



Moody's Corporation (MCO)

Updated February 24th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$272	5 Year CAGR Estimate:	1.1%	Market Cap:	\$51B
Fair Value Price:	\$185	5 Year Growth Estimate:	8.0%	Ex-Dividend Date:	02/24/20
% Fair Value:	147%	5 Year Valuation Multiple Estimate:	-7.4%	Dividend Payment Date:	03/18/20
Dividend Yield:	0.8%	5 Year Price Target	\$272	Years Of Dividend Growth:	17
Dividend Risk Score:	A	Retirement Suitability Score:	D	Last Dividend Increase:	12%

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 just over \$5 billion in annual revenue and a market capitalization of about \$51 billion. Moody's is still one of the largest players in the traditional ratings business, but has transformed itself in recent years by investing heavily in data and analytics, which is less cyclical and has very strong margins.

Moody's reported Q4 and full-year earnings on February 12th, and results once again were very strong, beating expectations on the top and bottom lines. Full-year revenue was up 9% to \$4.8 billion as forex translation unfavorably impacted the top line by 1%. MIS revenue was \$2.9 billion, up 6% year-over-year as forex reduced MIS revenue by 1%. Operating margin for the segment was 58.0%.

MA revenue was \$2.0 billion for 2019, up 13% from 2018. Forex translation unfavorably impacted the top line by 2%, while organic revenue was up 11% year-over-year. Operating margin was 27.8% for the segment.

Operating expenses were up 10% year-over-year to \$2.8 billion, as 2% of the increase was due to non-recurring expenses. There was, however, higher incentive and operating expenses due to acquisitions, as well as hiring and salary expenses. Cost controls helped offset some of this. Total operating income was \$2.0 billion, up 7%, while adjusted operating income was \$2.3 billion, up 8%. Operating margin was 47.4% on an adjusted basis.

Full-year diluted earnings-per-share came to \$8.29, up 12% year-over-year. Moody's guided for adjusted earnings-per-share of \$9.10 to \$9.30 for this year, and our initial estimate is for \$9.25.

Moody's also declared its dividend for the March payment raising the payout 12% to \$0.56 quarterly, its 17th consecutive year of dividend increases.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$2.15	\$2.49	\$3.05	\$3.60	\$4.21	\$4.60	\$4.81	\$6.07	\$7.39	\$8.29	\$9.25	\$13.59
DPS	\$0.42	\$0.54	\$0.64	\$0.90	\$1.12	\$1.36	\$1.48	\$1.14	\$1.76	\$2.00	\$2.24	\$3.77
Shares¹	231	222	224	214	203	196	191	191	191	191	191	191

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 8% 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

¹ Share count in millions

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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 see the dividend as growing at roughly the same rate as earnings-per-share and thus, are forecasting a payout of \$3.77 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	11.7	13.5	13.5	17.5	20.8	22.3	20.4	20.6	22.3	23.7	29.4	20.0
Avg. Yld.	1.7%	1.6%	1.6%	1.4%	1.3%	1.3%	1.5%	0.9%	1.1%	1.0%	0.8%	1.4%

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 29.4 is well in excess of our estimate of fair value at 20, 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 7.4% 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 1.4% over time from the current 0.8%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	20%	22%	22%	26%	23%	29%	30%	25%	24%	24%	24%	28%

