Morningstar, Inc. (MORN)

Updated August 2nd, 2021, by Josh Arnold

Key Metrics

Current Price:	$253	**5 Year CAGR Estimate:**	-0.8%	**Market Cap:**	$10.9 B
Fair Value Price:	$168	**5 Year Growth Estimate:**	7.0%	**Ex-Dividend Date:**	10/08/21[1]
% Fair Value:	151%	**5 Year Valuation Multiple Estimate:**	-7.9%	**Dividend Payment Date:**	10/30/21
Dividend Yield:	0.5%	**5 Year Price Target**	$236	**Years Of Dividend Growth:**	11
Dividend Risk Score:	A	**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 about nine million clients. It produces ~$1.5 billion in annual revenue and has a market capitalization of nearly $11 billion.

Morningstar reported second quarter earnings on July 28th, 2021, and results came in strong once again. Total revenue was up 26.7% to $415 million. Organic revenue, which excludes M&A revenue and forex, was up 16.7% year-over-year. Morningstar noted strong demand for products and solutions as market conditions continue to be positive.

License-based revenue was up 25% year-over-year, or 13% on an organic basis, which excludes revenue from the fairly recent Sustainalytics acquisition. PitchBook, Morningstar Data, and Morningstar Direct were the primary contributors to license-based organic revenue growth in the quarter. Asset-based revenue was up 25% year-over-year, and 23% organically. Transaction-based revenue was up 33.5%, and 24.6% on an organic basis, driven by stronger issuance activity at DBRS Morningstar and higher ad spending on Morningstar.com.

Operating expenses were up 38% to $368 million, which included $26.6 million of accruals against compensation expenses for earn-outs for the Sustainalytics acquisition, which are due in 2022. Excluding this, expenses were up 18% year-over-year. Operating income was $47 million, a decline of -23% year-over-year. On an adjusted basis, operating income was $96 million, an increase of 21%. Second quarter operating margin was 23.2% of revenue on an adjusted basis, off from 24.3% in last year's Q2.

Net income was $1.76 per diluted share on an adjusted basis in Q2, up 23% year-over-year. We've kept our estimate of $5.60 per share in earnings for this year unchanged following Q2 results, noting that adjusted earnings are on track for our expectations for this year.

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***
Shares[2]	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

[1] Estimated date
[2] Share count in millions

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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. Morningstar is also now buying back small amounts of its 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	***45.2***	***30.0***
Avg. Yld.	0.4%	0.9%	0.5%	1.0%	1.0%	1.1%	1.1%	0.9%	0.8%	0.7%	***0.5%***	***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 42.1 is well in excess of our estimate of fair value, which we see as 30, and indeed, is even higher than our last update. 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 below 1% for the foreseeable future; Morningstar is not a high-income stock.

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%***

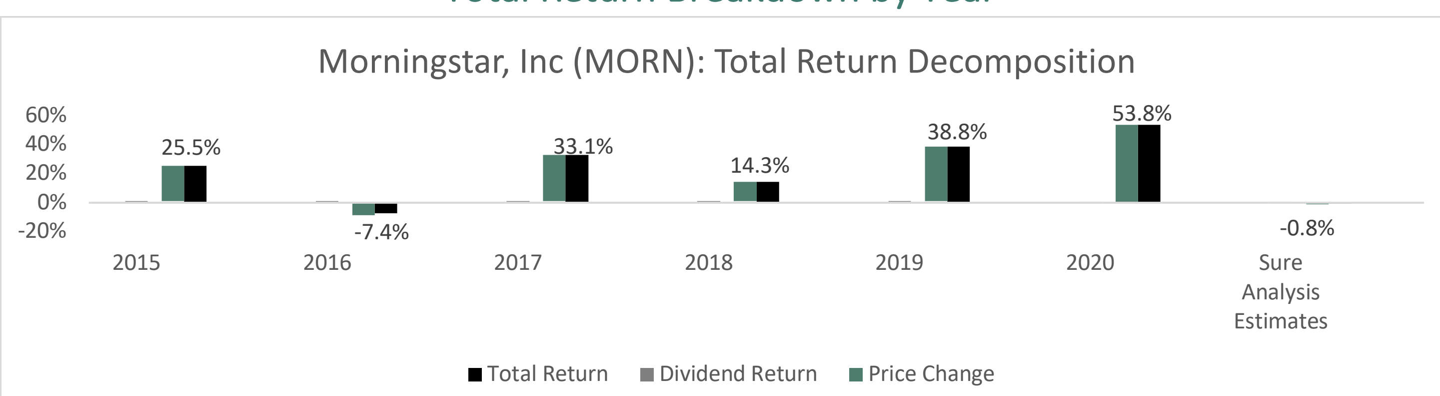
Morningstar's payout ratio is not likely to be significantly above a quarter of earnings anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying quite low for the foreseeable future. Certainly, management has been more interested in investing for future growth,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

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 negative 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 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.