

Morningstar, Inc.
Form 10-Q
July 31, 2014

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED June 30, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File Number: 000-51280

MORNINGSTAR, INC.

(Exact Name of Registrant as Specified in its Charter)

Illinois

(State or Other Jurisdiction of
Incorporation or Organization)

36-3297908

(I.R.S. Employer
Identification Number)

22 West Washington Street

Chicago, Illinois

(Address of Principal Executive Offices)

(312) 696-6000

(Registrant's Telephone Number, Including Area Code)

60602

(Zip Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

Edgar Filing: Morningstar, Inc. - Form 10-Q

As of July 25, 2014 there were 44,721,637 shares of the Company's common stock, no par value, outstanding.

Table of Contents

MORNINGSTAR, INC. AND SUBSIDIARIES
INDEX

<u>PART 1</u>	<u>FINANCIAL INFORMATION</u>	<u>3</u>
<u>Item 1.</u>	<u>Financial Statements</u>	<u>3</u>
	Unaudited Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2014 and 2013	<u>4</u>
	Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2014 and 2013	<u>5</u>
	Unaudited Condensed Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013	<u>6</u>
	Unaudited Condensed Consolidated Statement of Equity for the six months ended June 30, 2014	<u>7</u>
	Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013	<u>8</u>
	<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	<u>9</u>
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>42</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>	<u>42</u>
<u>PART 2</u>	<u>OTHER INFORMATION</u>	<u>44</u>
<u>Item 1.</u>	<u>Legal Proceedings</u>	<u>44</u>
<u>Item 1A.</u>	<u>Risk Factors</u>	<u>44</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>44</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>44</u>
<u>SIGNATURE</u>		<u>45</u>
<u>EXHIBIT INDEX</u>		<u>46</u>

Table of Contents

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

3

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

(in thousands except per share amounts)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Revenue	\$ 189,385	\$ 175,428	\$ 370,550	\$ 344,284
Operating expense (1):				
Cost of revenue	81,387	64,427	157,101	126,077
Sales and marketing	27,949	28,035	56,377	56,015
General and administrative	30,438	28,120	56,542	55,447
Depreciation and amortization	13,391	11,262	25,778	22,601
Litigation settlement (2)	61,000	—	61,000	—
Total operating expense	214,165	131,844	356,798	260,140
Operating income (loss)	(24,780	) 43,584	13,752	84,144
Non-operating income:				
Interest income, net	634	664	1,219	1,405
Gain on sale of investments, reclassified from other comprehensive income	371	423	347	1,148
Holding gain upon acquisition of additional ownership of equity and cost method investments	5,168	3,713	5,168	3,713
Other income (expense), net	(275	) (1,689	) 29	(2,210
Non-operating income, net	5,898	3,111	6,763	4,056
Income (loss) before income taxes and equity in net income of unconsolidated entities	(18,882	) 46,695	20,515	88,200
Equity in net income of unconsolidated entities	497	360	1,096	857
Income tax expense (benefit)	(8,611	) 15,955	5,039	28,382
Consolidated net income (loss)	(9,774	) 31,100	16,572	60,675
Net loss attributable to the noncontrolling interest	5	21	35	64
Net income (loss) attributable to Morningstar, Inc.	\$(9,769	) \$31,121	\$16,607	\$60,739
Net income (loss) per share attributable to Morningstar, Inc.:				
Basic	\$(0.22	) \$0.67	\$0.37	\$1.31
Diluted	\$(0.22	) \$0.66	\$0.37	\$1.30
Dividends per common share:				
Dividends declared per common share	\$0.17	\$0.13	\$0.34	\$0.25
Dividends paid per common share	\$0.17	\$0.13	\$0.34	\$0.13

Edgar Filing: Morningstar, Inc. - Form 10-Q

Weighted average shares outstanding:

Basic	44,777	46,400	44,778	46,403
Diluted	44,777	46,853	45,039	46,756

Three months ended June 30
2014 2013

Six months ended June 30
2014 2013

(1) Includes stock-based compensation expense of:

Cost of revenue	\$1,890	\$1,691	\$3,652	\$3,392
Sales and marketing	530	522	1,027	1,034
General and administrative	1,943	1,741	3,623	3,311
Total stock-based compensation expense	\$4,363	\$3,954	\$8,302	\$7,737

(2) See Note 11, Contingencies, for additional information.

