Moody's Investors Service Research Report

Written by Richard M. Rockwood
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Moody's Investors Service is the leading global provider of credit ratings, research and analysis of debt instruments and other securities for the capital markets.

Moody's publishes rating opinions on a broad range of credit obligations that include United States corporate and government obligations, Eurosecurities, structured finance securities and commercial paper issues. In 1996 Moody's began to widen its scope of operation by initiating rating services on insurance companies' obligations, bank loans, derivative product companies, debt, mutual funds, and derivates. At the beginning of 1999, it had ratings on 100,000 corporate and 68,000 public finance obligations (up from 70,000 and 60,000 respectively at the beginning of 1997).

Moody's also publishes investor-oriented credit research for over 15,000 subscribers. This includes over 100 research products.

Moody's is being separated from its current parent company, Dun & Bradstreet (NYSE: DNB). This spin-off should conclude on September 30, 2000. At that time the shares held under the old Dun & Bradstreet name revert to being shares in Moody's and investors will receive one share of the New Dun & Bradstreet Corporation for each two shares they held of the parent company before the spin-off.

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Financial Numbers & Ratios:

	1999	1998	1997	1996	1995
Revenue* (mill):	564.2	513.9	457.4	385.3	329.7
Income (mill):	278.9	237.9	190.2	133.0	114.9
Gross Profit Margins:	49.4	46.2	41.5	34.5	34.8
EPS (Diluted):	.95	.83	.61	.45	.51
EPS Growth (%):	14.5	36.1	35.6	(11.8)	-

Capital Expenditures:

In millions	9.8	7.5	11.0	10.3	-

(* Moody's has grown its revenues at a 17 percent compound annual rate since 1980.)

History of Moody's

Mr. Moody (1868 - 1958) laid the foundations for Moody's Investors Service in 1900, when he published Moody's Manual of Industrial and Corporation Securities. In 1909, Moody introduced the first bond ratings as part of Moody's Analyses of Railroad Investments. He used the Aaa-through-C symbols that have since become a world standard to rate some 1,500 individual securities of over 200 US railroads. From the very beginning, Moody assigned independent rating opinions to help his investor readers manage credit risk. Then -- as now -- Moody's ratings were based on public information and assigned without the request of issuers.

Not surprisingly, his innovation raised more than a few eyebrows among the financiers of Wall Street. Half a century later Moody recalled:

> *"In the Spring of 1909 I brought out the first edition of a new type of Railroad Manual which attempted to analyze railroad reports and rate their bond issues. While it raised a storm of opposition, not to mention ridicule from some quarters, it took hold with dealers and investment houses... and long before 1914 it was a recognized authority and "Moody's Ratings" had become an important factor in the bond trading and bond selling field. Moody's Investors Service was incorporated in 1914, the year Moody began expanding rating coverage to bonds issued by US cities and other municipalities. By 1924, Moody's ratings covered nearly 100 percent of the US bond market."*

Moody's continued to publish and monitor ratings during the Great Depression, when bond default rates skyrocketed but few bonds highly-rated by Moody's missed payments. In the 1970s, Moody's ratings were further extended to the commercial paper market and to bank deposits. Also in the 1970s, the major rating agencies including Moody's began the practice of charging issuers as well as investors for rating services. The rationale for this change was, and is, that issuers should pay for the substantial value objective ratings provide in terms of market access. In addition, it was recognized that the increasing scope and complexity of the capital markets demanded staffing at higher levels of compensation than could be received from publication subscriptions alone.

Recent Performance and News

Growth at Moody's Investors Service slowed in the first quarter, primarily because of the decline in U.S. debt issuance. Despite market conditions, Moody's results for revenue and operating income were the best in the firm's history for the first quarter.

