Morningstar, Inc. (MORN)

Updated March 12th, 2023, by Josh Arnold

Key Metrics

Current Price:	$191	**5 Year CAGR Estimate:**	11.1%	**Market Cap:**	$8.1 B
Fair Value Price:	$178	**5 Year Growth Estimate:**	12.0%	**Ex-Dividend Date:**	04/05/23
% Fair Value:	107%	**5 Year Valuation Multiple Estimate:**	-1.4%	**Dividend Payment Date:**	04/27/23
Dividend Yield:	0.8%	**5 Year Price Target**	$314	**Years Of Dividend Growth:**	12
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Rating:**	Buy

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 ~$2.1 billion in annual revenue and has a market capitalization of just over $8 billion.

Morningstar reported fourth quarter earnings on February 23rd, 2023, and results were once again somewhat weak. Adjusted earnings-per-share came to 58 cents, and for the full year, earnings were $3.87 per share. This is the lowest earnings level since 2019. Revenue was 2.8% higher year-over-year to $475 million.

License-based revenue was up 16% year-over-year, and up 14.9% on an organic basis. Asset-based revenue declined 6.1% from the year-ago period, and declined 8.9% organically. This was due to declines in all major asset classes in the segment.

Transaction-based revenue was down 34.5% year-over-year, and down 31.9% on an organic basis. This was due to the decline in DBRS Morningstar revenue as global credit issuance activity is very low. So long as interest rates remain high, Morningstar's transaction revenue is at risk.

Operating income was down 27.2% on an adjusted basis. Results were hurt by higher stock-based compensation, primarily. Adjusted earnings-per-share fell 61% year-over-year, capping an overall weak year.

We begin 2023 with an estimate of $5.40 in earnings-per-share.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$2.66	$2.54	$3.00	$3.72	$2.88	$4.25	$3.52	$5.40	$6.36	$3.87	***$5.40***	***$9.52***
DPS	$0.34	$0.38	$0.70	$0.79	$0.88	$0.92	$1.00	$1.12	$1.20	$1.44	***$1.50***	***$2.20***
Shares[1]	45	44	43	43	43	43	43	43	43	43	***42***	***40***

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 2023's relatively 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 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

[1] Share count in millions

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	27.7	28.2	25.8	21.4	28.1	27.2	40.2	29.8	41.1	56.0	***35.4***	***33.0***
Avg. Yld.	0.5%	1.0%	1.0%	1.1%	1.1%	0.9%	0.8%	0.7%	0.5%	0.7%	***0.8%***	***0.7%***

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 35.4 is still in excess of our estimate of fair value, which we see as 33. The stock has declined since our last update, but earnings estimates have risen. The security could experience a small 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	14%	27%	25%	24%	32%	24%	32%	22%	23%	39%	***28%***	***23%***

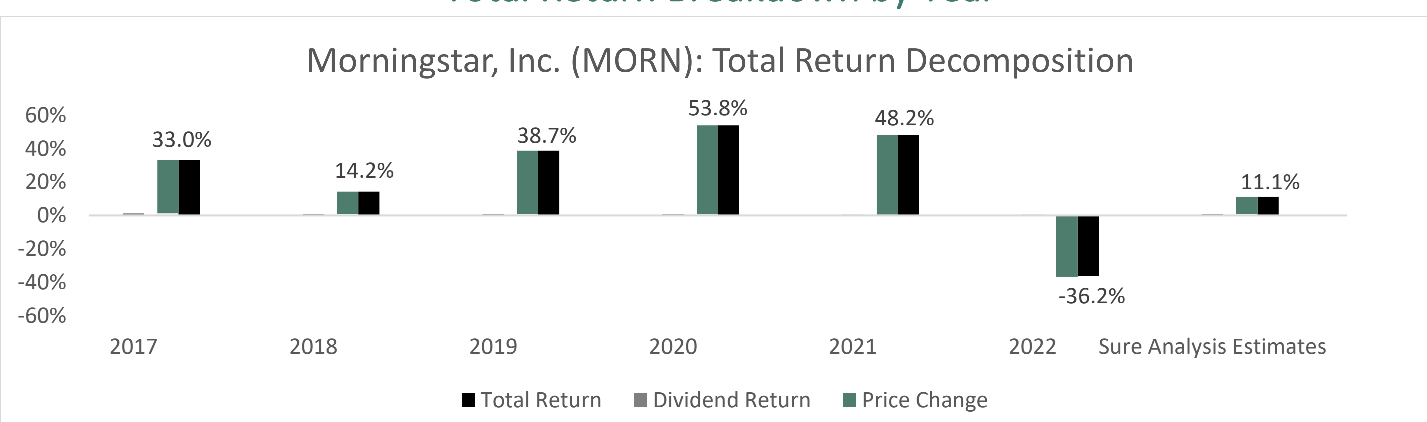
Morningstar's payout ratio is not likely to be above a third of earnings anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying quite low for the foreseeable future. Certainly, management has been more interested in investing for future growth, and that strategy 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 overvalued. We are forecasting robust 11.1% total annual returns moving forward, as 12% growth and the 0.8% yield could be partially offset by a 1.4% valuation headwind. As we look forward to 2023, we are giving the stock a two-notch upgrade from sell to buy.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	698	760	789	799	912	1,020	1,179	1,390	1,699	1,871
Gross Profit	427	442	459	454	525	609	696	833	1,001	1,091
Gross Margin	61.1%	58.1%	58.2%	56.9%	57.6%	59.7%	59.0%	60.0%	58.9%	58.3%
SG&A Exp.	211	220	204	203	264	296	389	478	593	757
D&A Exp.	46	55	64	71	91	97	118	140	151	167
Operating Profit	171	167	191	181	170	216	190	215	257	168
Operating Margin	24.4%	21.9%	24.2%	22.6%	18.6%	21.2%	16.1%	15.5%	15.1%	9.0%
Net Profit	124	78	133	161	137	183	152	224	193	71
Net Margin	17.7%	10.3%	16.8%	20.2%	15.0%	17.9%	12.9%	16.1%	11.4%	3.8%
Free Cash Flow	153	78	184	151	184	239	254	308	348	168
Income Tax	56	36	63	64	43	48	46	60	63	57

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,031	1,010	1,029	1,351	1,406	1,454	2,371	2,696	2,863	3,475
Cash & Equivalents	168	185	207	259	308	369	334	423	484	377
Accounts Receivable	114	137	139	146	148	172	189	205	269	308
Goodwill & Int. Ass.	430	466	438	678	660	631	1,373	1,585	1,535	2,120
Total Liabilities	339	356	388	654	601	519	1,287	1,425	1,447	2,268
Long-Term Debt	---	30	35	250	180	70	513	449	359	1,110
Shareholder's Equity	690	654	640	697	805	935	1,084	1,271	1,416	1,207
LTD/E Ratio	---	0.05	0.05	0.36	0.22	0.07	0.47	0.35	0.25	0.92

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	11.9%	7.7%	13.0%	13.5%	9.9%	12.8%	7.9%	8.8%	7.0%	2.2%
Return on Equity	17.4%	11.7%	20.5%	24.1%	18.2%	21.0%	15.1%	19.0%	14.4%	5.4%
ROIC	17.4%	11.4%	19.5%	19.8%	14.2%	18.4%	11.7%	13.5%	11.1%	3.4%
Shares Out.	45	44	43	43	43	43	43	43	43	43
Revenue/Share	15.02	16.93	17.81	18.44	21.20	23.72	27.29	32.16	39.15	43.60
FCF/Share	3.29	1.74	4.16	3.49	4.27	5.55	5.89	7.12	8.02	3.92

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