MORNINGSTAR®

American Capital, Ltd. ACAS [Nasdaq]

Morningstar Rating	Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship Grade	Industry	Sector
★★★	2.62	1.50	0.00	0.00	Extreme	None	D	Finance	Financial Services

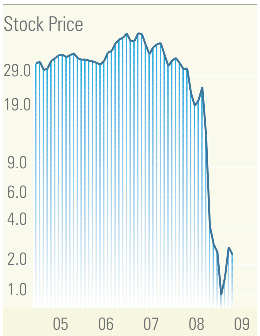
Per share prices in USD

American Capital Declares Dividend

by Jason Ren
Associate Stock Analyst
Analysts covering this company do not own its stock.

Pricing data through June 23, 2009.
Rating updated as of
June 23, 2009.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Jun. 11, 2009

American Capital has declared a dividend of $1.07 per share. The dividend effectively allows the company to keep its business development company status by paying out its remaining 2008 taxable income. Shareholders can choose to be paid in either cash or stock, but no more than 10% of the total dividends will be paid in cash. We believe this will be the only dividend of the year paid by the troubled company.

American Capital remains in default, and we believe there is still a substantial probability of financial distress. We are therefore leaving our fair value estimate unchanged. Generally, American Capital would be prohibited from distributing dividends given that it has broken its asset coverage ratios, but the Securities and Exchange Commission allowed for an exception this time, provided that no more than 10% of the dividend is paid in cash. We assign American Capital our highest fair value uncertainty rating.

Thesis Mar. 02, 2009

Like its other business-development company (BDC) brethren, there's a possibility American Capital may become distressed. The company's loan covenants will likely face further stress tests as mark-to-market accounting forces the company to pare down tangible net worth each quarter of the downturn. We have little clarity with regard to American Capital's ability to renew its credit lines. As such, we feel that any investment in American Capital is highly speculative until the market shows some semblance of broad recovery.

Public since 1997, American Capital is one of the largest BDCs. Although the company also has an asset management arm, American Capital primarily participates in backing private buyouts or expansions of middle-market companies. The company does this by investing in multiple levels of an investment's capital structure. American Capital harvests the fruits of its investment companies through interest income and gains on sales. Organized as a BDC, it used to pay out north of 90% of its taxable income to shareholders in the form of dividends. Prior to the market's downturn, this promise of dividends enabled the company to balloon its balance sheet by continually issuing new equity at above book value.

However, American Capital's financial health worsened in 2008. As a BDC, American Capital doesn't provision for potential losses. Rather, the company's balance sheet takes two hits; assets are marked to market, which cause unrealized depreciation to cut into tangible net worth, or shareholder's equity. Declining shareholders' equity forced the company to renegotiate a key $1.4 billion dollar revolving loan agreement in the third quarter of 2008. American Capital came back from its lenders with a reduced credit line that charged a higher interest rate. On shakier ground than before, the company also cut its dividend to preserve more equity.

The company broke its more-lenient covenants and also busted through the 200% asset coverage requirement in the fourth quarter. If its lenders pull the firm's revolving credit line, distressed asset sales may occur. If not, growth would still be difficult in a market like this. As a BDC, equity issuances are the main driver of growth given the restrictive leverage ceiling. Having shut off the dividend spigot to shareholders until the market improves, the appetite for new American Capital shares has disappeared, and might not return until a broad market recovery reverses the firm's unrealized depreciation. Although the company maintains a less-volatile asset management arm, we're unsure if income from that division can buoy the firm's health.

Valuation

We are paring down our fair value to $1.50 from $4.00 as we raise the company's chances of declaring Chapter 11. We now factor in a much higher percent chance of complete shareholder loss, as American Capital's

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
American Capital, Ltd.	USD	564	813	—	-2,849
Ares Capital Corporation	USD	734	244	132	-135
Allied Capital Corporation	USD	449	452	171	-1,347
Kohlberg Capital Corporation	USD	126	45	29	-12

Morningstar data as of June 23, 2009.

fourth-quarter results broke multiple debt covenants. We continue to weigh two scenarios in our projected dividend-discount model, with the difference being steeper markdowns and increased asset sales in our worse case. Collectively, we think the dividend could trend back to approximately $1.70 in five years with a growth rate of around 1%, provided that the firm can raise dilutive equity to shore up capital. We assume a 13.5% cost of equity in our valuation, and an 80% chance of complete shareholder loss, up from our previous 50% estimation. Our zero weighting is not 100% because we think its lenders could let American Capital's straggle on in the near-term, as interest revenues and gains on sales could probably cover expenses. We stress that there is an extreme amount of uncertainty surrounding our fair value estimate. We cannot accurately gauge the willingness of banks to lend to American Capital in this environment, nor can we assess its shareholders' appetite for dilution.

