Morningstar, Inc. (MORN)

Updated July 27th, 2018 by Josh Arnold

Key Metrics

Current Price:	$135	**5 Year CAGR Estimate:**	2.0%	**Volatility Percentile:**	34.2%
Fair Value Price:	$105	**5 Year Growth Estimate:**	6.1%	**Momentum Percentile:**	96.6%
% Fair Value:	128%	**5 Year Valuation Multiple Estimate:**	-4.8%	**Valuation Percentile:**	19.5%
Dividend Yield:	0.7%	**5 Year Price Target**	$138	**Total Return Percentile:**	10.1%

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. It has about $1 billion in annual revenue and a market cap of $5.7 billion.

Morningstar's Q2 results were reported on 7/25/18 and results were once again outstanding. Revenue was up more than 10%, mostly driven by organic gains. Operating income rose 17% as Morningstar continues to see margin improvement from sales leverage. Morningstar continues to see broad-based gains in all of its business segments, led by its PitchBook product. The company did say its operating expenses would continue to grow this year, as they did in Q2, in order to fuel future growth. Overall, Morningstar's Q2 was another tremendous report with a lot of good news.

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***

Morningstar'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 earnings at the height of the crisis in 2009 and there have been a couple of other small blips, but it has managed an average growth rate of 6%. We see this level of growth continuing moving forward, and are therefore forecasting 6.1% earnings-per-share growth for the foreseeable future.

This year's numbers will be much better as Morningstar 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% earnings-per-share growth look feasible. This growth estimate is also dependent on the company's appetite for acquisitions moving forward. With that said, its long-term revenue and earnings growth includes many acquisitions over time, so we see this estimate as including some additional M&A that hasn't occurred yet. Morningstar's position in its niche is well established and we see its future as very bright looking forward.

From an income perspective, we expect dividend growth to be roughly equal 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%	***0.7%***	***0.9%***

Morningstar'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 this stock and that is not 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 it 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.

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	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%*

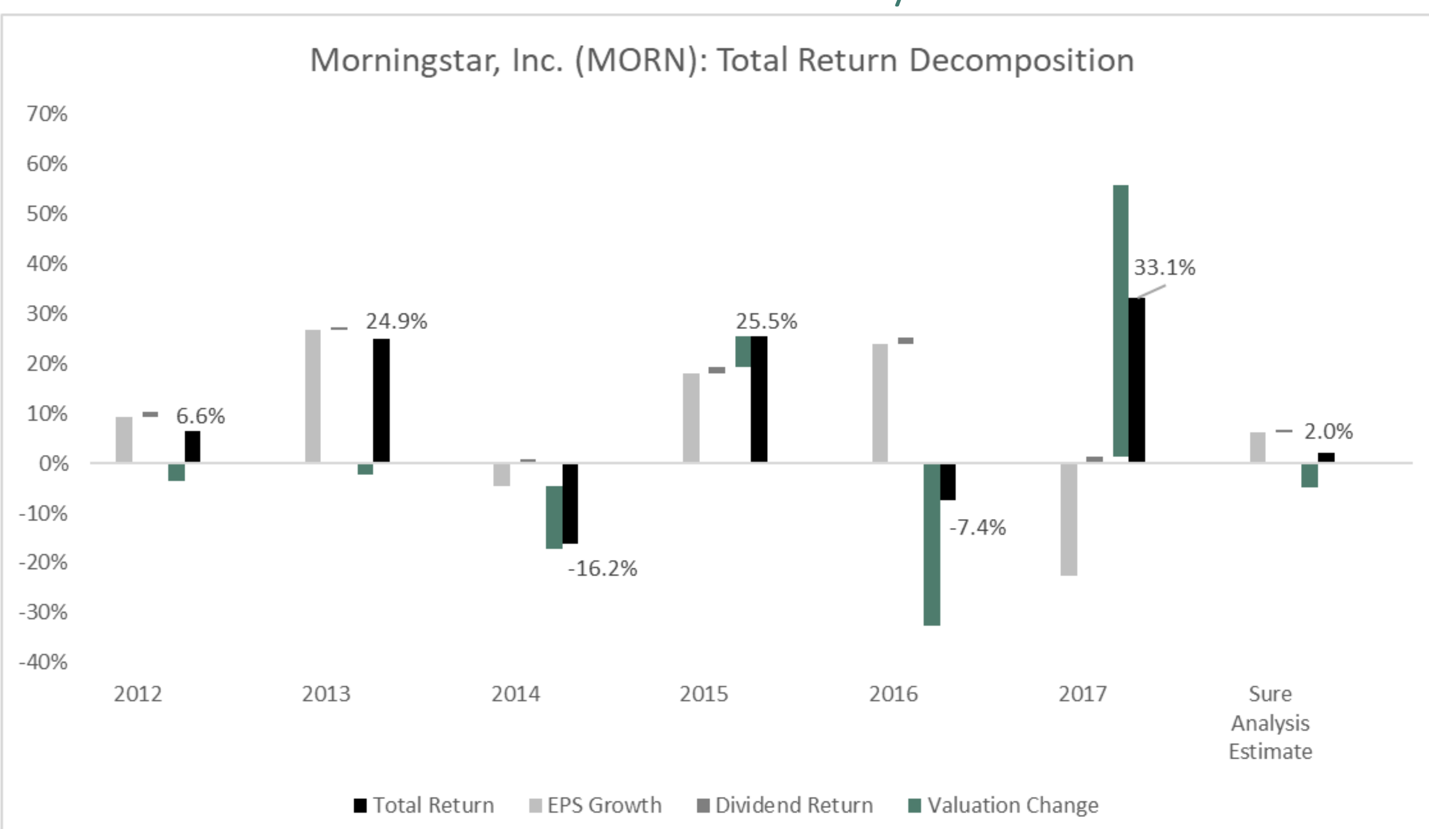
Morningstar's quality metrics have been stable during the past decade as it has managed to grow without unduly stressing its financials. The company's margins should remain about where they are today with a bit of operating margin potential built in as it grows revenue over time, consistent with past 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 is not 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, Morningstar's financials are in terrific shape and we don't see that changing.

Morningstar'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. Morningstar is 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 Morningstar 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 2.0% total annual returns moving forward, consisting of the current 0.7% yield, 6.1% earnings-per-share growth and a 4.8% headwind from the valuation resetting. Morningstar's future is very bright but after a strong performance in 2017 and an even better one so far this year, shares look to be overvalued at present.

Total Return Breakdown by Year



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