Morningstar, Inc. (MORN)

Updated November 26th, 2020 by Josh Arnold

Key Metrics

Current Price:	$198	**5 Year CAGR Estimate:**	0.1%	**Market Cap:**	$8.5 B
Fair Value Price:	$124	**5 Year Growth Estimate:**	9.0%	**Ex-Dividend Date:**	01/15/21[1]
% Fair Value:	159%	**5 Year Valuation Multiple Estimate:**	-8.9%	**Dividend Payment Date:**	01/31/21[2]
Dividend Yield:	0.6%	**5 Year Price Target**	$191	**Years Of Dividend Growth:**	10
Dividend Risk Score:	A	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	7.1%

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 produces about $1.1 billion in annual revenue and has a market capitalization of $8.5 billion.

Morningstar reported third quarter results on October 28th, 2020 and once again outperformed expectations. The company saw revenue soar 14% higher year-over-year to $357 million. Acquisitions accounted for 6% of the increase, but the balance of 8% was from organic revenue growth.

Operating income was down -11% to $44 million on a reported basis, but adjusted for amortization of intangible assets, as well as M&A expenses, operating income increased by a staggering 42% year-over-year. Morningstar continues to boast world-beating margins and given low variable costs, increases in revenue translate well into margin gains.

Diluted net income per share was up 46% on an adjusted basis to $1.55 as the company continues to see enormous growth. Free cash flow was down -17% year-over-year to $71 million.

We've boosted our estimate for this year to $4.60 in earnings-per-share as Morningstar once again outperformed our expectations and has not only survived the challenges of the pandemic but is thriving.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.70	$1.92	$2.10	$2.66	$2.54	$3.00	$3.72	$2.88	$4.25	$3.52	***$4.60***	***$7.08***
DPS	$0.05	$0.25	$0.53	$0.38	$0.70	$0.79	$0.88	$0.92	$1.00	$1.20	***$1.20***	***$1.76***
Shares[3]	50	50	46	45	44	43	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 growth accelerating moving forward and are therefore forecasting 9% earnings-per-share growth for the coming years.

We think mid-single-digit revenue growth and a bit of further margin growth potential make 9% earnings-per-share growth look feasible. This growth estimate is also dependent on the company's appetite for acquisitions moving forward. Its long-term revenue and earnings growth include 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 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, and the significant costs related to recent mergers should not recur in future years, which will also help boost margins.

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[1] Estimated date

[2] Estimated date

[3] Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	27.5	30.3	28.7	27.7	28.2	25.8	21.4	28.1	27.2	40.2	***43.0***	***27.0***
Avg. Yld.	0.1%	0.4%	0.9%	0.5%	1.0%	1.0%	1.1%	1.1%	0.9%	0.8%	***0.6%***	***0.9%***

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 43 is well in excess of our estimate of fair value, which we see as 27. That means the security could experience a significant 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	3%	10%	25%	14%	27%	25%	24%	32%	24%	34%	***26%***	***25%***