Risk

American Capital's main draw, fat dividends, won't be available to the company's shareholders as long as its equity needs more cushioning. That could be for a while longer as 14.5% of its loan book at face value is nonaccruing, and the company must mark its assets down to market value each quarter. Each declining quarter dices into the company's equity value and tests its loan covenants. If its lenders decide to call it quits, financial distress could occur.

Bulls Say

- Should American Capital's structured products keep performing, the company could realize significant gains on sales if liquidity for those investments return.
- The company's interest income and asset-management fees should cushion the firm against the volatility of gains and losses on the disposal of assets.

Bears Say

- The company broke through multiple debt covenants in the fourth quarter of 2008 and may have to declare Chapter 11 later this year. In our estimation, shareholders would be left with nothing should that occur.
- The company has suspended its dividend in an effort to shore up equity.
- American Capital has received permission to issue shares below net asset value (NAV), which would help it purchase the outstanding stock of one of its subsidiaries, European Capital. This could be significantly dilutive to current shareholders.
- The bulk of American Capital's assets are classified as Level III for accounting purposes, and there may be significant opacity with regard to management's valuations of its investments.

Financial Overview

Growth: Fed by increasing equity issuances, American Capital's balance sheet ballooned from $600 million to $11.7 billion from 2000 to 2007. A dilutive equity issuance may become necessary, if difficult for shareholders to stomach, for the firm's survival.

Profitability: American Capital's return on equity is going to remain depressed until more favorable market conditions come back.

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Financial Health: American Capital tripped multiple debt covenants in the fourth quarter, and we think its future will be determined by the grace of its lenders. Complete shareholder loss is probable should Chapter 11 be declared.

Company Overview

Profile: American Capital is a public private-equity firm, and funds middle-market companies for expansion and buyout purposes. The firm accomplishes this by investing in multiple levels of its investments' capital structure. American Capital has approximately $7.4 billion in investments at fair value, supported by a $3.2 billion equity cushion. The firm also maintains an alternative asset-management division, from which it collects fee income.

Strategy: Middle-market debt and equity instruments generate interest revenue and gains on sales for American Capital. The firm also oversees several alternative asset funds from which it obtains management fees.

Management: Malon Wilkus serves as both the chairman and CEO of American Capital. We'd rather have the positions split between two people to encourage a bit more oversight. There are other annoyances, as well. With regard to related-party transactions, Wilkus has a loan from the company worth $6.9 million. We also think that the firm could more clearly delineate its bonus performance metrics, which are somewhat vague. In a more recent development, management is asking its shareholders for permission to issue equity below net asset value. Although this could be necessary for the company's financial health, we note that it would likely come at a significantly dilutive cost to existing shareholders. The alternative doesn't look pretty. If capital-raising plans come to naught, and banks refuse to renegotiate lending lines, common shareholders could be left with nothing. We think management bears some responsibility for the specter of complete shareholder loss, and we are thus lowering American Capital's Stewardship Grade to a D.

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Analyst Notes

Jun. 11, 2009

American Capital Declares Dividend

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May 06, 2009

American Capital Posts 1Q Loss

Upon looking over American Capital's poor first-quarter performance, we're sticking with our fair value estimate. We continue to doubt the company's ability to return value to shareholders. In addition to depressed levels of earnings, the company remains in default on $2.3 billion of unsecured debt. We have little clarity on its lenders' appetite to renegotiate in this operating environment. In sum, we reiterate that an investment in American Capital is speculative given the depressed economy and the specter of a possible Chapter 11 filing.

The firm's net realized loss of $131 million and net unrealized depreciation of $492 million pared down the company's net asset value to $2.7 billion from $3.2 billion three months prior. Its debt/equity ratio now stands at 1.65:1, increasing slightly from 1.40:1 in the fourth quarter. This is despite American Capital's loan agreement with its unsecured lenders, which stipulates that debt cannot be in excess of equity. With continued stress in its investment portfolio, American Capital remains locked in negotiations with its lenders.

