International Moats

Among the more than 2,000 companies Morningstar's equity analysts cover worldwide, the best have economic moats—competitive advantages that will stand the test of time. These companies will keep competitors at bay for years, allowing them to earn excess returns. Morningstar gives most of these companies a narrow-moat rating. The best of the best earn a wide-moat rating.

The map shows where foreign companies that have Morningstar moat ratings are concentrated. The size of the blue circles indicates the number of firms in that country that have moats. (The exact number is listed.) For example, Canada is home to 50 companies with moats. The red interior circle corresponds with the number of wide-moat firms in that country. There are 267 international firms that have moats; 38 of these, listed in the table, possess wide moats. These firms are the highest-quality foreign companies that Morningstar covers. Only four wide-moat stocks—those with 4- or 5-star Morningstar Ratings—are considered undervalued. Most are fairly valued (they carry 3-star ratings) or overvalued (2-star ratings).

International Wide-Moat Companies

Company	Sector	Country	Morningstar Rating
ASX	Financial Services	Australia	★★★★
Brambles	Business Services	Australia	★★★
Telestra	Telecommunications	Australia	★★★★★
Westfield Group	Financial Services	Australia	★★★
Woolworth	Consumer Services	Australia	★★★★★
Anheuser-Busch InBev SA	Consumer Goods	Belgium	★★★
AmBev	Consumer Goods	Brazil	★★★
Bank of Montreal	Financial Services	Canada	★★★
Bank of Nova Scotia	Financial Services	Canada	★★
Canadian Imperial Bank of Commerce	Financial Services	Canada	★★★
CI Financial Corp	Financial Services	Canada	★★★
IGM Financial Inc.	Financial Services	Canada	★★★
Potash Corporation of Saskatchewan, Inc.	Industrial Materials	Canada	★★★
Ritchie Bros. Auctioneers, Inc.	Business Services	Canada	★★★
Royal Bank of Canada	Financial Services	Canada	★★★
Toronto-Dominion Bank	Financial Services	Canada	★★
Novo Nordisk A/S	Health Care	Denmark	★★★
Essilor International	Health Care	France	★★★
Dassault Systemes SA	Software	France	★★★
L'Oreal	Consumer Goods	France	★★
Sanofi-Aventis	Health Care	France	★★★
Central North Airport Group	Business Services	Mexico	★★★
Pacific Airport Group	Business Services	Mexico	★★
Southeast Airport Group	Business Services	Mexico	★★★
Svenska Handelsbanken	Financial Services	Sweden	★★★
Alcon, Inc.	Health Care	Switzerland	★★
Credit Suisse Group	Financial Services	Switzerland	★★★
Novartis AG	Health Care	Switzerland	★★★★★
Roche Holding AG	Health Care	Switzerland	★★★
UBS AG	Financial Services	Switzerland	★★★
AstraZeneca PLC	Health Care	United Kingdom	★★★
British American Tobacco PLC	Consumer Goods	United Kingdom	★★★
Cadbury PLC	Consumer Goods	United Kingdom	★★★
Diageo PLC	Consumer Goods	United Kingdom	★★★
GlaxoSmithKline PLC	Health Care	United Kingdom	★★★
HSBC Holdings PLC	Financial Services	United Kingdom	★★★
Imperial Tobacco Group PLC	Consumer Goods	United Kingdom	★★★
SABMiller PLC	Consumer Goods	United Kingdom	★★★

Get a complete list of all international wide- and narrow-moat stocks to keep on your radar at http://MorningstarAdvisor.com

Data and information as of Dec. 31, 2009.

U.S. Mutual Funds with High Exposure to Foreign Wide-Moat Companies

Dreyfus Worldwide Growth A PGROX
Solid core holding stuffed with consumer-goods firms, including global wide moats based abroad (L'Oreal, Diageo) and in the U.S. (Coca-Cola, Proctor & Gamble).

MFS Global Equity MWEFX
Fairly reserved global fund run by experienced management. Roche, Diageo, Canadian National Railway, among other wide moats, dot portfolio.

Mutual Global Discovery TEDIX
Deep-value strategy is a go-anywhere core holding. Wide-moats British American Tobacco, Imperial Tobacco, Cadbury in top 10 holdings.

Tweedy, Brown Value TWEBX
Consistent value strategy has big slug of consumer-goods firms, including wide-moat Diageo and narrow-moats Nestle and Heineken.

Van Kampen Global Franchise A VGFAX
Sound strategy invests in companies with dominant franchises. British American Tobacco and Imperial Tobacco are top two holdings.

