lost earnings over the past decade, and the significant room for cost cuts/productivity gains. Our intrinsic assessment assumes that Telstra replaces more than AUD 2 billion of the NBN-inflicted earnings hole, mostly via self-help measures of cost cuts and productivity gains. Third, the entry of TPG Telecom as a fourth player in the Australian mobile market will reduce Telstra's dominance. However, we see the overall impact on group earnings as less than 10%, given the likely inferiority of TPG's network in terms of quality and coverage. This could well explain TPG's surprise August 2018 announcement to merger with Vodafone Australia. It is a deal that, if consummated, could return the Australian mobile market back to a three-player market, with positive implications for the sector and Telstra. Finally, we think our recently revised dividend estimates from fiscal 2019 are sustainable, providing investors with an attractive 5%-plus fully franked yield at current prices, especially with a conservative leverage ratio of less than 2 times. This provides Telstra with sufficient financial flexibility to fight for and retain customers in the current competitive telecom environment.

Company	Rationale
Tencent Holdings Ltd (00700)	We think Tencent has numerous growth opportunities behind our forecast 10-year revenue compound annual growth rate of 34% and our adjusted operating profit CAGR of 25%. We now expect value-added services revenue to increase at a 10-year CAGR of 25%, driven by higher monetization of mobile games, expansion of game genres, e-sports, and increased willingness to subscribe for content in China (number of subscriptions grew 19% year over year in the last quarter). Online advertising revenue is expected to see a 10-year CAGR of 26%, driven by continuous shift of marketing budgets to social media and video (in both of which Tencent has a stronghold), improving targeting technologies, and the gradual yet inevitable increase in ad inventories in the long term. We believe revenue of the other segment can grow at a 10-year CAGR of 58% on the back of rapid expansion in payment and cloud business (which grew in the triple-digits in the quarter) and online lending and wealth-management businesses. Expansion in the merchant network globally to serve outgoing Chinese customers will drive payment revenue, while the gradual migration to the cloud in China and the provision of artificial-intelligence-enabled cloud services will drive cloud revenue. We believe our gradually declining revenue growth assumptions--6% for VAS, 8.5% for online advertising, and 10% for other by 2026--are achievable.
The a2 Milk Co Ltd (ATM)	Shares in the a2 Milk Co. currently offer a sizable margin of safety versus our fair value estimate. We expect continued high growth and stellar returns on invested capital for the narrow-moat firm. While we see risk from its heavy exposure to Chinese infant formula demand, the potential for unfavorable scientific developments, reliance on a small number of suppliers, and intense competition from global dairy majors with vastly deeper pockets, we believe the current discount to our valuation more than compensates for these concerns. We forecast strong 20% annual earnings growth over the next 10 years, driven by a percentage point of market share gain annually, on average, in Chinese infant formula and further margin expansion. Moreover, we expect a2 Milk's solid brand positioning to support premium pricing for the firm's products, and the company's capital-light business model will generate triple-digit ROICs.
Total SA (TOT)	Total continues to presents a compelling value at this point even after outperforming peers for the past year. Production growth paired with significant cost improvements are set to drive value for Total in the next five years. Although aggressive production guidance should typically be taken with a grain of salt, we believe Total's 5% compound annual growth rate target through 2022 has merit, given the company's long list of projects under construction and awaiting approval. We expect margins to improve as Total takes an ax to its operating costs across its upstream and downstream businesses, lowering its cost structure. Finally, one of the lowest gearing ratios among its peers gives us confidence in Total's commitment to grow the dividend 10% by 2020 while repurchasing $5 billion worth of shares.
+ Vodafone Group PLC (VOD)	Vodafone is one of the largest wireless carriers in the world, with 275 million fully-controlled wireless subscribers and 530 million including joint ventures. While Vodafone has had issues in some countries, such as India and Italy, it is growing revenue in local-currency terms in most markets. Its reported revenue has been hurt by currency moves as the euro has strengthened against most of the currencies where it has operations. We think the stock has significantly oversold relative to the issues it has faced. In the meantime, the stock yields 7.9% while shareholders wait for a turnaround, and we believe the dividend is safe. The firm has been focused on moving from a wireless-only provider to a provider of converged services. Within Europe, fixed-line telecom services now accounts for about 30% of revenue. We expect fixed-line service revenue to continue to grow faster than wireless services, so this percentage should continue to increase. Fixed-line revenue also tends to be more stable. On the wireless side, Vodafone continues to transition customers to smartphones and 4G technology, both of which generally lead to higher data usage and higher revenue. We believe this trend will continue.

