Morningstar, Inc. (MORN)

Updated November 7th, 2022, by Josh Arnold

Key Metrics

Current Price:	$232	**5 Year CAGR Estimate:**	-1.7%	**Market Cap:**	$9.8 B
Fair Value Price:	$116	**5 Year Growth Estimate:**	12.0%	**Ex-Dividend Date:**	01/17/23[1]
% Fair Value:	201%	**5 Year Valuation Multiple Estimate:**	-13.0%	**Dividend Payment Date:**	01/31/23
Dividend Yield:	0.6%	**5 Year Price Target**	$204	**Years Of Dividend Growth:**	11
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Rating:**	Sell

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 ~$1.8 billion in annual revenue and has a market capitalization of just under $10 billion.

Morningstar reported third quarter earnings on October 26th, 2022, and results were quite weak. Revenue was up 9% year-over-year to $468 million. Organic revenue was up 8.5%, led by strong license-based products. Indeed, license-based revenue soared 19.4% overall, and up 18.3% on an organic basis. The company's PitchBook, Morningstar Sustainalytics, Morningstar Data, and Morningstar Direct portfolios grew collectively at 24.5% on an organic basis in the third quarter.

Transaction-based revenue plummeted 21%, or 18% on an organic basis, due to the marked slowdown in global credit ratings activity. This is a direct result of soaring interest rates, thereby making new debt issuances unattractive for corporations and municipalities.

Operating expense was up 24% year-over-year, but about 9% of that was due to restructuring of the company's business in China. Excluding that, operating expenses rose 15%.

Operating income was down 8.3% to $77 million on an adjusted basis, as adjusted operating margin was 16.4% of revenue, down from 19.4% a year ago.

Earnings on an adjusted basis came to 77 cents, down almost half year-over-year. We have cut our estimate of earnings-per-share for this year to $3.50 following higher-than-expected expense growth.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$2.10	$2.66	$2.54	$3.00	$3.72	$2.88	$4.25	$3.52	$5.40	$6.36	***$3.50***	***$6.17***
DPS	$0.53	$0.38	$0.70	$0.79	$0.88	$0.92	$1.00	$1.12	$1.20	$1.44	***$1.44***	***$2.12***
Shares[2]	46	45	44	43	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 more than 10% in the past decade. We see growth as continuing at this pace going forward on the strength of PitchBook, in particular, and are therefore forecasting 12% earnings-per-share growth for the coming years.

We think high-single digit revenue growth and a bit of further margin growth potential make 12% earnings-per-share growth look feasible from 2022's low level of earnings. 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

[1] Estimated date

[2] 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.

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. We note that high interest rates globally will likely crimp transaction-based revenue for the foreseeable future. Morningstar is also now buying back small amounts of its shares.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	28.7	27.7	28.2	25.8	21.4	28.1	27.2	40.2	29.8	41.1	***66.3***	***33.0***
Avg. Yld.	0.9%	0.5%	1.0%	1.0%	1.1%	1.1%	0.9%	0.8%	0.7%	0.5%	***0.6%***	***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 66.3 is still well in excess of our estimate of fair value, which we see as 33. The stock has declined since our last update, and in conjunction with lower earnings, the valuation has deteriorated significantly. The security could experience a significant annual headwind to total returns as the valuation returns to more normalized levels. We see the yield remaining below 1% for the foreseeable future; Morningstar is not a high-income stock.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	25%	14%	27%	25%	24%	32%	24%	32%	22%	23%	***41%***	***34%***

