

# Stock Investor Reader's Guide

Welcome to *Morningstar StockInvestor*.

Our mission is to give you an unbiased opinion on stocks, without all the hype. Instead of focusing on short-term market trends or simplistic buy/sell ratings, we devote our energies to finding good stocks to hold for the long term—embodied in our Select List—along with tips on how to put fundamental stock analysis to work for you.

Our Reader's Guide explains every data point we present, with particular focus on our proprietary measures: Morningstar stock grades, the stock types, and our unique business-appraisal stock-valuation system. We also include links to more detailed definitions.

We encourage you to take your research even further with [www.morningstar.net](http://www.morningstar.net). Monitor your portfolio and our Select List, while catching up on the latest news and analyses of your stocks. Talk with us and other investors about *Morningstar StockInvestor* stories, individual stocks, or your portfolio—24 hours a day, seven days a week. We look forward to hearing from you.

Sincerely,

Haywood Kelly  
Editor

## Data Features

|                               |                | Growth     |                  |               |                   |               |                   | Profitability and Financial Health |                           |                       |                           |                       |                                |      |
|-------------------------------|----------------|------------|------------------|---------------|-------------------|---------------|-------------------|------------------------------------|---------------------------|-----------------------|---------------------------|-----------------------|--------------------------------|------|
|                               |                | Stock Type | Growth Grade A-F | Sales         |                   |               | Profits           |                                    | Return on Capital         |                       |                           |                       | Free Cash Flow 3Yr Avg (\$Mil) |      |
| Industry                      | Sales (\$Mil)  |            |                  | 1 Yr Growth % | 3 Yr Avg Growth % | 1 Yr Growth % | 3 Yr Avg Growth % | Profit Grade A-F                   | Return On Equity Current% | Return On Equity Avg% | Return On Assets Current% | Return On Assets Avg% |                                |      |
| 1                             | 2              | 3          | 4                | 5             | 6                 | 7             | 8                 | 9                                  | 10                        | 11                    | 12                        | 13                    | 14                             | 15   |
| <b>Durables</b>               |                |            | —                | 53,613        | 3                 | 6             | -19               | 23                                 | —                         | 15.9                  | 13.2                      | 3.5                   | 3.0                            | —    |
| American Axle & Mfg Hldgs AXL | Truck Makers   |            | +                | 2,155         | -1                | 1             | —                 | NMF                                | -                         | 8.8                   | 46.9                      | 1.1                   | 4.9                            | -102 |
| ★Borg Warner Automotive BWA   | Auto Parts     |            | C+               | 1,923         | 8                 | 11            | -3                | 8                                  | -                         | 10.6                  | 11.6                      | 3.7                   | 4.9                            | ↓43  |
| Burlington Industries BUR     | Textiles       |            | -                | 1,822         | -12               | -3            | -100              | 8                                  | C                         | 0.4                   | 11.0                      | 0.2                   | 3.6                            | ↓60  |
| ★Columbia Sportswear COLM     | Apparel Makers |            |                  | 442           | 18                | 12            | NMF               | NMF                                |                           | 20.6                  | 36.6                      | 12.5                  | 19.3                           | ↓7   |

- 1 **Sector** We group stocks into 10 broad sectors: utilities, energy, financials, industrials, durables, staples, services, retail, health, and technology.
  - 2 **Industry** The company's primary industry.
  - 3 **Stock Type** Morningstar's type categories distinguish companies by where they are in their economic life cycles or by the underlying economic force driving their earnings. The eight Morningstar stock types are:
    - Aggressive Growth** These are companies whose revenues and earnings have both been growing significantly faster than the general economy.
    - Classic Growth** These companies are growing re-spectably faster than the general economy, and often pay a steady dividend. They tend to be mature and solidly profitable businesses.
    - Slow Growth** These companies have shown slow revenue and earnings growth (typically less than the rate of GDP growth) over at least three years.
    - Speculative Growth** These companies have shown strong revenue growth but slower or spotty earnings growth. Very small or young companies also tend to fall into this class.
    - Cyclical** This type includes companies in the cyclicals and durables sectors, except those in the three types below. The profits of cyclicals tend to rise and fall with the general economy.
    - Distressed** These companies have had consistently declining cash flows and earnings over the past three years, and/or very high debt.
    - Hard Asset** These companies deal in assets such as oil, metals, and real estate, which tend to do well in inflationary environments.
  - 4 **High Yield** These companies have dividend yields at least twice the average for large-cap stocks. They tend to be mature, slow-growing companies.
  - 4 **Growth Grade** Shows how well the company's growth compares with its sector. (See back page.)
  - 5 **Sales** Total sales over the most recent 12 months (or the most recent fiscal year, for financials), in millions of dollars.
  - 6 **Sales 1 Yr Growth %** The percentage change in the company's sales over the past 12 months compared to the previous 12 months.
  - 7 **Sales 3 Yr Avg Growth %** The annualized percentage change in the company's sales over the past three years.
  - 8 **Profits 1 Yr Growth %** The percentage change in the company's earnings per share over the past 12 months compared to the previous 12 months.
  - 9 **Profits 3 Yr Avg Growth %** The average percentage change in the company's earnings per share over the past three years.
  - 10 **Profit Grade** Shows how the company's profitability compares with its sector. (See back page.)
- Return on Capital** We focus on two measures: return on equity and return on assets.
- 11 **Return on Equity Current %** Net income divided by net worth, expressed as a percentage. ROE is the product of profit margin, sales/assets, and debt leverage; it measures how efficiently a company uses shareholders' equity to generate profits.
  - 12 **Return on Equity Avg %** The company's average return on equity over the past five years.