Company	Rationale
Walt Disney Co (DIS)	Walt Disney's shares appear cheap for a wide-moat firm that should increase earnings more than 8% annually over the next five years. We believe Disney owns the most attractive combination of content creation and distribution among the major media companies, as its media networks segment and collection of Disney-branded businesses have demonstrated strong pricing power through the past few years. In light of the recent discussions and concerns about content distribution migrating to over-the-top or subscription video on demand channels from pay TV, we believe the wide-moat firms with the best production studios, deep content libraries, and live programming rights will have the best chance to navigate these changes. Disney's media networks segment includes ESPN, the dominant player in U.S. sports entertainment; Disney Channel, one of two dominant cable networks for children; and ABC, one of the four national broadcast networks. On the production side, Disney boasts four movie studios with tremendous records (Disney Animation, Pixar, Marvel, and Lucasfilm) along with multiple TV studios, including ABC Studios. We believe the launch of the third Star Wars movie under the Disney brand and the one-year anniversary of the opening of Shanghai Disneyland have multiyear implications for the growth rate of Disney due to the additional Star Wars movies already planned, the launch of Star Wars parks in 2019, and the long-term potential of the Chinese market. Average annual sales growth of 5% during the next five years at parks and resorts will be driven by the continued expansion at Shanghai Disneyland and the opening of the Star Wars parks. We project 3% average annual growth for the filmed entertainment segment due to the addition of the Star Wars movies and the growth in television, subscription video on demand, and other distribution outlets. As a result, we forecast average revenue growth of 4% for Disney through fiscal 2022, with operating margin expanding to 27.5% in fiscal 2021 from an average of 25% over the past three fiscal years.
Welltower Inc (WELL)	The top healthcare real estate stands to disproportionately benefit from the Affordable Care Act. There is an increased focus on higher-quality care in lower-cost settings. The best owners and operators in the industry, which can provide better outcomes while driving greater efficiencies, should see demand funneled to them from the best healthcare systems. Additionally, the baby boomer generation is starting to enter its senior years, and the 80-and-older population, which spends more than 4 times on healthcare per capita than the national average, should almost double over the next 10 years. Welltower will benefit from these industry tailwinds because of its portfolio of high-quality assets connected to top operators in a diversified portfolio of senior housing, skilled nursing facilities, and medical office buildings. Welltower has also spent years forming and developing relationships with many of the top operators in each segment. These relationships allow Welltower to push revenue-enhancing initiatives and cost-control efficiencies at the property level, creating net operating income growth above the industry average, and provide a natural pipeline of acquisition and development opportunities to meet the needs of its growing partners. Welltower's management team is forward-thinking and should be able to create value by promoting best practices to produce strong internal growth and forming creative combinations across the healthcare spectrum to produce accretive external growth.
Westpac Banking Corp (WBC)	Wide-moat-rated Westpac Banking Corporation is our preferred Australian major bank because of its stronger earnings growth potential, superior operational efficiency, and impressive returns on equity. The firm has a good record of discipline around cost control and risk management. At current prices, the fiscal 2018 forecast dividend yield of 7% provides some valuation support. The stock is attractively priced, trading 25% below our AUD 35 fair value estimate. In the near term, net interest margins are supported by politically unpopular loan repricing to offset higher wholesale market funding costs. We expect lending growth to slowly ease to around 4% per year. Combined with broadly stable net interest margins and benign credit quality, we expect low-single-digit earnings per share growth during our forecast period. We forecast average dividend growth of 2% during the next five years, despite expecting the payout ratio to decline to 75% in fiscal 2022 from 78% in fiscal 2017. Capital levels continue to build, and we anticipate no problems achieving the regulator's definition of "unquestionably strong" by the January 2020 deadline. In the medium term, we expect modest economic growth in Australia continuing to support favorable operating conditions for the major banks. Forecast nominal GDP growth around 5% per year underpins our credit growth assumptions. Low unemployment levels and continued low official interest rates should keep loan losses subdued, despite softening house prices.

