



Morningstar, Inc. (MORN)

Updated March 5th, 2021 by Josh Arnold

Key Metrics

Current Price:	\$227	5 Year CAGR Estimate:	1.4%	Market Cap:	\$9.9 B
Fair Value Price:	\$168	5 Year Growth Estimate:	7.0%	Ex-Dividend Date:	04/08/21
% Fair Value:	135%	5 Year Valuation Multiple Estimate:	-5.8%	Dividend Payment Date:	04/30/21
Dividend Yield:	0.6%	5 Year Price Target	\$236	Years Of Dividend Growth:	11
Dividend Risk Score:	B	Retirement Suitability Score:	D	Last Dividend Increase:	5.0%

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 ~9 million clients. It produces ~\$1.5 billion in annual revenue and has a market capitalization of \$9.9 billion.

Morningstar reported fourth quarter and full-year earnings on February 18th, 2021 with results capping what was an extremely good year for the ratings company. Revenue for the quarter was up 14.4% to \$380 million, as organic revenue was up 7.9%; the balance of growth was from M&A and forex translation.

License-based revenue soared 20% year-over-year, or 11% on an organic basis, which excludes revenue from the company's acquisition of Sustainalytics. Morningstar noted its PitchBook product continued to benefit from strong year-over-year growth in users at both existing and new accounts. In addition, the company enjoyed strong renewal rates and new sales activity. The company's index products saw record growth in assets during the quarter as well. Transaction-based revenue was up 1.8% year-over-year, or 0.7% on an organic basis.

Operating expense was up 7.7% to \$315 million, due primarily to the Sustainalytics acquisition. With that, operating expense was up slightly due mostly to higher compensation, production expense, and facilities costs.

Operating income came to \$65 million in Q4, up 64% year-over-year. On an adjusted basis, operating income was up 48% to \$85 million. Operating margin was 22.3% of revenue on an adjusted basis, up from 17.1% in the year-ago period. Earnings came to \$1.57 per share on an adjusted basis, up 67% year-over-year.

For the year, Morningstar earned \$5.40 per share on an adjusted basis, and our initial estimate is for much more modest growth this year at \$5.60.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$1.92	\$2.10	\$2.66	\$2.54	\$3.00	\$3.72	\$2.88	\$4.25	\$3.52	\$5.40	\$5.60	\$7.85
DPS	\$0.25	\$0.53	\$0.38	\$0.70	\$0.79	\$0.88	\$0.92	\$1.00	\$1.12	\$1.20	\$1.26	\$1.85
Shares¹	50	46	45	44	43	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 10.9% in the past decade. We see growth slowing down moving forward and are therefore forecasting 7% earnings-per-share growth for the coming years.

We think mid-single-digit revenue growth and a bit of further margin growth potential make 7% 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

¹ Share count in millions

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other licensed products, and the significant costs related to recent mergers should not recur in future years, which will also help boost margins. Morningstar is also now buying back small amounts of its own shares.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	30.3	28.7	27.7	28.2	25.8	21.4	28.1	27.2	40.2	29.8	40.5	30.0
Avg. Yld.	0.4%	0.9%	0.5%	1.0%	1.0%	1.1%	1.1%	0.9%	0.8%	0.7%	0.6%	0.8%

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 40.5 is well in excess of our estimate of fair value, which we see as 30. 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 a high-income stock and likely never will be.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	10%	25%	14%	27%	25%	24%	32%	24%	32%	22%	23%	24%

