



Moody's Corporation (MCO)

Updated May 14th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$184	5 Year CAGR Estimate:	3.4%	Volatility Percentile:	41.7%
Fair Value Price:	\$144	5 Year Growth Estimate:	7.0%	Momentum Percentile:	56.2%
% Fair Value:	127%	5 Year Valuation Multiple Estimate:	-4.7%	Growth Percentile:	66.6%
Dividend Yield:	1.1%	5 Year Price Target	\$202	Valuation Percentile:	16.5%
Dividend Risk Score:	B	Retirement Suitability Score:	D	Total Return Percentile:	12.2%

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 about \$35 billion.

Moody's reported Q1 earnings on 4/24/19 and results were in line with expectations. The company saw another robust performance from its Moody's Analytics business, which was offset by an expected decline in Moody's Investors Services' revenue. This weakness, which has been a problem in recent periods, was due to lower year-over-year debt issuances.

Total revenue was \$1.1 billion, up 1% from the comparable period last year. US revenue was \$612 million, +2% year-over-year, while international revenue was flat at \$530 million. In addition, foreign currency translation unfavorably impacted results by 2% in Q1.

Operating expenses rose 7% in Q1 to \$680 million, primarily as a result of increased compensation expense for merit increases and new hires. In addition, restructuring charges and foreign currency increased operating expenses, with the latter increasing costs by 3%.

This caused operating income to fall 6% year-over-year to \$462 million. On an adjusted basis, operating income fell 4%, excluding depreciation and amortization, restructuring charges, and merger integration costs. Once again, foreign exchange translation caused a 2% headwind to results. Still, adjusted operating margin was 45.4% of revenue in Q1.

Moody's enjoyed a tax rate of just 9.2% in Q1 against 14.6% in the prior-year period. Adjusted diluted earnings-per-share came in at \$2.07, a 2% gain from the comparable period a year ago, primarily due to the company's lower tax rate.

Moody's reiterated guidance for about \$8 per share in earnings this year, and we've reiterated this in our forecast.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.69	\$2.15	\$2.49	\$3.05	\$3.60	\$4.21	\$4.60	\$4.81	\$6.07	\$7.39	\$8.00	\$11.22
DPS	\$0.40	\$0.42	\$0.54	\$0.64	\$0.90	\$1.12	\$1.36	\$1.48	\$1.14	\$1.76	\$2.00	\$3.40
Shares	237	231	222	224	214	203	196	191	191	191	189	185

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% earnings-per-share growth moving forward.

Moody's can achieve this result by continuing its long tradition of buying growth, as we saw with the recent Bureau van Dijk purchase and the smaller purchases made in the second half of 2018, 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 revenue at rapid rates can be expensive, and we believe this will continue to be the case moving forward. Q1 results showed this once again. 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

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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, as seen in Q1's results.

We see the dividend as growing at roughly the same rate as earnings-per-share and thus, are forecasting a payout of \$3.40 in five years. Moody's has not shown the dividend to be a priority, as it is instead focused on business growth.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.5	11.7	13.5	13.5	17.5	20.8	22.3	20.4	20.6	22.3	22.9	18.0
Avg. Yld.	1.6%	1.7%	1.6%	1.6%	1.4%	1.3%	1.3%	1.5%	0.9%	1.1%	1.1%	1.7%

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 22.9 is well in excess our estimate of fair value at 18, meaning it now looks overpriced. That implies a 4.7% headwind to total returns from the valuation declining over time. We see the combination of a higher payout and lower valuation sending the yield up to 1.7% over time from the current 1.1%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	24%	20%	22%	22%	26%	23%	29%	30%	25%	24%	25%	30%

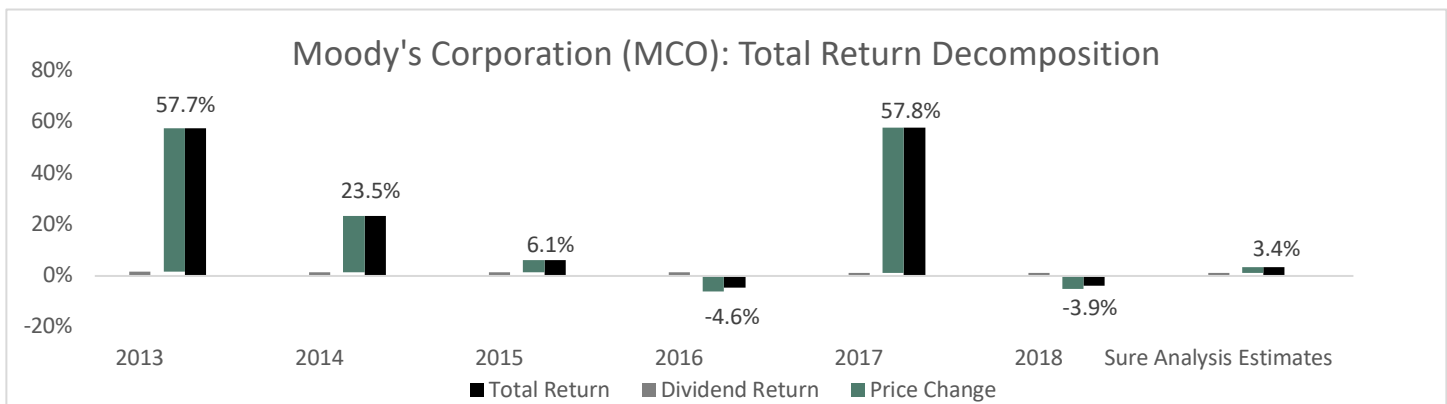
Moody's payout ratio is just one-quarter of earnings, which is in line with its historical norms. We do not believe that will change materially in the years to come as the company continues to grow earnings rapidly, and as it focuses on growth more than a high dividend yield.