Company	Rationale
Woodside Petroleum Ltd (WPL)	Woodside Petroleum shares remain materially undervalued; we think the market is insufficiently pricing for liquefied natural gas growth potential. At the current share price, the 2018 dividend equates to a fully franked 5.0% yield in a company with no shortage of healthy growth prospects. Woodside's production target of 100 million barrels of oil equivalent for 2020 is in line with our own, a 20% increase on 2017's 84 mmboe before forecast growth to 130 mmboe from 2024, with a second Pluto LNG train contributing. Our group fair value estimate equates to an unchanged fiscal 2027 enterprise value/EBITDA of 10.6, crediting a 10-year revenue compound annual growth rate of 7.4% to $8.0 billion, including the oil price declining 17% to our unchanged midcycle forecast of $60 per barrel (2021 real).
WPP PLC (WPP)	WPP, the world's largest ad holding company, is on our Best Ideas list, as we think the stock's decline due to disappointing 2018 results and the resignation of CEO Martin Sorrell earlier in the year has created an attractive entry point for this narrow-moat name. The shares are trading at a discount to our GBX 1,450 fair value estimate. The ADR, which represents a 1:5 ratio, is valued at $93. At current levels, WPP's dividend yields 7%. On Sept. 3, 2018, the firm announced the appointment of Mark Read as its CEO, ending uncertainty that had surrounded the leadership of the company for months after Sorrell's departure. We think the decision indicated some steadiness for WPP as Read is a veteran of the firm having been there for over 15 years. At the same time, we believe Read will instill more of the necessary technology-driven creative thinking into the company as he was also the CEO of WPP's Wunderman, which is one of WPP's strongest digital agencies, utilizing data to add more value to and enhance the effectiveness of the agency's creativity. Before becoming WPP's CEO, Read served as WPP's co-COO for five months (after the departure of Sir Martin Sorrell in April). We remain bullish on the stock for a few reasons. First, we continue to rate WPP with a narrow moat as its brand equity and the strong reputations of its ad agencies are based on the quality of services and not necessarily Sorrell's leadership. We are confident that the brand equity of WPP and its agencies remains strong, while organic growth numbers have been disappointing, we might see improvement during the next one to two years as indicated by WPP's year-to-date big account wins and losses. Based on the firm's 2018 first three quarters numbers and our estimates, the wins represented around 34% more advertising billing than the losses. Second, with new leadership, the firm may implement some strategies a bit more quickly. They include possible sales of some of its assets such as the custom research side of the data investment management business and more aggressive integration of creativity and media with data analytics. We note that while WPP is still working on this integration, its peers have had at least a 24-month head start. Last, although WPP is losing some market share, we think down the road, after successfully integrating its platforms, the firm will have a chance to regain some share during additional account reviews and opportunities. We note that the top ad holding firms (including Omnicom, Publicis, IPG, and the largest, WPP) continue to be the main ones pitching to the biggest advertisers.