Moody's first-quarter revenues increased by 2 percent to $139.2 million from $136.9 million a year ago. Operating income increased by 3 percent to $65.5 million from $63.7 million in the first quarter of 1999. Securities issuance in the U.S. capital markets declined in the first quarter 2000 versus the same period in 1999 as a result of unsettled market conditions related to interest rate increases. This resulted in revenue declines in the taxable, structured and tax-exempt markets. However, bank loan ratings revenues doubled and offset declines in high-yield bonds. International ratings revenues increased 44 percent, driven by new corporate issuers in Europe and strong growth in structured finance in Europe and Japan. Revenue from research products grew 24 percent due to international sales and strong demand for Internet delivery.

John Rutherfurd, Jr., president of Moody's Investors Service, will become president and chief executive officer of Moody's Corporation after the spin-off in September.

Mr. Rutherfurd joined The Dun & Bradstreet Corporation in 1988. At Moody's, he served as managing director of new business development and as chief administrative officer before being named president in 1998. Earlier, Mr. Rutherfurd was a founder and president of Interactive Data Corporation, a leading provider of securities pricing and other data for investment accounting. Prior to that, he was vice president and chief of staff, Chase Information Services Group, Chase Manhattan Bank. He began his career as an attorney at Shearman & Sterling in New York City. Mr. Rutherfurd has an A.B. degree from Princeton University and an L.L.B. degree from Harvard University.

Growth Prospects

Over the last ten years the global market for fixed-income securities has more than doubled in outstanding principal amount. Not only have they doubled but also they have become increasingly more complex. I believe both these factors will continue going forward and Moody's will be in a position to use its competitive advantages to gain more business in the future. Another interesting fact is that information is flowing freely across the globe creating demand for security issues issued outside their own countries; they can turn to Moody's for high-quality information on these securities. Moody's also benefits from this global interest because more issuers are choosing to finance in the global public market.

Areas of Concern

Most of Moody's revenues come from rating fees (approximately 90%) paid by security issuers, this makes Moody's profits sensitive to the volume of debt securities issued in the global market. Regulators in various countries have created their own national rating agencies, these may give less credible rating which could make all rating agencies appear in a bad light.

Moody's most direct competitor is the Standard and Poor's Corporation (a division of McGraw Hill). The two companies are evenly matched and this industry has allowed both to prosper. Duff & Phelps and Fitch IBCA are smaller companies in this industry and can be counted to fight for more market share in the rating industry. In short competition doesn't seem as destructive in this industry as say in the retail industry.

Moody's Strategy*

Moody's intends to focus its business strategy on the following opportunities:

CONTINUING INTERNATIONAL EXPANSION

Moody's maintains a global network of offices and business affiliations, including full-service rating and marketing operations in the major global financial centers of Frankfurt, Hong Kong, London, Paris and Tokyo. Moody's expects that these centers will position it to benefit from the expansion in global capital markets and offer the greatest potential for its revenue growth. Moody's also expects accelerated growth of its ratings activities as a consequence of financial market integration under the EMU and from ongoing global development of non-traditional financial instruments (e.g., derivatives, credit-linked bonds and catastrophe bonds). Moody's expects to continue its expansion into developing markets through joint ventures or affiliations.

DEVELOPING NEW RATING PRODUCTS

Moody's is pursuing initiatives that expand credit ratings from securities markets to other sectors with credit risk exposures. Moody's has a committed effort to extend its opinion franchise to the global bank counterparty universe through emerging market ratings, including bank financial strength ratings. Insurance financial strength ratings in the property and casualty, reinsurance, and life insurance markets represent additional growth opportunities. Moody's has also introduced issuer ratings for mid-sized corporations not active in the debt markets and Moody's is investigating numerous non-traditional opportunities to extend its opinion franchise.

As the loan and capital markets converge, Moody's expects to continue to expand coverage for ratings of bank loans. Moody's has also introduced equity mutual fund indices and fund analyzers for institutional fund managers.