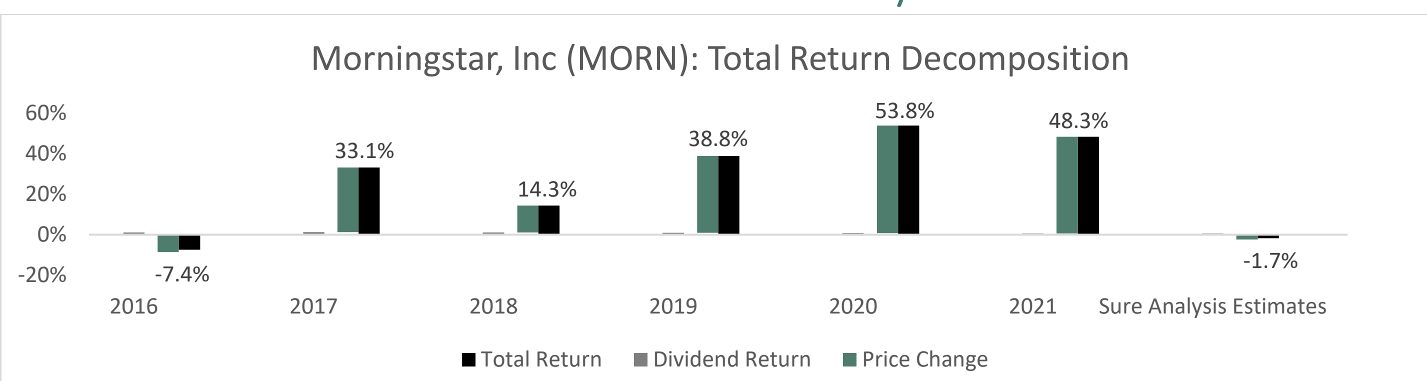
Morningstar's payout ratio is not likely to be above half of earnings anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying quite low for the foreseeable future. Certainly, management has been more interested in investing for future growth, and that strategy 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 is still quite overvalued, making it less compelling at present. We are forecasting -1.7% total annual returns moving forward, as 12% growth and the 0.6% yield could be offset by the 13% valuation headwind. We are downgrading the stock from hold to sell following Q3 results.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	658	698	760	789	799	912	1,020	1,179	1,390	1,699
Gross Profit	412	427	442	459	454	525	609	696	833	1,001
Gross Margin	62.5%	61.1%	58.1%	58.2%	56.9%	57.6%	59.7%	59.0%	60.0%	58.9%
SG&A Exp.	218	211	220	204	203	264	296	389	478	593
D&A Exp.	43	46	55	64	71	91	97	118	140	151
Operating Profit	151	171	167	191	181	170	216	190	215	257
Operating Margin	22.9%	24.4%	21.9%	24.2%	22.6%	18.6%	21.2%	16.1%	15.5%	15.1%
Net Profit	108	124	78	133	161	137	183	152	224	193
Net Margin	16.4%	17.7%	10.3%	16.8%	20.2%	15.0%	17.9%	12.9%	16.1%	11.4%
Free Cash Flow	116	153	78	184	151	184	239	254	308	348
Income Tax	53	56	36	63	64	43	48	46	60	63

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	1,042	1,031	1,010	1,029	1,351	1,406	1,454	2,371	2,696	2,863
Cash & Equivalents	164	168	185	207	259	308	369	334	423	484
Accounts Receivable	114	114	137	139	146	148	172	189	205	269
Goodwill & Int. Ass.	438	430	466	438	678	660	631	1,373	1,585	1,535
Total Liabilities	315	339	356	388	654	601	519	1,287	1,425	1,447
Long-Term Debt	--	---	30	35	250	180	70	513	449	359
Shareholder's Equity	726	690	654	640	697	805	935	1,084	1,271	1,416
LTD/E Ratio	---	---	0.05	0.05	0.36	0.22	0.07	0.47	0.35	0.25

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	9.8%	11.9%	7.7%	13.0%	13.5%	9.9%	12.8%	7.9%	8.8%	7.0%
Return on Equity	13.7%	17.4%	11.7%	20.5%	24.1%	18.2%	21.0%	15.1%	19.0%	14.4%
ROIC	13.6%	17.4%	11.4%	19.5%	19.8%	14.2%	18.4%	11.7%	13.5%	11.1%
Shares Out.	46	45	44	43	43	43	43	43	43	43
Revenue/Share	13.39	15.02	16.93	17.81	18.44	21.20	23.72	27.29	32.16	39.15
FCF/Share	2.36	3.29	1.74	4.16	3.49	4.27	5.55	5.89	7.12	8.02

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