On the call, management was optimistic about its ability to come to some kind of agreement, noting that Chapter 11 is rare for companies that cover interest and continue to have shareholder value. Nonetheless, we note that the company's fundamentals have deteriorated significantly even after discounting the vagaries of mark-to-market accounting. American Capital's interest coverage stood at 2.2 times in the first quarter, while it had historically amounted to above 3 times. Additionally, 18.1% of the company's loans at face value are either past due or on nonaccrual, a 3.6 percentage point increase from the fourth quarter.

We also point out that American Capital intends to declare $300 million in dividends by June 15, which were rolled over from taxable income in 2008. Our view on this is tempered, as a recent IRS ruling allows up to 90% of dividends to be paid in stock. Should Chapter 11 become American Capital's end game, the company's stock would likely become worthless, making the stock dividend moot.

Mar. 02, 2009

American Capital Reports Weak 4Q

Depressed markets caused American Capital to bust

Analyst Notes (continued)

through multiple loan covenants in the fourth quarter, and we continue to doubt the company's ability to return value to shareholders. Indeed, we are paring down our fair value estimate as we think there's a reasonably high possibility of Chapter 11 being declared. With common equityholders last in line in case of reorganization, we stress that a common stock investment in American Capital is highly speculative and will remain so until signs of a broad market recovery.

A perfect storm of deteriorating credit quality and widening credit spreads sank American Capital operating results. $47 million in net realized losses and $1.7 billion in net unrealized depreciation caused the company's net asset value to tumble to $3.2 billion from $5.1 billion three months prior. This raised the company's debt/equity ratio to 1.4:1 from 0.90:1. Organized as a business development company, American Capital's debt generally cannot exceed its equity. Additionally, the equity value is also far below its previously renegotiated debt covenant requiring $4.5 billion of equity. This essentially places American Capital in default with its unsecured lenders. While the unsecured lenders cannot foreclose on assets, they can accelerate debt payments. Should lenders decide to accelerate payment demands beyond what is deemed capable, American Capital could declare Chapter 11.

It is very difficult for us to handicap the chances of bankruptcy occurring, but it looks like American Capital may have difficulty paying off its expenses without cash from asset sales. Past due and nonaccrual loans as a percentage of face value rose to 14.5% from 10.7% in the third quarter. That declining credit quality, combined with more-expensive funding costs per its previously renegotiated lending line caused net interest income to compress to $145 million in the fourth quarter from $201 million in the third quarter. Additionally, management's previous decision to suspend dividends has caused the company to be taxed $43 million at the corporate level. Without a significant decline in operating expenses, net operating income for the quarter declined to just $44 million, $109 million less than its results three months prior. That said, the company does have a slight safety valve in the sense that it can distribute 90% of its $296 million in undistributed dividends in the form of company stock, preserving cash. Overall, much of our thesis has been confirmed by American Capital's poor showing, and we continue to believe that the company's future depends on the grace of its lenders.

Feb. 19, 2009

American Capital Can Issue Shares below NAV

American Capital's shareholders have voted on and approved the company's measure to issue shares of common stock below net asset value. The number of shares issued will be limited to the amount necessary to complete American's acquisition of European Capital, plus an additional 42.8 million. We had already anticipated a dilutive equity-raising, so our fair value estimate is unchanged.

Disclaimers & Disclosures

No Morningstar employees are officers or directors of this company. Morningstar Inc. does not own more than 1% of the shares of this company. Analysts covering this company do not own its stock. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security.

American Capital, Ltd. ACAS

Sales Mil	Mkt Cap Mil	Industry	Sector
$813	$564	Finance	Financial Services

American Capital is a public private-equity firm, and funds middle-market companies for expansion and buyout purposes. The firm accomplishes this by investing in multiple levels of its investments' capital structure. American Capital has approximately $7.4 billion in investments at fair value, supported by a $3.2 billion equity cushion. The firm also maintains an alternative asset-management division, from which it collects fee income.