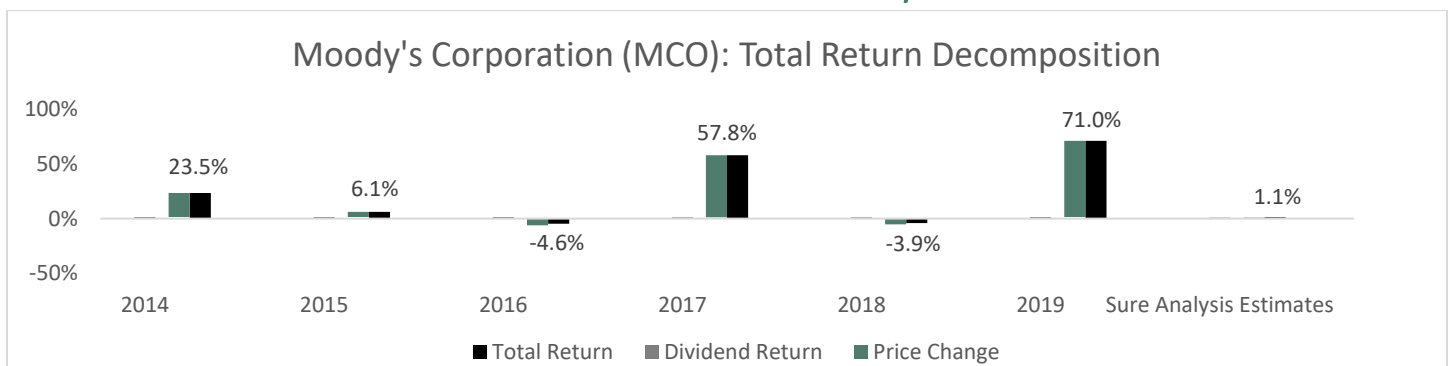
Moody's payout ratio is just one-quarter of earnings, which is in-line with its historical norms. We do not believe that will change materially in the years to come as the company continues to grow earnings rapidly, and as it focuses on growth more than a high dividend yield.

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 1.1% in total annual returns moving forward, consisting of the 0.8% current yield, 8% 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 147% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	2032	2280.7	2730.3	2972.5	3334.3	3484.5	3604.2	4204.1	4442.7	4829
Gross Profit	1427.2	1597.2	1935.3	2150.1	2404	2508.2	2577.6	2981.3	3197.2	3442
Gross Margin	70.2%	70.0%	70.9%	72.3%	72.1%	72.0%	71.5%	70.9%	72.0%	71.3%
SG&A Exp.	588	629.6	752.2	822.1	869.3	921.3	936.4	991.4	1080.1	1167
D&A Exp.	66.3	79.2	93.5	93.4	95.6	113.5	126.7	158.3	N/A	200
Operating Profit	767.7	889.8	1107.2	1248.8	1440.4	1475.2	1508.5	1816.3	1909.8	2075
Op. Margin	37.8%	39.0%	40.6%	42.0%	43.2%	42.3%	41.9%	43.2%	43.0%	43.0%
Net Profit	507.8	571.4	690	804.5	988.7	941.3	266.6	1000.6	1309.6	1422
Net Margin	25.0%	25.1%	25.3%	27.1%	29.7%	27.0%	7.4%	23.8%	29.5%	29.4%
Free Cash Flow	574.3	735.6	778.1	884.5	944	1109.1	1144	656.9	1370.7	1606
Income Tax	201	261.8	324.3	353.4	455	430	282.2	779.1	351.6	381

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2540.3	2876.1	3960.9	4395.1	4669	5103	5327.3	8594.2	9526.2	10265
Cash & Equivalents	659.6	760	1755.4	1919.5	1219.5	1757.4	2051.5	1071.5	1685	1832
Acc. Receivable	497.5	489.8	621.8	694.2	792.4	802	887.4	1147.2	N/A	1419
Goodwill & Int.	634.3	896.5	863.6	886.8	1366.6	1275.4	1320	5384.8	N/A	5220
Total Liabilities	2838.7	3034.5	3564.3	4047.2	4626.1	5436	6354.6	8709.1	8869.7	9434
Accounts Payable	14.3	16.4	14.3	16.4	19.4	22.2	28.4	21.8	N/A	38
Long-Term Debt	1239.6	1243.8	1671.2	2101.8	2547.3	3380.6	3363	5540.5	N/A	5581
Total Equity	-309.6	-169	385.2	337	-187.8	-565	-1225	-327.7	N/A	612
D/E Ratio	-4.00	-7.36	4.34	6.24	-13.56	-5.98	-2.75	-16.91	N/A	9.12

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	22.4%	21.1%	20.2%	19.3%	21.8%	19.3%	5.1%	14.4%	14.5%	14.4%
Return on Equity	-111%	-239%	638%	223%	1325%	-250%	-29.8%	-129%	N/A	266%
ROIC	66.0%	56.4%	43.8%	35.6%	39.2%	33.4%	9.9%	25.8%	N/A	22.3%
Shares Out.	231	222	224	214	203	196	191	191	191	191
Revenue/Share	8.59	9.94	12.05	13.30	15.53	17.13	18.45	21.65	22.85	25.20
FCF/Share	2.43	3.21	3.43	3.96	4.40	5.45	5.85	3.38	7.05	8.38

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

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