Morningstar, Inc. (MORN)

Updated August 4th, 2023, by Josh Arnold

Key Metrics

Current Price:	$225	**5 Year CAGR Estimate:**	4.3%	**Market Cap:**	$9.6 B
Fair Value Price:	$134	**5 Year Growth Estimate:**	15.0%	**Ex-Dividend Date:**	10/05/23[1]
% Fair Value:	168%	**5 Year Valuation Multiple Estimate:**	-9.9%	**Dividend Payment Date:**	10/27/23
Dividend Yield:	0.7%	**5 Year Price Target**	$269	**Years Of Dividend Growth:**	12
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Rating:**	Hold

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 billion in annual revenue and has a market capitalization of almost $10 billion.

Morningstar posted second quarter earnings on July 26th, 2023, and results were mixed. The company posted revenue growth of 7.3% to $505 million, with organic revenue contributing 5.1% of that. Management noted that transaction-based revenue was impacted by weakness in the commercial mortgage-backed securities market, which is struggling due to rising rates. However, license-based revenue was a source of strength once again. Licensing revenue was up 14.8% year-over-year, including a 12.2% organic increase.

Reported operating income fell 22.6% to $41.7 million, while adjusted operating income fell 5%. Operating expenses rose 11.2% to $463 million, including $7 million in costs related to closing operations in China. Compensation costs, severance costs, and depreciation all contributed.

Operating margin was 13.8% of revenue on an adjusted basis, which was off from 15.6% in the year-ago period. Net income was $1.30 per share on an adjusted basis, up from $1.17 in the last year's Q2. However, we've reduced our estimate to $4.05 following Q2 results.

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	***$4.05***	***$8.15***
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[2]	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 15% earnings-per-share growth for the coming years.

We think high-single digit revenue growth and a bit of further margin growth potential make 15% 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 related to recent mergers should not recur in future years, which will also help boost margins. We note that high

[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.

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	***55.6***	***33.0***
Avg. Yld.	0.5%	1.0%	1.0%	1.1%	1.1%	0.9%	0.8%	0.7%	0.5%	0.7%	***0.7%***	***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 55.6 is far in excess of our estimate of fair value, which we see as 33. The stock has risen since our last update, but earnings estimates have fallen. The security could experience a sizable 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%	***37%***	***27%***

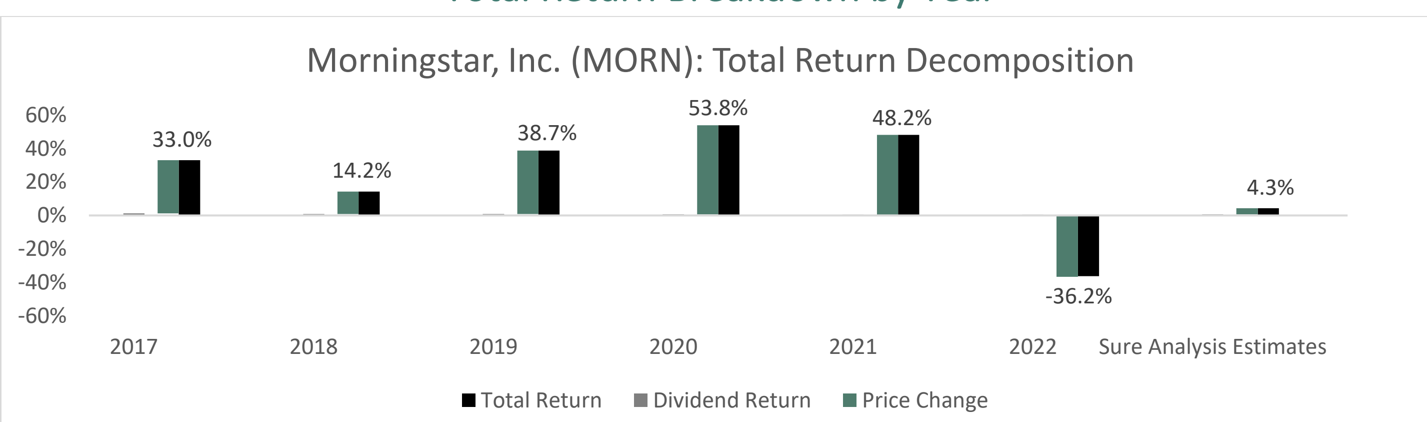
Morningstar's payout ratio is not likely to be above 40% of earnings anytime soon, barring a major shift in capital allocation strategy, so we see the yield as staying quite low for the foreseeable future. Certainly, management has been more interested in investing for future growth, and that strategy isn't going to change anytime soon. We also see rapidly rising earnings as a way to reduce the payout ratio.

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 excessively overvalued. We are forecasting 4.3% total annual returns moving forward, as 15% growth and the 0.7% yield could be partially offset by a 9.9% valuation headwind. Given this, we're reiterating the stock at a hold rating.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

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.

Morningstar, Inc. (MORN)

Updated August 4th, 2023, by Josh Arnold

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.