



Morningstar, Inc. (MORN)

Updated October 26th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$146	5 Year CAGR Estimate:	2.3%	Volatility Percentile:	51.0%
Fair Value Price:	\$115	5 Year Growth Estimate:	6.0%	Momentum Percentile:	80.3%
% Fair Value:	124%	5 Year Valuation Multiple Estimate:	-4.3%	Growth Percentile:	57.8%
Dividend Yield:	0.8%	5 Year Price Target	\$157	Valuation Percentile:	14.2%
Dividend Risk Score:	B	Retirement Suitability Score:	D	Total Return Percentile:	8.2%

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 \$6.2 billion.

Morningstar reported Q3 earnings on October 23rd and results were characteristically strong once again. During the quarter, Morningstar completed the integration of DBRS Morningstar, its newly combined credit rating organization. DBRS was acquired by Morningstar earlier in 2019.

Revenue was up 20.1% to \$314 million year-over-year. DBRS was worth 15.5% of the total growth seen, while Morningstar's legacy businesses contributed 4.6%. Excluding the nonrecurring revenue impact of an amended license agreement from last year's Q3, revenue would have been up 9.1% instead of 4.6%. Organic revenue growth was up 5.6%, and excluding the license amendment, organic growth was 10.2%. All of Morningstar's segments performed well once again in Q3.

Operating income was down -24.2% in Q3 as integration expenses negatively impacted operating income by 4.7%. The rest of the business saw a -19.5% decline in operating income and excluding the license amendment, operating income declined -4.2%. Net income was off -13.6% to \$1.14, including the \$0.14 dilutive impact of DBRS. However, excluding one-time costs, DBRS would have been accretive by \$0.03.

Cash from operating activities was up 32.5% to \$106 million in Q3, and free cash flow soared 42.2% to \$86 million. After another good quarter, we've boosted our estimate for this year by a dime to \$4.35 in earnings-per-share.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.66	\$1.70	\$1.92	\$2.10	\$2.66	\$2.54	\$3.00	\$3.72	\$2.88	\$4.25	\$4.35	\$5.82
DPS	---	\$0.05	\$0.25	\$0.53	\$0.38	\$0.70	\$0.79	\$0.88	\$0.92	\$1.00	\$1.12	\$1.60
Shares¹	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

¹ Share count in millions

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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, which occurred once again in Q3.

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	33.6	27.0
Avg. Yld.	---	0.1%	0.4%	0.9%	0.5%	1.0%	1.0%	1.1%	1.1%	0.9%	0.8%	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. However, today's price-to-earnings ratio of 33.6 is well in excess of our estimate of fair value, which we see as 27. That means the security could experience a -4.3% annual headwind to total returns as the valuation returns to more normalized levels. We see the yield as remaining around 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%	26%	28%

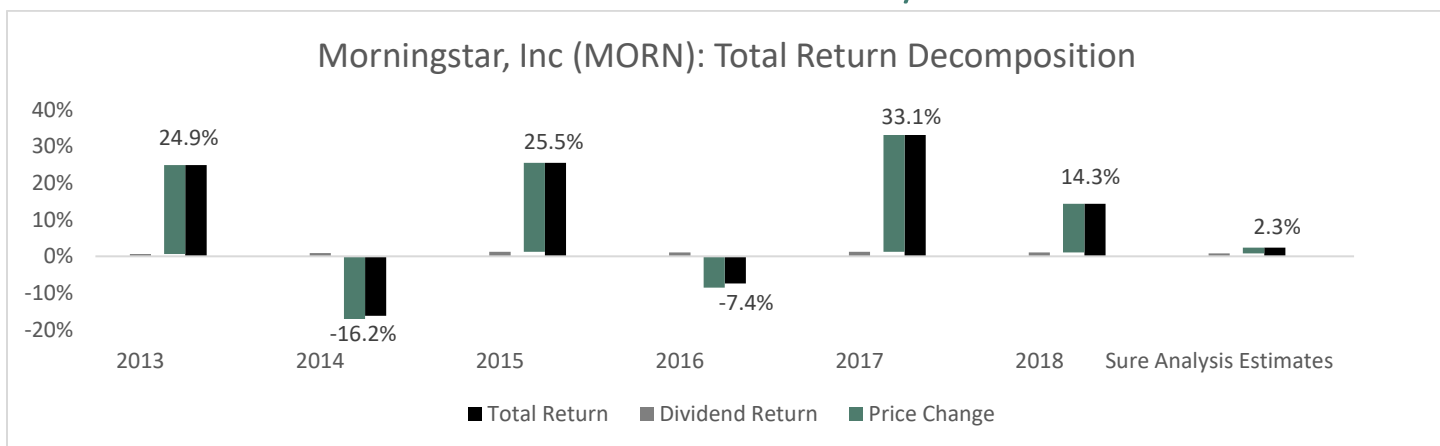
Morningstar's payout ratio is not likely to crest 30% anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying around 1% for the foreseeable future. Certainly, management has been more interested in investing for future growth, and that strategy isn't going to 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 less compelling at present. We are forecasting just 2.3% total annual returns moving forward, consisting of the current small yield, 6% earnings-per-share growth and a moderate headwind from the valuation resetting. Morningstar's future is very bright, but given the low expected returns, we are reiterating it at a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	479	555	631	658	698	760	789	799	912	1020
Gross Profit	350	398	396	412	427	442	459	454	525	609
Gross Margin	73.1%	71.7%	62.7%	62.5%	61.1%	58.1%	58.2%	56.9%	57.6%	59.7%
SG&A Exp.	155	188	215	218	211	220	204	203	264	296
D&A Exp.	32	40	43	43	46	55	64	71	91	97
Operating Profit	125	121	138	151	171	167	191	181	170	216
Operating Margin	26.0%	21.8%	21.9%	22.9%	24.4%	21.9%	24.2%	22.6%	18.6%	21.2%
Net Profit	82	86	98	108	124	78	133	161	137	183
Net Margin	17.1%	15.6%	15.6%	16.4%	17.7%	10.3%	16.8%	20.2%	15.0%	17.9%
Free Cash Flow	89	109	142	116	153	78	184	151	184	239
Income Tax	47	43	44	53	56	36	63	64	43	48

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	919	1086	1172	1042	1031	1010	1029	1351	1406	1454
Cash & Equivalents	130	180	200	164	168	185	207	259	308	369
Accounts Receivable	82	111	113	114	114	137	139	146	148	172
Goodwill & Int. Ass.	385	487	458	438	430	466	438	678	660	631
Total Liabilities	253	305	315	315	339	356	388	654	601	519
Accounts Payable	N/A	N/A	41	44	42	34	39	45	49	54
Long-Term Debt	0	0	0	0	0	30	35	250	180	70
Shareholder's Equity	665	780	855	726	690	654	640	697	805	935
D/E Ratio	0.00	0.00	0.00	0.00	0.00	0.05	0.05	0.36	0.22	0.07

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	9.5%	8.6%	8.7%	9.8%	11.9%	7.7%	13.0%	13.5%	9.9%	12.8%
Return on Equity	13.7%	12.0%	12.0%	13.7%	17.4%	11.7%	20.5%	24.1%	18.2%	21.0%
ROIC	13.7%	11.9%	12.0%	13.6%	17.4%	11.4%	19.5%	19.8%	14.2%	18.4%
Shares Out.	50	50	50	46	45	44	43	43	43	43
Revenue/Share	9.62	10.99	12.38	13.39	15.02	16.93	17.81	18.44	21.20	23.72
FCF/Share	1.79	2.15	2.78	2.36	3.29	1.74	4.16	3.49	4.27	5.55

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

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