+ = Recently Added

Recent Removals Rationale

Company	Rationale
Mitsubishi UFJ Financial Group Inc (8306)	We are removing Mitsubishi UFJ Financial Group from the Best Ideas list after a change in covering analyst. We will consider an additional financial services Best Idea at a later date.
MYOB Group Ltd (MYO)	We have removed narrow-moat-rated MYOB from our Best Ideas list on valuation grounds, as we see more attractive opportunities elsewhere. Following a AUD 3.70 per share takeover bid from private equity firm KKR, the share price discount to our fair value estimate has tightened materially. We believe the bid is fair and has a strong chance of succeeding, considering KKR has already bought 19.9% of MYOB's shares, something it would only have done if it had high confidence of the support of other shareholders for the bid. Aside from the bid, we continue to expect MYOB to generate strong revenue and EPS growth, driven by strong sales of its cloud accounting software, and we maintain our AUD 3.82 fair value estimate. MYOB unfairly remains in Xero's shadow in the eyes of investors as its New Zealand-based competitor has grown more quickly, albeit off a low base, and is building a global business in contrast to MYOB's regional business. We applaud management's connected practice strategy, which essentially means creating a platform across which businesses, customers, advisors, and regulators can interact. Features such as Pay Super, PayDirect, and smart bills are also increasing customer switching costs--the source of the company's economic moat--and retention rates. The Paycorp acquisition in particular significantly increases MYOB's total addressable market and provides a relatively straightforward and logical cross-sell to existing clients.
Ramsay Health Care Ltd (RHC)	We have removed narrow-moat-rated Ramsay Health Care from our Best Ideas list following our recent fair value estimate downgrade, as we see more attractive opportunities elsewhere. Although we continue to believe the shares are undervalued, we've become increasingly concerned about weaker long-term earnings growth due to increasingly challenging regulatory environments in Ramsay's main markets in Australia, France, and the United Kingdom, and we believe a larger margin of safety is now warranted. We believe the eagerness with which the company acquired Swedish hospital operator Capio points to revenue growth challenges in other areas of the group to some degree, supporting our thesis. We also have growing concerns regarding the balance sheet. Although Ramsay's balance sheet is in reasonable shape, it is vulnerable to a deterioration in earnings, given sizable operating lease obligations. Net debt was AUD 3.2 billion at June 30 on a fully consolidated basis, which implies a reasonable net debt/EBITDA ratio of 2.3 and EBIT/interest coverage of 9. However, metrics look worse on a lease-adjusted basis, with net debt/EBITDAR of 3.8 and EBITR/interest plus rent of 2.3. We expect the Capio acquisition to increase fully consolidated net debt by AUD 1.4 billion, which will stretch the net debt/EBITDA ratio to 3.2 and reduce the EBIT/interest coverage to 7.6. Although the interest coverage ratio is satisfactory currently, it depends on low interest rates to a certain degree. If the already weak revenue outlook deteriorates further, the fixed-cost nature of the operating leases could cause the relatively high net debt/EBITDA ratio to become an issue.

Reckitt Benckiser Group PLC (RB.)	We are removing RB from the Best Ideas list following sector outperformance, the emergence of a new operational issue in the third quarter, and the opportunity to find greater value elsewhere. Since we added RB to the Best Ideas list in March, its stock has increased by over 10% versus a modest pullback in the sector. The S&P 1,200 Global Consumer Staples Index is down by over 1% during the same period. We still think there is upside to RB, and we continue to believe in the company's wide economic moat. We think that RB is on the right path to delivering strong shareholder returns in the long term and that the Mead Johnson acquisition will deliver price/mix at an above-industry average. However, the revelation in the third-quarter results release of yet another operational hiccup, this time at an infant formula manufacturing facility in the Netherlands, may make the upside harder to achieve. After several missteps over the last few years, including failed innovation in footcare and a cyberattack that disrupted operations last year, we think management is on a yellow card and must prove that its cost-cutting strategies are not cutting into the muscle of the business.
Royal Philips NV (PHIA)	We are removing Royal Philips from the Best Ideas List due to a change of analyst.
Synaptics Inc (SYNA)	We are removing Synaptics from the Best Ideas list. While shares continue to trade at an attractive margin of safety, we think the recent sell-off in the semiconductor space has created superior opportunities in firms with stronger economic moats. The firm recently announced it will be restructuring its optical fingerprint business for the mobile market. We had previously been positive on the firm's in-display fingerprint sensors, particularly as original equipment manufacturers increasingly make devices with end-to-end displays. However, many of these infinity display smartphones have placed the fingerprint sensor on the back of the phone (or completely eliminated it as in the Apple iPhone X with Face ID). Though Synaptics' in-display solution would have allowed for a slimmer and more elegant design, the high costs involved have prevented the broad adoption management had been anticipating. Consequently, management felt the optical fingerprint market wasn't a sticky or highly differentiated one and would be prone to harsh pricing erosion. We foresee the firm doubling down in opportunities for advanced touch and display controllers (OLED) and consumer Internet of Things devices.

