# Morningstar, Inc. (MORN)

*Updated June 13th, 2018 by Josh Arnold*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $131 | **5 Year CAGR Estimate:** | 2.1% | **Quality Percentile:** | N/A |
| **Fair Value Price:** | $102 | **5 Year Growth Estimate:** | 6.1% | **Momentum Percentile:** | N/A |
| **% Fair Value:** | 128% | **5 Year Valuation Multiple Estimate:** | -4.8% | **Total Return Percentile:** | N/A |
| **Dividend Yield:** | 0.8% | **5 Year Price Target** | $138 | **Valuation Percentile:** | N/A |

## Overview & Current Events

Morningstar was founded in 1984 as a way for individual investors to seek information about hundreds of popular mutual funds that was out of reach prior to the company's Sourcebook product. Since that time Morningstar has grown tremendously, serving 9M clients today. The company has about $1B in annual revenue and a market cap of $5.6B.

The company's recently-reported Q1 was stellar as it saw revenue rise 16.2% YoY. More impressively, organic revenue was up 13.7%, driven in part by the company's PitchBook service, which is now part of the comparable base, having been acquired just over a year ago. Earnings-per-share more than doubled as the company saw a much lower tax rate as well as lower operating expenses as a percentage of revenue, driven by leverage from higher volume. Looking forward, MORN didn't begin to capitalize software development expenses for PitchBook until Q2 of last year, meaning the comparable base for expenses will be higher for the rest of the year, making earnings comparisons easier for 2018. In other words, MORN is seeing everything go the right direction as of now and it is being rewarded by the market.

## Growth on a Per-Share Basis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $1.88 | $1.66 | $1.70 | $1.92 | $2.10 | $2.66 | $2.54 | $3.00 | $3.72 | $2.88 | ***$3.80*** | ***$5.10*** |
| **DPS** | -- | -- | $0.05 | $0.25 | $0.53 | $0.38 | $0.70 | $0.79 | $0.88 | $0.92 | ***$1.00*** | ***$1.28*** |

MORN's earnings-per-share history is very strong considering the wide array of economic conditions that have existed in the past decade. The company saw a small dip in EPS at the height of the crisis in 2009 and there have been a couple of other small blips but on the whole, an average growth rate of 6% is robust. We see this level of growth continuing moving forward, and are therefore forecasting 6.1% EPS growth for the foreseeable future.

This year's numbers will be much better as MORN digests PitchBook and the revenue it brings, as well as a substantially lower tax rate compared to last year. However, those are one-time gains that won't be present after 2018 so growth should normalize in 2019 and beyond. Still, we think a small tailwind from a lower share count, low to mid-single digit revenue growth and a bit of margin growth potential make 6% EPS growth look feasible, pending whether or not MORN acquires more growth in the future. However, its long term revenue and EPS growth includes many acquisitions over time, so we see this estimate as including some additional M&A that hasn't occurred yet. MORN's position in its niche is well established and we see its future as very bright looking forward.

We think higher earnings will afford some additional dividend growth, although the payout isn't a priority for management. As a result, investors will see dividend growth roughly congruent to earnings growth in the coming years.

## Valuation Analysis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Now | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 31.6 | 25.0 | 27.5 | 30.3 | 28.7 | 27.7 | 28.2 | 25.8 | 21.4 | 28.1 | ***34.5*** | ***27.0*** |
| **Avg. Yld.** | -- | -- | 0.1% | 0.4% | 0.9% | 0.5% | 1.0% | 1.0% | 1.1% | 1.1% | ***0.8%*** | ***0.9%*** |

MORN's average price-to-earnings ratio has been very high in the past decade as its trough value was 21.4, set in 2016. Investors have always been willing to pay a premium for MORN and that isn't going to change. However, today's price-to-earnings ratio of 34.5 is well in excess of fair value, which we see as 27. That means MORN is likely to experience a sizable 4.8% headwind to total returns going forward as the valuation returns to more normalized levels. We see the yield as remaining roughly where it is today as the dividend keeps pace with earnings.

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

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **GP/A** | 74.2% | 73.1% | 71.8% | 62.8% | 62.5% | 61.2% | 58.1% | 58.1% | 56.9% | 57.6% | ***58.0%*** | ***59.0%*** |
| **Debt/A** | 33% | 28% | 28% | 27% | 30% | 33% | 35% | 38% | 48% | 43% | ***42%*** | ***40%*** |
| **Int. Cov.** | --- | --- | --- | --- | --- | --- | --- | --- | 121 | 31 | ***45*** | ***50*** |
| **Payout** | --- | --- | 3% | 10% | 25% | 14% | 27% | 25% | 24% | 32% | ***26%*** | ***25%*** |
| **Std. Dev.** | 51.2% | 40.2% | 23.6% | 16.3% | 13.9% | 17.8% | 15.9% | 18.2% | 18.7% | 13.5% | ***18.0%*** | ***22.9%*** |

MORN's quality metrics have been stable during the past decade as it has managed to grow without unduly stressing its financials. The company's margins should remain about where they are today with a bit of operating margin potential built in as it grows revenue over time, consistent with past performance. Its debt is very low as most of its liabilities are of the short term variety and thus, its interest coverage is superb. The payout ratio isn't likely to crest 30% anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying in the sub-1% range for the foreseeable future. Overall, MORN's financials are in terrific shape and we don't see that changing.

MORN's competitive advantage is in its long history and powerful brand among investors, as well as its impressive suite of digital products that keep it current and relevant in an ever-changing industry. MORN is certainly well-positioned moving forward and while the next recession will be painful, it shouldn't be a hugely negative event for earnings.

## Final Thoughts & Recommendation

Overall, we see MORN as a stock with a strong moat but also one that has had a major run, making it overvalued at present. The stock has roughly doubled in the past year and as such, we think investors should wait for a better entry point. That said, we are forecasting 2.1% total annual returns moving forward, consisting of the current 0.8% yield, 6.1% earnings-per-share growth and a 4.8% headwind from the valuation resetting. MORN's future is very bright but after a strong performance in 2017 and an even stronger one so far this year, shares look to be overvalued at present.

## Total Return Breakdown by Year