



# Moody's Corporation (MCO)

Updated November 6<sup>th</sup>, 2019 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$213	<b>5 Year CAGR Estimate:</b>	0.7%	<b>Volatility Percentile:</b>	37.7%
<b>Fair Value Price:</b>	\$148	<b>5 Year Growth Estimate:</b>	7.0%	<b>Momentum Percentile:</b>	95.9%
<b>% Fair Value:</b>	144%	<b>5 Year Valuation Multiple Estimate:</b>	-7.1%	<b>Growth Percentile:</b>	71.2%
<b>Dividend Yield:</b>	0.9%	<b>5 Year Price Target</b>	\$207	<b>Valuation Percentile:</b>	10.9%
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	D	<b>Total Return Percentile:</b>	8.7%

## 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 \$4.8 billion in annual revenue and a market capitalization of about \$40 billion.

Moody's reported Q3 earnings on October 30<sup>th</sup> and results beat top and bottom line estimates. Total revenue came in at \$1.2 billion, which was a 15% increase from the year-ago period. Moody's Investors Service revenue was up 16% year-over-year to \$747 million, while Moody's Analytics revenue rose 13% to \$494 million. Growth was once again stronger in the US, but Moody's is having success in all of its markets. International revenue was 47% of the total in Q3, down from 48% in the year-ago period.

Operating expenses were up 13% year-over-year, driven primarily from higher incentive compensation, acquisitions, and compensation for new hires and merit increases. This was partially offset by the benefits of the company's cost control initiatives and restructuring. Forex translation positively impacted expenses by 2% during the quarter.

Operating income was \$614 million on an adjusted basis, up 19% from the year-ago period. Operating margin was 49.5% of revenue on an adjusted basis, up 190bps from last year's Q3. This led to adjusted Q3 earnings-per-share of \$2.15, up a staggering 27% year-over-year. The company boosted its guidance once more to a new range of \$8.05 to \$8.20; we're at the high end as Moody's has been easily beating estimates in recent quarters and has very strong momentum heading into Q4.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$1.69	\$2.15	\$2.49	\$3.05	\$3.60	\$4.21	\$4.60	\$4.81	\$6.07	\$7.39	<b>\$8.20</b>	<b>\$11.50</b>
<b>DPS</b>	\$0.40	\$0.42	\$0.54	\$0.64	\$0.90	\$1.12	\$1.36	\$1.48	\$1.14	\$1.76	<b>\$2.00</b>	<b>\$3.37</b>
<b>Shares<sup>1</sup></b>	237	231	222	224	214	203	196	191	191	191	<b>187</b>	<b>185</b>

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. Moody's earnings growth has averaged 17% per year over the last decade. 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 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. 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. We note that Q3 was an outlier with the US outperforming the international business.

<sup>1</sup> Share count in millions

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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 \$3.37 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	26.0	18.0
Avg. Yld.	1.6%	1.7%	1.6%	1.6%	1.4%	1.3%	1.3%	1.5%	0.9%	1.1%	0.9%	1.6%

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 26 is well in excess of our estimate of fair value at 18, meaning it now looks quite overpriced. Indeed, it is more expensive today than it has been at any point in the past decade. That implies a 7.1% 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 1.6% over time from the current 0.9%.

## 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%	24%	29%

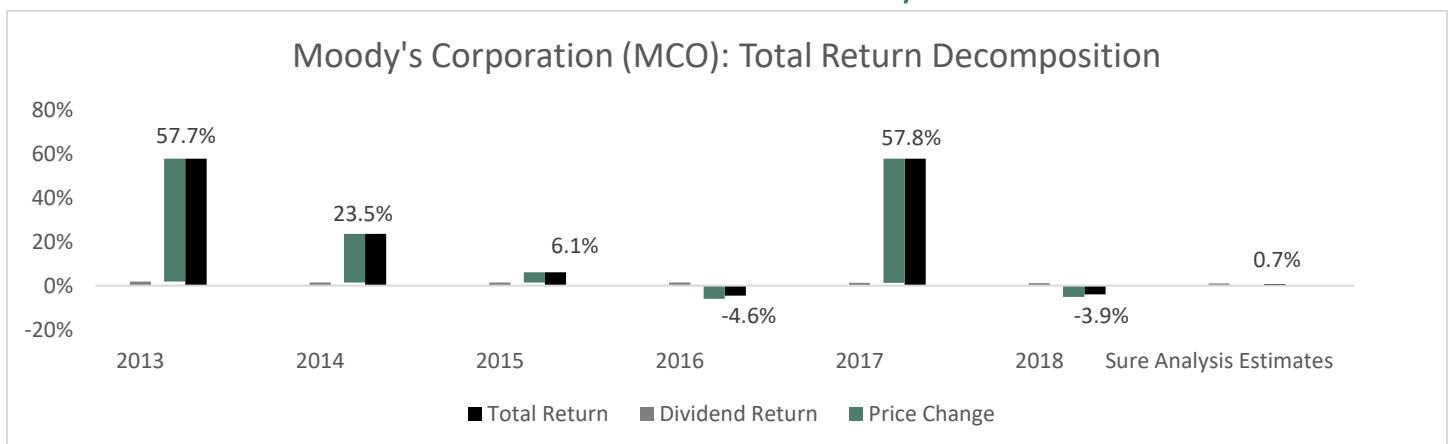
Moody's payout ratio is just one-quarter of earnings, which is in line with its historical norms. We do not believe that will change materially in the years to come as the company continues to grow earnings rapidly, and as it focuses on growth more than a high dividend yield.