Research Methodology for Valuing Companies

Components of Our Methodology

- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

We believe 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 and the current market price. This process ultimately culminates in our single-point star rating. Underlying this rating is a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's
equity analysts.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our actual calculation of our fair value estimates. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns on invested capital over at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. The assumptions that we make about a firm's economic moat play a vital role in determining the length of "economic outperformance" that we assume in the terminal sections of our valuation model. To assess the sustainability of excess profits, analysts perform ongoing assessments of what we call the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model— where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from one year (for companies with no economic moat) to 10-15 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard perpetuity formula. In deciding on the rate at which to discount future cash flows, we use a building block approach,

Morningstar Research Methodology for Valuing Companies

Source: Morningstar, Inc.

Research Methodology for Valuing Companies

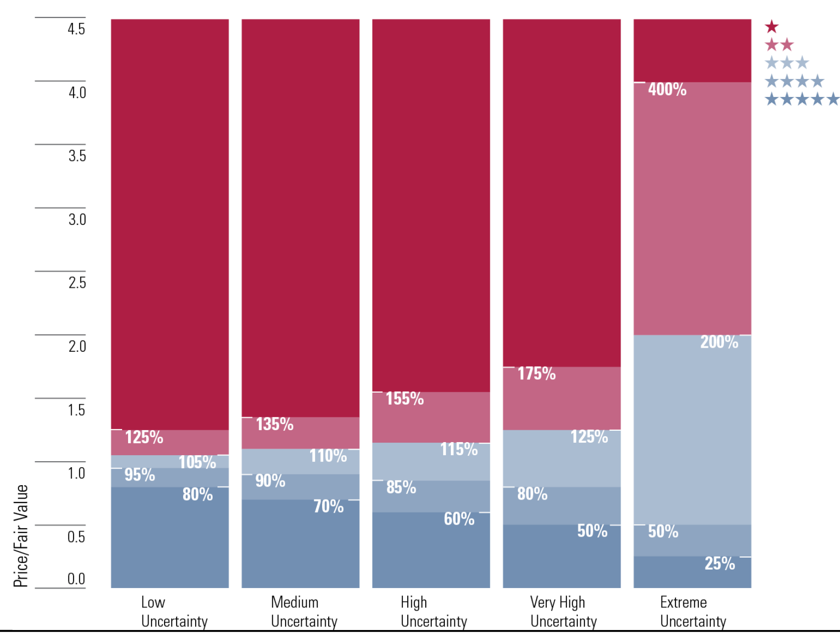
which takes into account expectations for marketreal return, inflation, country risk premia, corporate credit spread, and any additional systematic risk.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts model three scenarios for each company we cover, stresstesting the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of likely potential fair values and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The 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, and other company-specific factors.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Equity Research Star Rating Methodology



Global Equity Research Disclosure

This Report has not been made available to the issuer of the relevant financial products prior to publication.

The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value. Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate, and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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