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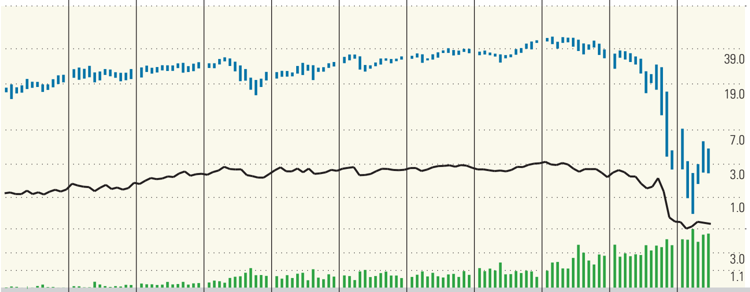
★★★	$2.62	$1.50	Extreme	None	D

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	YTD	
23.13	27.75	29.89	32.98	30.00	34.91	39.61	46.45	49.96	37.86	7.39	Annual Price High
14.00	19.81	21.88	15.17	20.75	24.70	29.51	29.65	32.36	2.77	0.58	Low
											Recent Splits



Price Volatility
Monthly High/Low
Rel Strength to S&P 500
52 week High/Low $
28.49 - 0.58
10 Year High/Low $
49.96 - 0.58
Bear-Market Rank
8 (10=worst)
Trading Volume Million

Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	-15.2	23.8	38.5	51.1
Operating Income %	-17.0	16.3	28.5	42.0
Earnings/Share %	—	—	—	—
Dividends %	-16.9	0.4	2.5	9.7
Book Value/Share %	-55.5	-16.9	-5.8	1.0
Stock Total Return %	-86.0	-30.3	-8.7	4.5
+/- Industry	-48.2	-3.9	7.4	11.4
+/- Market	-53.8	-19.8	-4.0	7.9

Stock Performance

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	YTD	
42.1	20.3	21.7	-14.8	50.6	22.0	17.8	37.0	-20.7	-80.8	-19.1	Total Return %
22.6	30.4	34.7	8.6	24.2	13.0	14.8	23.4	-24.2	-42.3	-18.0	+/- Market
11.5	20.2	33.0	2.8	21.5	15.0	18.5	31.5	14.7	-29.0	-37.7	+/- Industry
9.3	7.7	7.8	11.8	9.2	8.6	8.4	7.2	11.3	—	79.4	Dividend Yield %
253	625	1011	873	1699	2856	3939	6670	6188	670	564	Market Cap $Mil

Profitability Analysis

Grade: D	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	-68.0	0.5	-40.4	19.3
Return on Assets %	-32.7	0.8	-2.1	7.5
Revenue/Employee $K	2117.2	2217.3	408.4	929.5
Compensation Exp/Rev	—	—	—	—
Operating Margin %	—	55.6	6.1	16.7
Net Margin %	—	-0.9	-57.6	8.0
Free Cash Flow/Rev %	26.6	—	—	0.0

Financials

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	TTM	Financials
26	49	78	108	141	234	325	479	712	-220	-288	Net Interest Inc $Mil
7	4	16	25	47	65	51	470	106	1271	1101	Fee Income
25	45	72	103	141	259	314	425	594	493	—	Oper Income $Mil
97	-4	19	20	118	220	365	896	700	-3115	-2849	Net Income $Mil
6.80	-0.19	0.58	0.50	2.15	3.63	3.60	6.55	3.96	-15.29	-13.79	Earnings Per Share $
1.74	1.95	2.21	2.55	2.73	2.85	3.05	3.33	3.72	3.09	2.08	Dividends $
14	22	32	39	54	77	101	136	176	203	206	Shares Mil
28.07	17.93	17.95	17.00	20.58	21.87	26.64	30.12	34.31	15.26	12.32	Book Value Per Share $
395	615	904	1319	2042	3491	5449	8609	11732	7910	7211	Assets $Mil
312	445	640	688	1176	1872	2898	4342	6441	3155	2654	Total Equity $Mil
-62	-138	-176	-27	-370	-476	-660	-548	-1399	171	216	Free Cash Flow

Financial Position

Grade: D	12-08 $Mil	03-09 $Mil
Loans (Gross)	—	—
Less: Allowances	—	—
Net Loans	—	—
Securities	7427	6849
Trading Assets	—	—
Intangibles	—	—
Other	-10445	362
Total Assets	7910	7211
Deposits	—	—
Short-Term Debt	—	—
Long-Term Debt	4428	4377
Other	327	180
Total Liabilities	4755	4557
Preferred Stock	0	0
Total Equity	3155	2654

Profitability

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	TTM	Profitability
29.2	-0.9	2.5	1.8	7.0	8.0	8.2	12.8	6.9	-31.7	-32.7	Return on Assets %
41.9	-1.2	3.4	3.0	12.7	14.4	15.3	24.8	13.0	-64.9	-68.0	Return on Equity %
290.9	-7.0	17.9	13.6	57.2	65.5	65.8	104.2	56.5	—	—	Net Margin %
0.10	0.12	0.14	0.13	0.12	0.12	0.12	0.12	0.12	0.11	0.09	Asset Turnover
1.3	1.4	1.4	1.9	1.7	1.9	1.9	2.0	1.8	2.5	2.7	Financial Leverage

