



Moody's Corporation (MCO)

Updated August 6th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$203	5 Year CAGR Estimate:	1.4%	Volatility Percentile:	37.8%
Fair Value Price:	\$144	5 Year Growth Estimate:	7.0%	Momentum Percentile:	83.7%
% Fair Value:	141%	5 Year Valuation Multiple Estimate:	-6.6%	Growth Percentile:	66.3%
Dividend Yield:	1.0%	5 Year Price Target	\$202	Valuation Percentile:	9.5%
Dividend Risk Score:	A	Retirement Suitability Score:	D	Total Return Percentile:	8.5%

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 \$39 billion.

Moody's reported Q2 earnings on 7/31/19 and results were characteristically strong for the ratings agency. Total revenue came in at \$1.2 billion, up 3% year-over-year and another record. Geographically, US revenue was up 2%, while non-US revenue rose 5%. Non-US revenue is now 47% of the total as Moody's continues its global expansion.

Moody's Investor Services revenue was down 2% as global issuances remain weak, a key revenue source for Moody's. However, it was able to offset this loss of revenue with strength elsewhere. In addition, Moody's Analytics, which we view as the future of the business, saw its revenue climb 12% year-over-year. Strength was seen across the board for Moody's Analytics as all three sub-segments posted robust sales gains.

Total operating expenses were up 14% year-over-year but 10% of the move higher was due to restructuring and impairment charges. The balance of 4% was the true operating expense increase, which was largely in line with the revenue gain. Adjusted operating income rose 2% year-over-year as adjusted operating margin came to 49.4%.

Adjusted diluted earnings-per-share came to \$2.07 in Q2, essentially flat year-over-year.

Moody's also said it was selling its Moody's Analytics Knowledge Services business to Equistone Partners Europe, a private equity firm. The company expects the transaction to reduce earnings-per-share by \$0.20 due to nonrecurring charges. However, the firm will use the proceeds to offset those losses with \$300 million of share repurchases. As a result, our estimate for this year is unchanged at \$8.00 in earnings-per-share.

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	187	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. Q2 results showed more modest expense growth. 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.

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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	25.3	18.0
Avg. Yld.	1.6%	1.7%	1.6%	1.6%	1.4%	1.3%	1.3%	1.5%	0.9%	1.1%	1.0%	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 25.3 is well in excess of our estimate of fair value at 18, meaning it now looks quite overpriced. That implies a 6.6% headwind to annual 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%.

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%

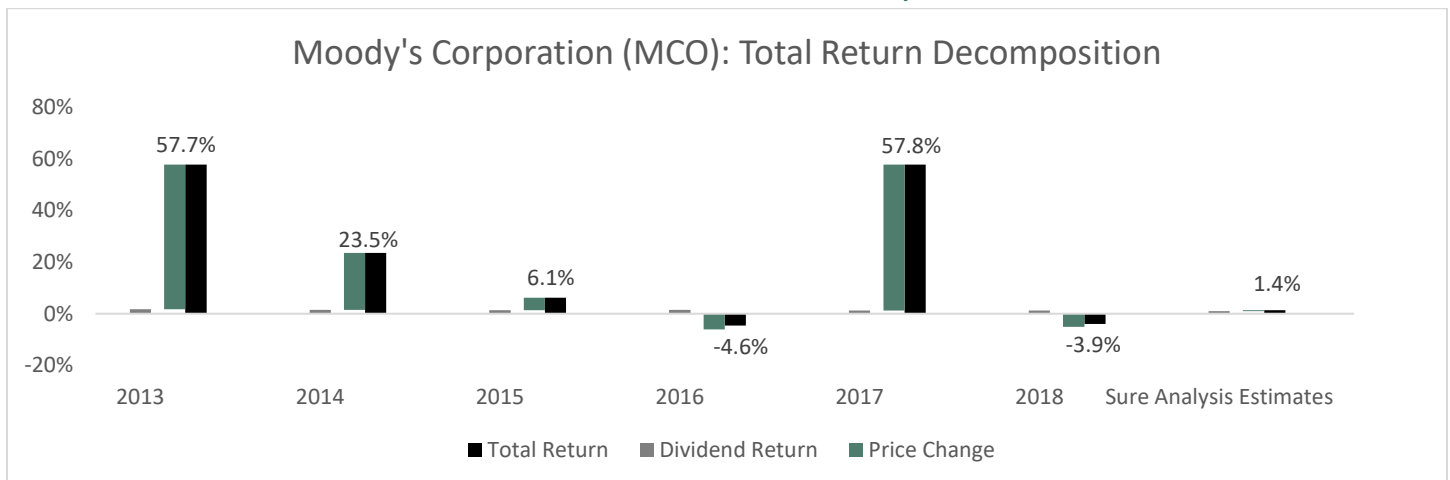
Moody's payout ratio is just one-quarter of earnings, which is in line with its historical norms. We do not believe that will change materially in the years to come as the company continues to grow earnings rapidly, and as it focuses on growth more than a high dividend yield.

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 even more overvalued after another rally. We are forecasting just 1.4% in total annual returns moving forward, consisting of the 1% current yield, 7% earnings-per-share growth and a 6.6% 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 141% of our estimate of fair value and that operating expenses and currency translation continue to crimp earnings growth, we are reiterating Moody's as 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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