



# Moody's Corporation (MCO)

Updated June 14<sup>th</sup>, 2018 by Josh Arnold

## Key Metrics

<b>Current Price:</b> \$178	<b>5 Year CAGR Estimate:</b> 3.4%	<b>Quality Percentile:</b> N/A
<b>Fair Value Price:</b> \$139	<b>5 Year Growth Estimate:</b> 7.3%	<b>Momentum Percentile:</b> N/A
<b>% Fair Value:</b> 128%	<b>5 Year Valuation Multiple Estimate:</b> -4.9%	<b>Total Return Percentile:</b> N/A
<b>Dividend Yield:</b> 1.0%	<b>5 Year Price Target</b> \$197	<b>Valuation Percentile:</b> N/A

## Overview & Current Events

Moody's was created back in 1909, becoming the first company to analyze securities and rate their investment quality for investors on a large scale. Moody's began with its *Analyses of Railroad Investments* in 1909 and has blossomed into the company we know today, with \$4.7B in annual revenue and a market cap of more than \$34B.

The company's recent Q1 report was nothing short of stellar as it reported a revenue increase of 16% and adjusted earnings-per-share growth of 35%. Operating expenses rose sharply in Q1 but they were due mostly to costs associated with the Bureau Van Dijk acquisition in various forms. Apart from that, operating income was also favorably impacted by forex to the tune of 4% during the quarter as the company's global reach takes advantage of a relatively weak dollar. Indeed, non-US revenue grew 33% during Q1 and now makes up 47% of total revenue for Moody's. The company also reaffirmed its guidance for \$7.65 to \$7.85 in earnings-per-share for 2018.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$1.86	\$1.69	\$2.15	\$2.49	\$3.05	\$3.60	\$4.21	\$4.60	\$4.81	\$6.07	<b>\$7.75</b>	<b>\$11.00</b>
<b>DPS</b>	\$0.40	\$0.40	\$0.42	\$0.54	\$0.64	\$0.90	\$1.12	\$1.36	\$1.48	\$1.14	<b>\$1.76</b>	<b>\$2.24</b>

Moody's earnings-per-share history is quite strong as it has seen just one year in the past decade where its profits have dipped from the prior year. That occurred in 2009 at the height of the financial crisis but since that time, Moody's has seen tremendous earnings growth, averaging 15% per year. While we don't think that sort of performance is sustainable over the long term, we do see 7.3% earnings-per-share growth annually moving forward.

Moody's can achieve this result by continuing its long tradition of buying growth, as we saw late last year with the Bureau Van Dijk purchase, as well as a smaller amount of organic revenue growth. The company's operating costs have hampered earnings growth at times in the past as growing at rapid rates is expensive, and we believe this will continue to be the case moving forward. However, longer term tailwinds are in place for Moody's as it continues to feed seemingly insatiable investor demand for real-time analytical data on a wide variety of global securities. Keep in mind the core US business is growing very slowly and as such, Moody's relies almost entirely upon the global business for expansion, exposing it to currency risk over time as well. This year will see a significant boost in earnings-per-share from a lower tax rate – which fell from 23.4% to 14.6% in Q1 – but that tailwind will not reoccur after 2018.

We see the dividend as growing at roughly the same rate as earnings-per-share and thus, are forecasting a payout of \$2.24 in five years. Moody's hasn't shown the dividend to be a priority, as it is instead focused on growth.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	17.9	14.5	11.7	13.5	13.5	17.5	20.8	22.3	20.4	20.6	<b>23.0</b>	<b>17.9</b>
<b>Avg. Yld.</b>	1.2%	1.6%	1.7%	1.6%	1.6%	1.4%	1.3%	1.3%	1.5%	0.9%	<b>1.0%</b>	<b>1.1%</b>

The valuation for Moody's has moved around significantly in the past decade after hitting its nadir in 2010 at 11.7.

Today's price-to-earnings ratio of 23 is well in excess of what we see as fair value at 17.9, meaning that Moody's looks overvalued at present. That implies a meaningful 4.9% headwind to total returns as the valuation normalizes over time.

We also see the dividend yield as being maintained near 1% over time but Moody's is certainly not a pure income stock.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	71.9%	70.4%	70.2%	70.0%	70.9%	72.3%	72.1%	72.0%	71.5%	70.9%	<b>71.0%</b>	<b>71.0%</b>
Debt/A	156%	130%	112%	103%	88%	90%	99%	107%	119%	101%	<b>100%</b>	<b>95%</b>
Int. Cov.	19.4	20.4	14.7	14.6	17.2	13.8	13.6	13.1	5.1	10.6	<b>12.0</b>	<b>18.0</b>
Payout	21%	24%	20%	22%	22%	26%	23%	29%	30%	25%	<b>23%</b>	<b>20%</b>
Std. Dev.	53.1%	60.8%	36.3%	31.6%	23.9%	31.2%	15.5%	15.4%	24.7%	12.5%	<b>20.0%</b>	<b>27.5%</b>

Moody's has realized steady margins over time, something we don't think will change in the foreseeable future. With its gross margins in excess of 70% and adjusted operating margins nearing 50%, there is certainly nothing wrong with that. Moody's used to have significant leverage but has reduced it meaningfully over the last decade. Even with liabilities roughly equal to assets, interest coverage is superb and should continue to get better as earnings rise. Overall, Moody's is in fantastic shape financially and should be able to continue to grow moving forward.

MCO's competitive advantage is that it was the company that basically created the industry more than 100 years ago. Its recent acquisitions and internal product advancements have kept it relevant with data-hungry investors. Moody's product assortment is strong at a time when competition is tougher than ever and we think that will serve Moody's well during the next recession, which shouldn't crimp earnings unduly.

### Final Thoughts & Recommendation

Overall, Moody's looks like a strong growth story but one that is trading in excess of fair value. We are forecasting 3.4% in total annual returns moving forward, consisting of the 1.0% current yield, 7.3% earnings-per-share growth and a 4.9% headwind from a lower valuation. Moody's looks well-positioned for further growth but investors appear to have priced much of that growth into the stock, meaning that if prospective investors are interested in taking a position, waiting for a lower entry price seems the prudent course of action.

### Total Return Breakdown by Year