Financial Health

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	03-09	Financial Health
—	—	—	—	—	—	—	—	—	—	—	Net Loans $Mil
79	155	251	620	840	1561	2467	3926	4824	4428	4377	Long-Term Debt $Mil
—	—	—	—	—	—	—	—	—	—	—	Deposits $Mil

Valuation

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	TTM	Valuation
3.4	—	48.8	43.1	13.8	9.2	10.1	7.1	8.3	—	—	Price/Earnings
0.1	—	2.1	2.2	0.7	0.5	0.6	0.4	0.5	—	—	P/E vs. Market
9.7	8.3	8.7	5.8	7.9	7.7	6.2	6.9	4.7	0.6	0.7	Price/Sales
0.8	1.4	1.6	1.3	1.4	1.5	1.4	1.5	1.0	0.2	0.2	Price/Book

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	—	—	-3.5	14.5
Forward P/E	3.5	—	—	13.4
Price/Free Cash Flow	2.5	—	-6.7	15.2
Dividend Yield %	79.4	—	1.9	2.9
Price/Book	0.2	1.1	1.5	1.9
Price/Sales	0.7	5.2	2.1	0.9
PEG Ratio	0.6	—	—	1.9

Quarterly Results

Revenue $Mil	Jun 08	Sep 08	Dec 08	Mar 09
Most Recent Period	263.0	278.0	218.0	24.0
Prior Year Period	326.0	231.0	568.0	229.0

Rev Growth %	Jun 08	Sep 08	Dec 08	Mar 09
Most Recent Period	-19.3	20.4	-61.6	-89.5
Prior Year Period	53.7	0.1	132.8	-8.4

Earnings Per Share $	Jun 08	Sep 08	Dec 08	Mar 09
Most Recent Period	-0.34	-2.63	-8.23	-2.65
Prior Year Period	4.68	0.11	-1.54	-4.16

Industry Peers by Market Cap

	Mkt Cap $Mil	Rev $Mil	P/E	ROE%
American Capital, Lt	564	813	—	-68.0
Ares Capital Corpora	734	244	—	-12.3
Allied Capital Corpo	449	452	—	-64.2

Major Fund Holders

	% of shares
Vanguard Small Cap Index	1.07
Fidelity Diversified International	0.90
Vanguard Total Stock Mkt Idx	0.85

Morningstar's Approach to Rating Stocks

Our Key Investing Concepts

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such

Morningstar Research Methodology for Valuing Companies

Competitive Analysis → **Economic Moat™ Rating** → Company Valuation → **Fair Value Estimate** → Uncertainty Assessment → ★★★★★

Competitive Analysis: Analyst conducts company and industry research:

- Management interviews
- Conference calls
- Trade-show visits
- Competitor, supplier, distributor, and customer interviews

Economic Moat™ Rating: The depth of the firm's competitive advantage is rated:

- None
- Narrow
- Wide

Company Valuation: Analyst considers company financial statements and competitive position to forecast future cash flows.

Assumptions are input into a discounted cash-flow model.

Fair Value Estimate: DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework.

Uncertainty Assessment: An uncertainty assessment establishes the margin of safety required for the stock rating.

★★★★★:

★
★★
★★★
★★★★
★★★★★

The current stock price relative to fair value, adjusted for uncertainty, determines the rating.

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

We're big fans of companies that are low-cost producers, create high switching costs for their customers, or have strong brands or long-lasting patents, because all of these characteristics allow companies to protect their competitive position. For example, Tiffany is far more profitable than a run-of-the-mill jewelry chain because it has a strong brand that creates a moat around its business, allowing it to charge more than competitors.

Discounted Cash Flow
This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate
We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value
This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty
To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety
This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling
The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades
We evaluate the commitment to shareholders demonstrated by each firm's board and management team by assessing transparency, shareholder friendliness, incentives, and ownership. We aim to identify firms that provide investors with insufficient or potentially misleading financial information, seek to limit the power of minority shareholders, allow management to abuse its position, or which have management incentives that are not aligned with the interests of long-term shareholders. The grades are assigned on an absolute scale--not relative

to peers--and can be interpreted as follows: A means "Excellent," B means "Good," C means "Fair," D means "Poor," and F means "Very Poor."