Morningstar, Inc. (MORN)

Updated October 26th, 2018 by Josh Arnold

Key Metrics

Current Price:	$131	**5 Year CAGR Estimate:**	4.4%	**Volatility Percentile:**	35.0%
Fair Value Price:	$116	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	98.2%
% Fair Value:	113%	**5 Year Valuation Multiple Estimate:**	-2.4%	**Growth Percentile:**	47.4%
Dividend Yield:	0.8%	**5 Year Price Target**	$155	**Valuation Percentile:**	27.9%
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Total Return Percentile:**	14.8%

Overview & Current Events

Morningstar was founded in 1984 as a way for 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 9 million clients today. It has about $1 billion in annual revenue and a market capitalization of $5.6 billion.

Morningstar reported Q3 earnings on 10/24/18 and the stock soared on the results. Revenue was up 14% on a reported and organic basis as the company continues to enjoy immense success from its PitchBook product. That product saw licenses jump 63% and revenue increase 52% year-over-year as it remains the key growth driver for Morningstar. Investment costs to support PitchBook and other platforms weighed on operating margins, as did higher compensation costs. But even so, earnings-per-share increased 67% year-over-year to $1.32. Morningstar continues to gain significant traction with its core products and we've boosted our earnings-per-share estimate for 2018 to $4.30 after Q3 results.

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	***$4.30***	***$5.75***
DPS	--	--	$0.05	$0.25	$0.53	$0.38	$0.70	$0.79	$0.88	$0.92	***$1.00***	***$1.28***
Shares	49	50	50	50	46	45	44	43	43	43	***43***	***42***

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 6.0% earnings-per-share growth for the coming years.

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. Indeed, the enormous gains in earnings seen in Q3 are not repeatable for this reason. 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 has not occurred yet. Morningstar's position in its niche is well established and we see its future as very bright looking forward.

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	***30.5***	***27.0***
Avg. Yld.	--	--	0.1%	0.4%	0.9%	0.5%	1.0%	1.0%	1.1%	1.1%	***0.8%***	***0.9%***

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 30.5 is in excess of fair value, which we see as 27. That means it is likely to experience a modest 2.4% headwind to total returns 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; Morningstar is not an income stock.

Safety, Quality, Competitive Advantage, & Recession Resiliency

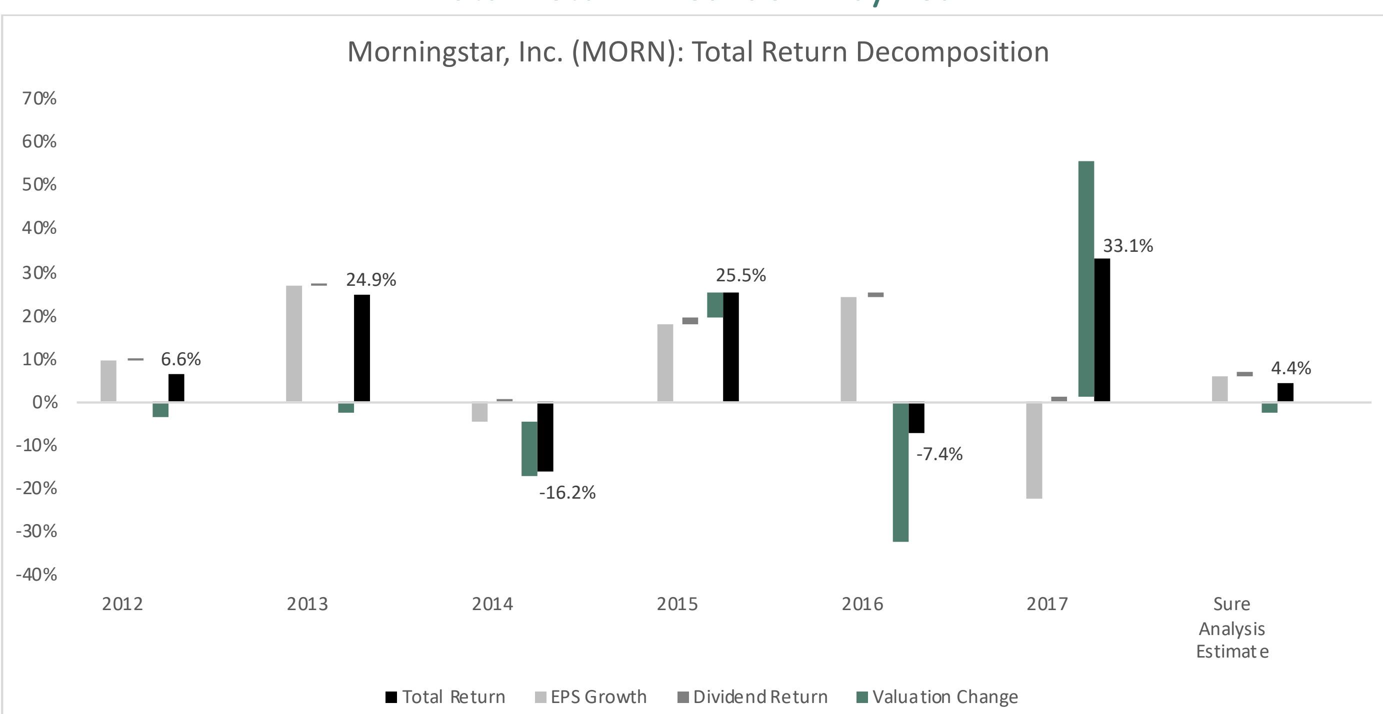
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	74.2%	73.1%	71.8%	62.8%	62.5%	61.2%	58.1%	58.1%	56.9%	57.6%	***58.0%***	***59.0%***
Debt/A	33%	28%	28%	27%	30%	33%	35%	38%	48%	43%	***42%***	***40%***
Int. Cov.	---	---	---	---	---	---	---	---	121	31	***45***	***50***
Payout	---	---	3%	10%	25%	14%	27%	25%	24%	32%	***23%***	***22%***
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 do not see that changing.