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 0.7% in total annual returns moving forward, consisting of the 0.9% current yield, 7% earnings-per-share growth and a sizable 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 144% 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
<b>Revenue</b>	1797.2	2032	2280.7	2730.3	2972.5	3334.3	3484.5	3604.2	4204.1	4442.7
<b>Gross Profit</b>	1264.8	1427.2	1597.2	1935.3	2150.1	2404	2508.2	2577.6	2981.3	3197.2
<b>Gross Margin</b>	70.4%	70.2%	70.0%	70.9%	72.3%	72.1%	72.0%	71.5%	70.9%	72.0%
<b>SG&amp;A Exp.</b>	495.7	588	629.6	752.2	822.1	869.3	921.3	936.4	991.4	1080.1
<b>D&amp;A Exp.</b>	64.1	66.3	79.2	93.5	93.4	95.6	113.5	126.7	158.3	N/A
<b>Operating Profit</b>	705	767.7	889.8	1107.2	1248.8	1440.4	1475.2	1508.5	1816.3	1909.8
<b>Op. Margin</b>	39.2%	37.8%	39.0%	40.6%	42.0%	43.2%	42.3%	41.9%	43.2%	43.0%
<b>Net Profit</b>	402	507.8	571.4	690	804.5	988.7	941.3	266.6	1000.6	1309.6
<b>Net Margin</b>	22.4%	25.0%	25.1%	25.3%	27.1%	29.7%	27.0%	7.4%	23.8%	29.5%
<b>Free Cash Flow</b>	553.1	574.3	735.6	778.1	884.5	944	1109.1	1144	656.9	1370.7
<b>Income Tax</b>	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
<b>Total Assets</b>	2003.3	2540.3	2876.1	3960.9	4395.1	4669	5103	5327.3	8594.2	9526.2
<b>Cash &amp; Equivalents</b>	473.9	659.6	760	1755.4	1919.5	1219.5	1757.4	2051.5	1071.5	1685
<b>Acc. Receivable</b>	444.9	497.5	489.8	621.8	694.2	792.4	802	887.4	1147.2	N/A
<b>Goodwill &amp; Int.</b>	454.1	634.3	896.5	863.6	886.8	1366.6	1275.4	1320	5384.8	N/A
<b>Total Liabilities</b>	2599.4	2838.7	3034.5	3564.3	4047.2	4626.1	5436	6354.6	8709.1	8869.7
<b>Accounts Payable</b>	7.1	14.3	16.4	14.3	16.4	19.4	22.2	28.4	21.8	N/A
<b>Long-Term Debt</b>	1193.7	1239.6	1243.8	1671.2	2101.8	2547.3	3380.6	3363	5540.5	N/A
<b>Total Equity</b>	-606.2	-309.6	-169	385.2	337	-187.8	-565	-1225	-327.7	N/A
<b>D/E Ratio</b>	-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
<b>Return on Assets</b>	21.3%	22.4%	21.1%	20.2%	19.3%	21.8%	19.3%	5.1%	14.4%	14.5%
<b>Return on Equity</b>	-50.2%	-111%	-239%	638%	223%	1325%	-250%	-29.8%	-129%	N/A
<b>ROIC</b>	74.5%	66.0%	56.4%	43.8%	35.6%	39.2%	33.4%	9.9%	25.8%	N/A
<b>Shares Out.</b>	237	231	222	224	214	203	196	191	191	191
<b>Revenue/Share</b>	7.56	8.59	9.94	12.05	13.30	15.53	17.13	18.45	21.65	22.85
<b>FCF/Share</b>	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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