Moody's Corporation (MCO)

Updated July 27th, 2018 by Josh Arnold

Key Metrics

Current Price:	$178	**5 Year CAGR Estimate:**	3.4%	**Volatility Percentile:**	37.9%
Fair Value Price:	$139	**5 Year Growth Estimate:**	7.3%	**Momentum Percentile:**	88.3%
% Fair Value:	128%	**5 Year Valuation Multiple Estimate:**	-4.9%	**Valuation Percentile:**	13.8%
Dividend Yield:	1.0%	**5 Year Price Target**	$197	**Total Return Percentile:**	13.0%

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 $4.7 billion in annual revenue and a market capitalization of more than $34 billion.

Moody's reported Q2 earnings on 7/27/18 and results were characteristically strong. Revenue was up 17%, as was adjusted operating income. Half of the company's revenue increase was from the Bureau van Dijk acquisition and merger-related costs elevated expenses during Q2, keeping a lid on operating profits. Investors are accustomed to operating leverage from Moody's and we believe that will be the case again once Bureau van Dijk is fully integrated. A lower tax rate helped drive adjusted earnings-per-share up 32% in Q2 and the company also once again reaffirmed its guidance for $7.65 to $7.85 in earnings-per-share for 2018; our estimate therefore remains unchanged.

Growth on a Per-Share Basis

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

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. Since then, Moody's earnings growth has averaged 15% per year. While we do not believe that sort of performance is sustainable in the long run, we see 7.3% earnings-per-share growth 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 for the balance of 2018. 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 32.1% to 23.7% in Q2 – 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 business growth.

Valuation Analysis

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

The valuation for Moody's has moved around significantly in the past decade after hitting its lowest point in 2010 at 11.7. Today's price-to-earnings ratio of 23 is well above 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.

Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.

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%	***71.0%***	***71.0%***
Debt/A	156%	130%	112%	103%	88%	90%	99%	107%	119%	101%	***100%***	***95%***
Int. Cov.	19.4	20.4	14.7	14.6	17.2	13.8	13.6	13.1	5.1	10.6	***12.0***	***18.0***
Payout	21%	24%	20%	22%	22%	26%	23%	29%	30%	25%	***23%***	***20%***
Std. Dev.	53.1%	60.8%	36.3%	31.6%	23.9%	31.2%	15.5%	15.4%	24.7%	12.5%	***20.0%***	***27.5%***

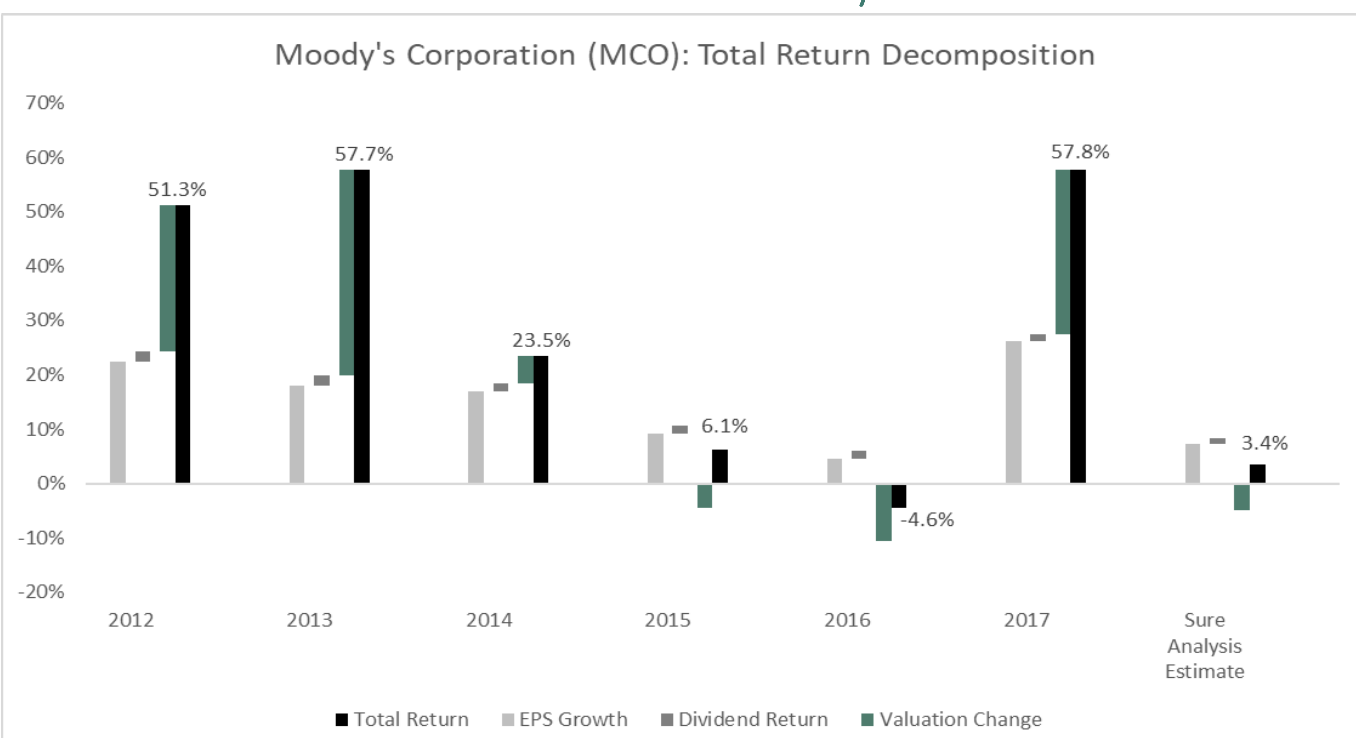
Moody's has realized steady margins over time, something we don't think will change in the foreseeable future. With its gross margins in excess of 70% and adjusted operating margins nearing 50%, there is certainly nothing wrong with that. Moody's used to have significant leverage but has reduced it meaningfully 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.

Moody'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. Indeed, the investor reaction from the Q2 report would suggest too much growth is priced into the stock at current levels. Moody's earns a sell recommendation from Sure Dividend at current prices, due entirely to its hard-to-stomach valuation.

Total Return Breakdown by Year



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