Stock Performance

Valuation

| Financial Health Grade A-F | Return on Equity Breakdown |              |               |                    | Total Return %           |               |                     |                     |                 | Dividend Yield% | Valuation Grade A-F | 6-30-99 Stock Price(\$) | Business Appraisal |           |                    | Price Multiples        |            |              |    |
|----------------------------|----------------------------|--------------|---------------|--------------------|--------------------------|---------------|---------------------|---------------------|-----------------|-----------------|---------------------|-------------------------|--------------------|-----------|--------------------|------------------------|------------|--------------|----|
|                            | Profit Margin              | Sales/Assets | Debt Leverage | Year To Date Stock | Year To Date +/- S&P 500 | 3Yr Avg Stock | 3Yr Avg +/- S&P 500 | Appraisal/Share(\$) | Appraisal Ratio |                 |                     |                         | Predictability     | Style Box | Market Cap (\$Mil) | Forward Price/Earnings | Price/Book | Cash Return% |    |
|                            |                            |              |               |                    |                          |               |                     |                     |                 |                 |                     |                         |                    |           |                    |                        |            |              | 16 |
| —                          | —                          | —            | —             | 11.0               | 4.6                      | 1.5           | -25.5               | 0.4                 | —               | —               | —                   | 0.78                    | —                  | 41,377    | 17.2               | 2.68                   | 6.0        |              |    |
| ●                          | -Avg                       | +Avg         | High          | —                  | —                        | —             | —                   | 0.0                 | C+              | 15.06           | 24.50               | 1.63                    | ●                  | 594       | 7.5                | 3.37                   | -11.7      |              |    |
| ●                          | +Avg                       | Low          | +Avg          | -0.6               | -7.0                     | 13.2          | -13.7               | 1.1                 | ●               | 55.19           | 76.52               | 1.38                    | ●                  | 1,474     | 11.0               | 1.55                   | 6.0        |              |    |
| ●                          | -Avg                       | -Avg         | +Avg          | -23.0              | -29.5                    | -15.4         | -42.3               | 0.0                 | ●               | 8.56            | 18.94               | 2.15                    | ●                  | 452       | 15.3               | 0.72                   | 10.6       |              |    |
| C+                         | High                       | +Avg         | -Avg          | -17.0              | -23.5                    | —             | —                   | 0.0                 | ●               | 14.00           | 19.09               | 1.36                    | ●                  | 354       | 11.9               | 2.36                   | 5.1        |              |    |

**13 Return on Assets Current %** Net income divided by assets, expressed as a percentage.

**14 Return on Assets Avg %** The company's average return on assets over the past five years.

**15 Free Cash Flow 3 Yr Avg** Free cash flow is the cash the company generates from its operations, less what it spends to maintain those operations. We give each company's average free cash flow over the past three years, and show (with arrows) whether those free cash flows have risen or fallen.

**16 Financial Health Grade** Shows how the company's financial health compares with its sector. (See back page.)

**Return on Equity Breakdown** The following three elements, multiplied together, give return on equity. Instead of giving raw numbers, we show how each company compares within its sector: High, +Avg, Avg, -Avg, or Low.

**17 Profit Margin** The percentage of profit a company makes on its sales, equal to net income divided by sales. The higher the better.

**18 Sales/Assets** Revenue divided by total assets; also known as asset turnover. Higher is better.

**19 Debt Leverage** Total assets divided by net worth. The lower the better.

**20 Total Return % Year to Date Stock** The percentage the stock has returned since the beginning of the year, including capital gains and dividends.

**21 Total Return % Year to Date +/- S&P 500** The stock's total return compared to that of the S&P 500 since the beginning of the year. A positive number means the stock has beaten the S&P 500; a negative one means it has lagged the benchmark.

**22 Total Return % 3 Yr Avg Stock** The stock's annualized total return over the past three years.

**23 Total Return % 3 Yr Avg +/- S&P 500** The stock's annualized total return over the past three years compared with that of the S&P 500.