Virtus Foreign Opportunities A JVIAX
Growth fund that has substantial portion of assets devoted to wide-moat tobacco firms. Also has stakes in European health-care wide moats Roche, Novo Nordisk, and Essilor.

market in the United Kingdom, and French fragrance champion L'Oreal.

Local Currencies and Other Challenges
As you see, investors often need to go abroad to gain access to the best companies. And while we use the same criteria for determining moats for international stocks as we do for U.S. companies, there are differences between the two of which investors need to be aware.

The first difference concerns currencies. Most foreign companies' stocks are quoted in their local currency, and they sell their products in a currency other than the U.S. dollar. This has several effects. First, the price of the firm's ADR will change with currency fluctuations versus its ordinary shares. Second, financial statements have translational differences at the end of the quarter or half year. (Many international companies only report full results twice per year, instead of the four times that U.S. companies report.) Finally, many international companies—and many U.S. companies—have operations outside of their own countries. These cause more translational issues when revenues in countries outside of the home country are converted into the local currency.

In our opinion, there will continue to be pressure on the dollar versus most currencies as a result of the United States' huge fiscal and current account deficits. We think having exposure to other currencies makes lots of sense for investors, so instead of viewing exposure to other currencies as a risk, we view exposure to many of them as a positive.

The other big issue with investing outside the United States is different economic and political conditions, especially in emerging markets. While almost the entire world has struggled over the past two years, many emerging-markets countries have suffered less and are recovering faster than the United States. We expect emerging-markets countries to continue to grow faster than the United States and think investors should have exposure to them. However, these markets tend to swing in and out of favor rapidly, so it is important to pay attention to valuation and have a margin of safety (and a moat) when investing. We currently think many emerging-stocks are overvalued.

Emerging markets also tend to be less stable politically than developed markets. A change in politics can throw a wrench in a firm's strategy. Instead of directly buying emerging-markets firms, investors without strong stomachs might be better off buying strong companies in developed markets that have operations in emerging markets.

Also, the information that companies outside the United States are required to disclose to the public varies from country to country, and even from company to company. It can be difficult for investors to get an accurate picture of what is happening at a company. This is when having a moat becomes very crucial. When disclosure is reduced, it is important to own companies that have competitive advantages that an investor can count on to help the firm succeed.

Four Great Wide-Moat Companies
Now let's look at some wide moats in greater detail. Two of our longstanding favorite international wide-moat firms are Novartis and Diageo. While these firms aren't as cheap as they used to be, their stocks have not run up in price as much as many others. We've recently picked up coverage of L'Oreal, a company we'd love to own if it ever becomes cheaper. Finally, British American Tobacco, like Diageo, is a nice indirect play on emerging markets.

Novartis
Not only is Switzerland's Novartis a leading branded-pharmaceutical company, but it is also the second-largest generic drug manufacturer and has a strong vaccine position and a consumer business. This diversification provides a reliable stream of revenues and cash flows. The company has one of the strongest pipelines of new drug candidates of the major firms. Many pharmaceutical firms have exited the vaccine business, leaving Novartis' vaccine business more profitable. Its H1N1 vaccine should be a big winner in 2010.

Diageo
Diageo's premium brands have been hurt during the recession as consumers traded down to cheaper brands. But the U.K. firm is still the best spirits company in the world. In addition to the strength of its brands, its global distribution is unrivaled. Morningstar's analysts expect that these features will lead to an improvement in the firm's returns as the economy comes back. Diageo's brands fill aspirational desires of greater wealth in many emerging markets. Analysts expect that emerging markets will be a key driver to Diageo's long-term growth, so Diageo is a great stock for conservative investors who want to gain exposure to risky countries.

L'Oreal
L'Oreal is the queen of the health and beauty industry. It has the largest market share and is a pure play on society's emphasis on beauty. During the recession, L'Oreal increased its exposure to low-cost consumer brands. It now has strong brands that cover the price spectrum, from Garnier at the low end to Giorgio Armani at the high end. Morningstar's analysts expect the company to continue to perform well.

British American Tobacco
Like Diageo, British American Tobacco is looking to emerging markets for its growth. Developed markets are seeing declines in smoking, but emerging markets are still growing and now account for about half of the firm's revenues. It owns several brands with global appeal, including Dunhill, Kent, and Lucky Strike in the premium sector and Pall Mall in the value sector. It also owns some strong local brands. The combination provides a nice way to play growth in emerging markets.

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