Morningstar, Inc. (MORN)

Updated February 23rd, 2019 by Josh Arnold

Key Metrics

Current Price:	$126	**5 Year CAGR Estimate:**	6.2%	**Volatility Percentile:**	46.0%
Fair Value Price:	$122	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	92.2%
% Fair Value:	104%	**5 Year Valuation Multiple Estimate:**	-0.7%	**Growth Percentile:**	51.7%
Dividend Yield:	0.9%	**5 Year Price Target**	$163	**Valuation Percentile:**	46.0%
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Total Return Percentile:**	28.5%

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 about 9 million clients today. It has about $1 billion in annual revenue and a market capitalization of $5.4 billion.

Morningstar reported Q4 earnings on 2/21/19 and results were once again very strong. Revenue was up 8.1% in Q4 year-over-year on a reported basis, and rose 8.7% on an organic basis. The company's PitchBook product continues to do very well, sending license-based revenue up 10%. The company's asset-based revenue also rose 4.6% in Q4 despite the market volatility seen in late December of 2018.

Operating expenses rose 6.5%, slower than the pace of revenue growth, thanks to higher salaries, higher production costs, and higher incentive payouts commensurate with the company's strong performance. These factors were partially offset by lower benefits costs, as well as lower commissions in the company's investment management business, as soft net flows negatively impacted the segment.

Operating margins rose as revenue gains outpaced those of expenses, leading to a 15.7% increase in operating income in Q4. As a percentage of revenue, operating earnings rose 130bps to 18.8%. Diluted earnings-per-share were up from $0.91 in last year's Q4 to $0.99 despite income tax expense that more than doubled year-over-year.

Morningstar doesn't provide guidance but we're out with an initial estimate of 2019 earnings-per-share of $4.50, reflecting continued revenue growth, somewhat offset by expense growth; Morningstar doesn't buy back stock on a meaningful scale. We continue to see very favorable fundamentals for Morningstar moving forward, but 2018 represented record earnings and thus makes further growth more challenging from a higher base.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.66	$1.70	$1.92	$2.10	$2.66	$2.54	$3.00	$3.72	$2.88	$4.25	***$4.50***	***$6.03***
DPS	--	$0.05	$0.25	$0.53	$0.38	$0.70	$0.79	$0.88	$0.92	$1.00	***$1.12***	***$1.60***
Shares	50	50	50	46	45	44	43	43	43	43	***43***	***43***

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

One-time gains related to tax reform won't be present beginning this year so growth should normalize in 2019 and beyond. Still, we think low to mid-single digit revenue growth and a bit of further 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. It also continues to experience tremendous success with its PitchBook and other licensed products.

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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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	25.0	27.5	30.3	28.7	27.7	28.2	25.8	21.4	28.1	27.2	***28.0***	***27.0***
Avg. Yld.	--	0.1%	0.4%	0.9%	0.5%	1.0%	1.0%	1.1%	1.1%	0.9%	***0.9%***	***1.0%***

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. Morningstar, and other businesses like it with lucrative subscription models, tend to receive premium valuations due to their high rates of recurring revenue and superior profitability. Morningstar's recent growth levels have supported a premium valuation and we believe it will persist for the foreseeable future. However, today's price-to-earnings ratio of 28 is still slightly in excess of fair value, which we see as 27. That means it is likely to experience a modest 0.7% headwind to total returns as the valuation returns to more normalized levels. We see the yield as remaining where it is today as the dividend keeps pace with earnings; Morningstar is not an income stock.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	3%	10%	25%	14%	27%	25%	24%	32%	24%	***25%***	***27%***

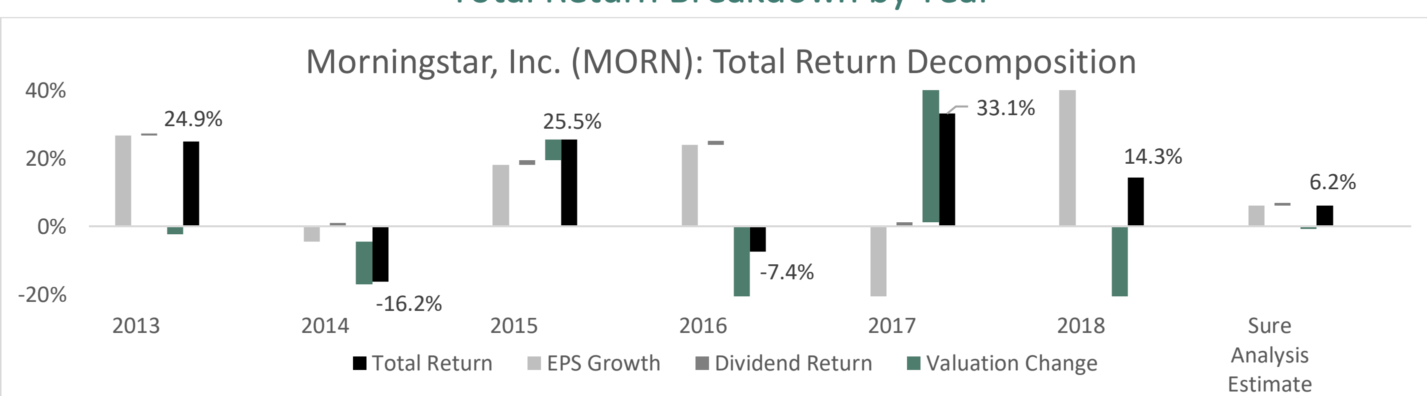
The payout ratio is not likely to crest 30% anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying around 1% for the foreseeable future. Certainly, management has been more interested in investing for future growth, and that strategy isn't going to change anytime soon.

Morningstar's competitive advantage is in its very long operating history in a niche of the investment world it helped create. The company's subscription service, particularly with its PitchBook product, is a key differentiator and we see it powering future growth for many years to come.

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. Recent relative weakness in the stock has made the valuation more attractive, but it is still in excess of our fair value target. That said, we are forecasting 6.2% total annual returns moving forward, consisting of the current 0.9% yield, 6% earnings-per-share growth and a 0.7% headwind from the valuation resetting. Morningstar's future is very bright and given the recent moderation in the valuation, we are upgrading Morningstar to a hold from sell. While we'd prefer a slightly lower valuation to move it to a buy rating, Morningstar's total return prospects are much better today than they were at the time of our last report.

Total Return Breakdown by Year



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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.