**24 Dividend Yield** Dividends per share divided by current price, expressed as a percentage.

**25 Valuation Grade** Shows how the stock's valuation compares with its sector. (See back page.)

**26 Stock Price (\$)** The stock's closing price on the date shown.

**27 Appraisal/Share (\$)** Our estimate of the stock's fair value. (See back page.)

**28 Appraisal Ratio:** Appraisal/share divided by stock price. (See back page.)

**29 Predictability:** A measure of how reliable our estimate of the stock's appraisal/share is.

**30 Style Box** See the back page of this guide.

**31 Market Cap** The total market value of the company's stock, figured by multiplying price by total number of shares outstanding.

**32 Forward Price/Earnings** The stock's current price divided by the average consensus estimates of earnings per share for the current fiscal year.

**33 Price/Book** The stock's current price divided by book value (net worth) per share.

**34 Cash Return %** Free cash flow divided by market cap plus net debt (long-term debt minus cash). This number shows the percentage a company earns on its total market value.

## Valuation Tools from Morningstar

### Style Box

The Morningstar style box displays a stock's market capitalization in relation to its price multiples.

Along the vertical axis, we categorize stocks by market capitalization. The 250 largest stocks in the U.S. market by market cap are large caps, the next 750 by market cap are medium caps, and any smaller stocks are small caps.

Along the horizontal axis, each stock is categorized as value, growth, or blend. We add each stock's P/E ratio relative to its market-cap group and its price/book ratio relative to its market-cap group. Stocks with a combined relative P/E and price/book of less than 1.75 are considered value stocks; those with a combined figure of 1.75 to 2.25 are considered blends; and stocks with a combined figure greater than 2.25 are classified as growth stocks.

Morningstar also identifies a subset of small-cap stocks called micro-caps, consisting of stocks not included in the biggest 2,500 by market cap. Micro-cap stocks generally have market caps below \$300 million.

### The Business Appraisal Measure

Morningstar's business appraisal measure is an estimate of a stock's value based on the discounted value of its future profits. Our model takes a firm's book value and adds to it the firm's estimated future profits, based on analysts' estimates. We adjust these future profits downward, or discount them, to account for the riskiness of the business, as measured by the variability of the analysts' estimates.

This gives us an estimated fair value for the stock. Dividing this appraisal/share by the stock's actual price gives the appraisal ratio. A ratio higher than 1.0 indicates that the stock is potentially undervalued, while a ratio lower than 1.0 means that it's potentially overvalued.

All appraisal ratios are not the same, however. Such models are very sensitive to the inputs, and our values are only as good as the estimates we plug in. We know more about some stocks than others, and are more confident in the estimates for stocks for which we have a lot of information. The predictability measure accompa-

nying the business appraisal tells how reliable the appraisal/share is; stocks with low predictability tend to be more volatile than those with high predictability.

We go through several steps to generate the stock lists that appear in *Morningstar StockInvestor*. First, we separate out micro-cap stocks, weed out the troubled or unstable companies using a quality screen, and rank the survivors according to their appraisal ratios to form our Micro-caps list.

For the larger companies, we rank the stocks within each sector according to their appraisal ratio, giving greater weight to those with higher predictability ratings, and present those with the highest ratios in our Select list. Finally, the Blue Chips and Popular Stocks list presents the most popular larger stocks based on trading volume that don't make the Select list.

We generate all these lists based on the data, rather than our personal opinions of the stocks. When a stock drops off a list, that doesn't necessarily mean it's become a worse investment.

### Stock Grades

Each stock earns four grades, designed to measure how a stock stacks up against its sector peers in four key areas.

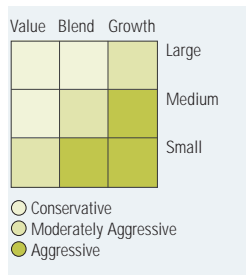
*Growth:* This grade measures not only how fast a company's sales have been growing, but how consistent this growth has been and whether it is speeding up or slowing down.

*Profitability:* This grade similarly measures a company's profitability, as measured by return on assets. It measures not only raw profitability, but whether a company's ROA is consistent and improving.

*Financial Health:* To get a high grade in this area, a company should have low financial leverage (assets/equity), high cash-flow coverage (total cash flow/long-term debt), and a high cash position (cash/assets). Also, companies with improving financial health are rewarded, while those with deteriorating health are punished.

*Valuation:* The first part of this grade is the appraisal ratio, adjusted downward for lower predictability levels. The second part is the average of the other three grades, the idea being that good companies are worth more. ■■

### Style Box



### Business Appraisal

#### Appraisal Ratio

> 1.0 = Undervalued  
< 1.0 = Overvalued

#### Predictability

- Highest Predictability
- High Predictability
- Medium Predictability
- Low Predictability
- Lowest Predictability