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 should not crimp earnings unduly.

Final Thoughts & Recommendation

Overall, Moody's looks like a strong growth story that is back to being overvalued after another rally. We are forecasting just 3.4% in total annual returns moving forward, consisting of the 1.1% current yield, 7% earnings-per-share growth and a 4.7% headwind from a lower valuation. Moody's looks well-positioned for further growth, but that growth is once again already priced into the stock. Given that the stock is trading at 127% of our estimate of fair value and that operating expenses and currency translation continue to crimp earnings growth, we are downgrading Moody's to a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	1797.2	2032	2280.7	2730.3	2972.5	3334.3	3484.5	3604.2	4204.1	4442.7
Gross Profit	1264.8	1427.2	1597.2	1935.3	2150.1	2404	2508.2	2577.6	2981.3	3197.2
Gross Margin	70.4%	70.2%	70.0%	70.9%	72.3%	72.1%	72.0%	71.5%	70.9%	72.0%
SG&A Exp.	495.7	588	629.6	752.2	822.1	869.3	921.3	936.4	991.4	1080.1
D&A Exp.	64.1	66.3	79.2	93.5	93.4	95.6	113.5	126.7	158.3	N/A
Operating Profit	705	767.7	889.8	1107.2	1248.8	1440.4	1475.2	1508.5	1816.3	1909.8
Op. Margin	39.2%	37.8%	39.0%	40.6%	42.0%	43.2%	42.3%	41.9%	43.2%	43.0%
Net Profit	402	507.8	571.4	690	804.5	988.7	941.3	266.6	1000.6	1309.6
Net Margin	22.4%	25.0%	25.1%	25.3%	27.1%	29.7%	27.0%	7.4%	23.8%	29.5%
Free Cash Flow	553.1	574.3	735.6	778.1	884.5	944	1109.1	1144	656.9	1370.7
Income Tax	239.1	201	261.8	324.3	353.4	455	430	282.2	779.1	351.6

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	2003.3	2540.3	2876.1	3960.9	4395.1	4669	5103	5327.3	8594.2	9526.2
Cash & Equivalents	473.9	659.6	760	1755.4	1919.5	1219.5	1757.4	2051.5	1071.5	1685
Acc. Receivable	444.9	497.5	489.8	621.8	694.2	792.4	802	887.4	1147.2	N/A
Goodwill & Int.	454.1	634.3	896.5	863.6	886.8	1366.6	1275.4	1320	5384.8	N/A
Total Liabilities	2599.4	2838.7	3034.5	3564.3	4047.2	4626.1	5436	6354.6	8709.1	8869.7
Accounts Payable	7.1	14.3	16.4	14.3	16.4	19.4	22.2	28.4	21.8	N/A
Long-Term Debt	1193.7	1239.6	1243.8	1671.2	2101.8	2547.3	3380.6	3363	5540.5	N/A
Total Equity	-606.2	-309.6	-169	385.2	337	-187.8	-565	-1225	-327.7	N/A
D/E Ratio	-1.97	-4.00	-7.36	4.34	6.24	-13.56	-5.98	-2.75	-16.91	N/A

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	21.3%	22.4%	21.1%	20.2%	19.3%	21.8%	19.3%	5.1%	14.4%	14.5%
Return on Equity	-50.2%	-111%	-239%	638%	223%	1325%	-250%	-29.8%	-129%	N/A
ROIC	74.5%	66.0%	56.4%	43.8%	35.6%	39.2%	33.4%	9.9%	25.8%	N/A
Shares Out.	237	231	222	224	214	203	196	191	191	191
Revenue/Share	7.56	8.59	9.94	12.05	13.30	15.53	17.13	18.45	21.65	22.85
FCF/Share	2.33	2.43	3.21	3.43	3.96	4.40	5.45	5.85	3.38	7.05

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

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