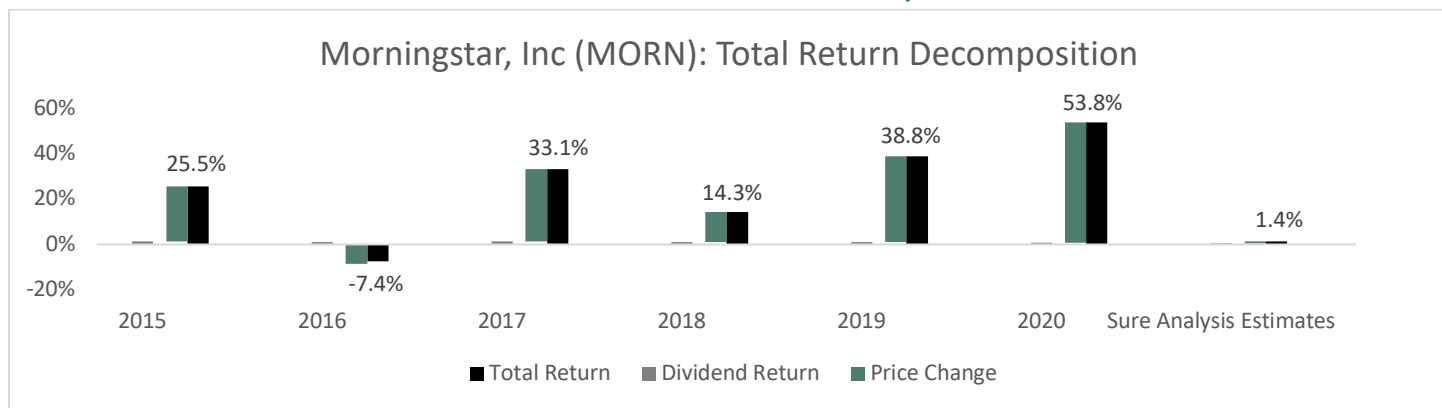
Morningstar's payout ratio is not likely to be significantly above a quarter of earnings anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying quite low for the foreseeable future. Certainly, management has been more interested in investing for future growth, 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 very small total annual returns moving forward, as growth and the small yield could be nearly completely offset by the valuation, which we see as far too high once again. 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	631	658	698	760	789	799	912	1020	1,179	1,390
Gross Profit	396	412	427	442	459	454	525	609	696	833
Gross Margin	62.7%	62.5%	61.1%	58.1%	58.2%	56.9%	57.6%	59.7%	59.0%	60.0%
SG&A Exp.	215	218	211	220	204	203	264	296	389	478
D&A Exp.	43	43	46	55	64	71	91	97	118	140
Operating Profit	138	151	171	167	191	181	170	216	190	215
Operating Margin	21.9%	22.9%	24.4%	21.9%	24.2%	22.6%	18.6%	21.2%	16.1%	15.5%
Net Profit	98	108	124	78	133	161	137	183	152	224
Net Margin	15.6%	16.4%	17.7%	10.3%	16.8%	20.2%	15.0%	17.9%	12.9%	16.1%
Free Cash Flow	142	116	153	78	184	151	184	239	254	308
Income Tax	44	53	56	36	63	64	43	48	46	60

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	1172	1042	1031	1010	1029	1351	1406	1454	2,371	2,696
Cash & Equivalents	200	164	168	185	207	259	308	369	334	423
Accounts Receivable	113	114	114	137	139	146	148	172	189	205
Goodwill & Int. Ass.	458	438	430	466	438	678	660	631	1,373	1,585
Total Liabilities	315	315	339	356	388	654	601	519	1,287	1,425
Long-Term Debt	0	0	0	30	35	250	180	70	513	449
Shareholder's Equity	855	726	690	654	640	697	805	935	1,084	1,271
D/E Ratio	0.00	0.00	0.00	0.05	0.05	0.36	0.22	0.07	0.47	0.35

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	8.7%	9.8%	11.9%	7.7%	13.0%	13.5%	9.9%	12.8%	7.9%	8.8%
Return on Equity	12.0%	13.7%	17.4%	11.7%	20.5%	24.1%	18.2%	21.0%	15.1%	19.0%
ROIC	12.0%	13.6%	17.4%	11.4%	19.5%	19.8%	14.2%	18.4%	11.7%	13.5%
Shares Out.	50	46	45	44	43	43	43	43	43	43
Revenue/Share	12.38	13.39	15.02	16.93	17.81	18.44	21.20	23.72	27.29	32.16
FCF/Share	2.78	2.36	3.29	1.74	4.16	3.49	4.27	5.55	5.89	7.12

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

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