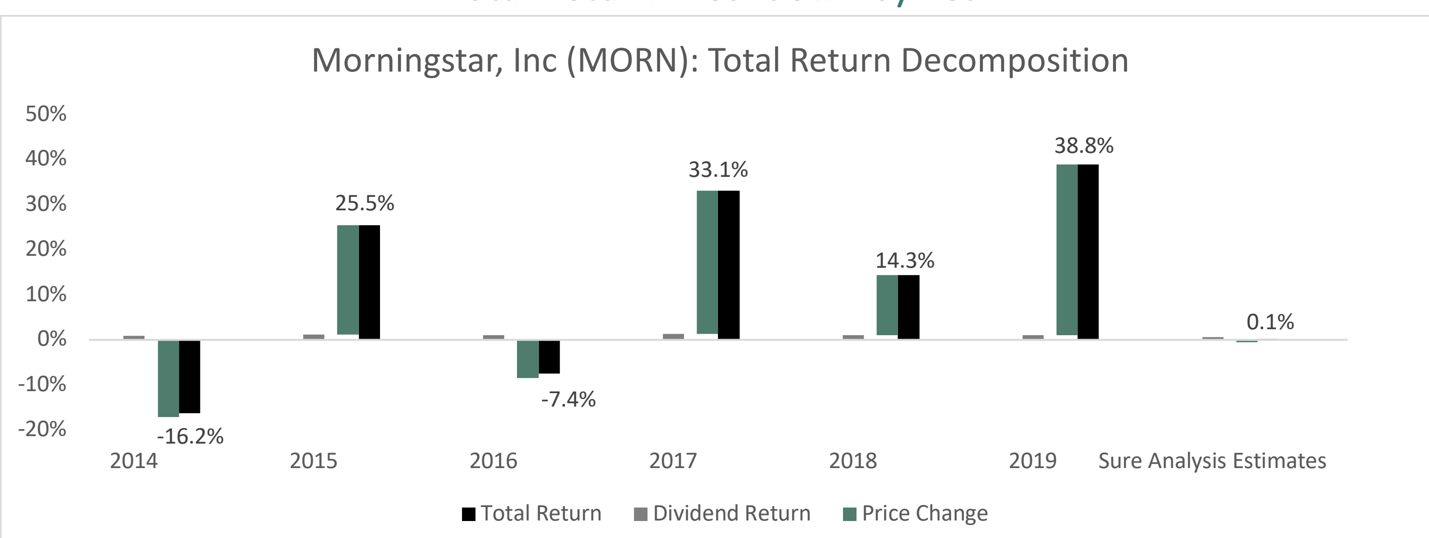
Morningstar's payout ratio is not likely to be significantly above a quarter of earnings anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying quite low for the foreseeable future. Certainly, management has been more interested in investing for future growth, 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. Morningstar seems to be largely unaffected by COVID-19 thus far.

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 essentially no total annual returns moving forward, as growth and the small yield could be completely offset by the valuation, which we see as far too high. Morningstar's future is very bright, but given weak expected returns, we are reiterating it at a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	555	631	658	698	760	789	799	912	1020	1,179
Gross Profit	398	396	412	427	442	459	454	525	609	696
Gross Margin	71.7%	62.7%	62.5%	61.1%	58.1%	58.2%	56.9%	57.6%	59.7%	59.0%
SG&A Exp.	188	215	218	211	220	204	203	264	296	389
D&A Exp.	40	43	43	46	55	64	71	91	97	118
Operating Profit	121	138	151	171	167	191	181	170	216	190
Operating Margin	21.8%	21.9%	22.9%	24.4%	21.9%	24.2%	22.6%	18.6%	21.2%	16.1%
Net Profit	86	98	108	124	78	133	161	137	183	152
Net Margin	15.6%	15.6%	16.4%	17.7%	10.3%	16.8%	20.2%	15.0%	17.9%	12.9%
Free Cash Flow	109	142	116	153	78	184	151	184	239	254
Income Tax	43	44	53	56	36	63	64	43	48	46

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	1086	1172	1042	1031	1010	1029	1351	1406	1454	2,371
Cash & Equivalents	180	200	164	168	185	207	259	308	369	334
Accounts Receivable	111	113	114	114	137	139	146	148	172	189
Goodwill & Int. Ass.	487	458	438	430	466	438	678	660	631	1372
Total Liabilities	305	315	315	339	356	388	654	601	519	1,373
Accounts Payable	N/A	41	44	42	34	39	45	49	54	1,287
Long-Term Debt	0	0	0	0	30	35	250	180	70	513
Shareholder's Equity	780	855	726	690	654	640	697	805	935	513
D/E Ratio	0.00	0.00	0.00	0.00	0.05	0.05	0.36	0.22	0.07	1,084

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	8.6%	8.7%	9.8%	11.9%	7.7%	13.0%	13.5%	9.9%	12.8%	7.9%
Return on Equity	12.0%	12.0%	13.7%	17.4%	11.7%	20.5%	24.1%	18.2%	21.0%	15.1%
ROIC	11.9%	12.0%	13.6%	17.4%	11.4%	19.5%	19.8%	14.2%	18.4%	11.7%
Shares Out.	50	50	46	45	44	43	43	43	43	43
Revenue/Share	10.99	12.38	13.39	15.02	16.93	17.81	18.44	21.20	23.72	27.29
FCF/Share	2.15	2.78	2.36	3.29	1.74	4.16	3.49	4.27	5.55	5.89

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