PURSUING OPPORTUNITIES IN SECURITIZATION

The repackaging of financial assets has had a profound effect on the U.S. fixed-income market. New patterns of securitization are expected to emerge in the next decade. Although, the bulk of assets securitized in the past five years are consumer assets owned by banks, commercial assets, principally commercial mortgages, term receivables and corporate loans, are now increasingly being securitized. Securitization concepts are rapidly being exported to Europe and Asia, evolving into a strategic corporate finance tool.

Moody's is aggressively pursuing opportunities in these areas.

PURSUING CREDIT RISK MANAGEMENT SERVICES

Moody's will continue to provide banks and other financial institutions with credit risk management services. Moody's believes that there will be increased demand for such services because of recent proposals by international bank regulatory authorities to recognize bank internal credit risk management systems for the purposes of determining regulatory capital.

PURSUING GROWTH OF RESEARCH PRODUCTS

Moody's will continue to expand its research products business by seeking customers in new geographic areas, producing and acquiring by arrangements with others additional research products and pursuing growth by means of Internet delivery. Internet delivery enables Moody's to provide services to more individuals within a client organization than paper-based products and to offer higher-value services because customers do not need to handle paper-based reports.

- Source: DNB 10K FOR THE FISCAL YEAR ENDED DECEMBER 31, 1999

<u>Reasons to Consider Purchase</u>

- Name (i.e. Harvard)

  Moody's has a strong reputation and a well-known brand name. Charlie Munger at the 2000 Berkshire Hathaway had this to say: "Moody's is like Harvard, a self-fulfilling prophecy." I believe he is trying to relay the idea that people go to Harvard because of the "image" it creates in people's minds, I think the Moody brand name conveys an image of respect, quality and trust.

- Repeat business (i.e. Coke)

  Moody's business model revolves around repeat business; its customers will always need to issue debt in the future and Moody will be waiting. Warren Buffett had this to say about Moody's, " The moat is far wider and deeper in the case of Moody's than the operating company." Social Proof seems to apply in this business, that is, when companies are all being rated by Moody's new companies will want to be rated versus the same standard.

- Intrinsic Value

  Using a three-stage discount cash flow model I came up with an intrinsic value of Moody's between $31 and $34 a share. My assumptions were earnings would grow at 12-15% per year for the first ten years, 10% for the next ten, and 1% thereafter. I used a 7% discount rate.

- Arbitrage Possibility

  The D& B Operating Company is worth in the $5 dollar range; it is hard to calculate what the company is truly worth since the business is being reorganized to focus on an internet model. If you can purchase the stock before the spin-off for a price of $28 dollars you are getting Moody's for a 11-

21% discount to intrinsic value and getting the D&B Operating company spin-off for free.

- Berkshire Hathaway as a Major Shareholder (14.9%)

  Dun & Bradstreet has a poison pill that goes into effect if anyone acquires 15% or more of its shares so Mr. Buffett had to stop purchasing shares at the 14.9% ownership level. Moody's has already adopted a shareholder's rights plan so I don't see Berkshire Hathaway's ownership level increasing from this level anytime soon.

- Great Free Cash Flow

  Moody's requires very little capital expenditures to keep the business functioning properly. This will allow Moody's to either increase dividends or repurchase shares in the future (or pay down debt). Moody's can also re-invest the earnings back into its business; it has grown earnings by approximately 18.6% over the last 4 years.

- High Margins

  Moody's has a high profit margin, which has been increasing over the last several years. High margins are generally a sign of a very healthy and profitable business. They also tend to attract competitors; however, I think Moody has a fairly well stocked moat to keep them at bay.

- Stock Repurchase Program

  Dun & Bradstreet and Moody's expect to commence share repurchase programs following the distribution to offset the dilutive effect of shares issued under their respective employee benefit plans. Moody's intends to use additional share repurchase programs (as well as dividends) as a way to return free cash flow to shareholders going forward.

- Volatility of Earnings

  I believe Moody's earnings have an excellent change of being volatile in any given quarter or year since their revenues are so tied to the fortunes of the debt market. Volatility is the friend of the patient investor so in the future the possibility of acquiring more shares of Moody's at an advantageous price is strong.