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 is up by half in the past year and as such, we think investors should wait for a better entry point. That said, we are forecasting 4.4% total annual returns moving forward, consisting of the current 0.8% yield, 6.0% earnings-per-share growth and a 2.4% headwind from the valuation resetting. Morningstar's future is very bright but after a strong performance in 2017 and 2018, shares look to be overvalued at present; we rate it a sell at current prices.

Total Return Breakdown by Year



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

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	502	479	555	631	658	698	760	789	799	912
Gross Profit	372	350	398	396	412	427	442	459	454	525
Gross Margin	74.1%	73.1%	71.7%	62.7%	62.5%	61.1%	58.1%	58.2%	56.9%	57.6%
SG&A Exp.	167	155	188	215	218	211	220	204	203	264
D&A Exp.	26	32	40	43	43	46	55	64	71	91
Operating Profit	139	125	121	138	151	171	167	191	181	170
Operating Margin	27.7%	26.0%	21.8%	21.9%	22.9%	24.4%	21.9%	24.2%	22.6%	18.6%
Net Profit	93	82	86	98	108	124	78	133	161	137
Net Margin	18.4%	17.1%	15.6%	15.6%	16.4%	17.7%	10.3%	16.8%	20.2%	15.0%
Free Cash Flow	104	89	109	142	116	153	78	184	151	184
Income Tax	52	47	43	44	53	56	36	63	64	43

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	804	919	1086	1172	1042	1031	1010	1029	1351	1406
Cash & Equivalents	174	130	180	200	164	168	185	207	259	308
Accounts Receivable	90	82	111	113	114	114	137	139	146	148
Goodwill & Int. Ass.	307	385	487	458	438	430	466	438	678	660
Total Liabilities	268	253	305	315	315	339	356	388	654	601
Accounts Payable	N/A	N/A	N/A	41	44	42	34	39	45	49
Long-Term Debt	0	0	0	0	0	0	30	35	250	180
Shareholder's Equity	536	665	780	855	726	690	654	640	697	805
D/E Ratio	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.05	0.36	0.22

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	12.7%	9.5%	8.6%	8.7%	9.8%	11.9%	7.7%	13.0%	13.5%	9.9%
Return on Equity	19.6%	13.7%	12.0%	12.0%	13.7%	17.4%	11.7%	20.5%	24.1%	18.2%
ROIC	19.6%	13.7%	11.9%	12.0%	13.6%	17.4%	11.4%	19.5%	19.8%	14.2%
Shares Out.	49	50	50	50	46	45	44	43	43	43
Revenue/Share	10.21	9.62	10.99	12.38	13.39	15.02	16.93	17.81	18.44	21.20
FCF/Share	2.11	1.79	2.15	2.78	2.36	3.29	1.74	4.16	3.49	4.27

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.