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)

(in thousands)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Consolidated net income (loss)	\$(9,774	) \$31,100	\$16,572	\$60,675
Other comprehensive income (loss):				
Foreign currency translation adjustment	2,861	(7,128	) 5,333	(16,199
Unrealized gains on securities, net of tax:				
Unrealized holding gains (losses) arising during period	280	(166	) 396	1,000
Reclassification of gains included in net income	(233	) (271	) (218	) (734
Other comprehensive income (loss)	2,908	(7,565	) 5,511	(15,933
Comprehensive income (loss)	(6,866	) 23,535	22,083	44,742
Comprehensive loss attributable to noncontrolling interest	10	64	15	206
Comprehensive income (loss) attributable to Morningstar, Inc.	\$(6,856	) \$23,599	\$22,098	\$44,948

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(in thousands except share amounts)	As of June 30 2014	As of December 31 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 176,254	\$ 168,160
Investments	44,696	130,407
Accounts receivable, less allowance of \$762 and \$1,089, respectively	135,017	114,131
Deferred tax asset, net	6,437	3,892
Income tax receivable, net	18,616	3,942
Other current assets	21,565	26,361
Total current assets	402,585	446,893
Property, equipment, and capitalized software, less accumulated depreciation and amortization of \$119,859 and \$106,166, respectively	109,900	104,986
Investments in unconsolidated entities	30,287	38,714
Goodwill	388,837	326,450
Intangible assets, net	111,779	103,909
Other assets	7,835	9,716
Total assets	\$ 1,051,223	\$ 1,030,668
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 97,251	\$ 42,131
Accrued compensation	58,409	71,403
Deferred revenue	161,921	149,225
Other current liabilities	4,607	6,786
Total current liabilities	322,188	269,545
Accrued compensation	7,512	8,193
Deferred tax liability, net	19,183	23,755
Deferred rent	23,158	23,938
Other long-term liabilities	10,520	13,947
Total liabilities	382,561	339,378
Equity:		
Morningstar, Inc. shareholders' equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 44,715,637 and 44,967,423 shares were outstanding as of June 30, 2014 and December 31, 2013, respectively	5	5
Treasury stock at cost, 7,676,092 shares as of June 30, 2014 and 7,202,896 shares as of December 31, 2013	(484,560)	(449,054)
Additional paid-in capital	545,624	539,507
Retained earnings	595,911	594,626
Accumulated other comprehensive income:		
Currency translation adjustment	9,922	4,609
Unrealized gain on available-for-sale investments	742	564
Total accumulated other comprehensive income	10,664	5,173
Total Morningstar, Inc. shareholders' equity	667,644	690,257

Edgar Filing: Morningstar, Inc. - Form 10-Q

Noncontrolling interests	1,018	1,033
Total equity	668,662	691,290
Total liabilities and equity	\$ 1,051,223	\$ 1,030,668

See notes to unaudited condensed consolidated financial statements.

6

Table of Contents

Morningstar, Inc. and Subsidiaries
 Unaudited Condensed Consolidated Statement of Equity
 For the six months ended June 30, 2014

(in thousands, except share amounts)	Morningstar, Inc. Shareholders' Equity					Accumulated Other Comprehensive Income (Loss)	Non Controlling Interests	Total Equity
	Common Stock Shares Outstanding	Par Value	Treasury Stock	Additional Paid-in Capital	Retained Earnings			
Balance as of December 31, 2013	44,967,423	\$5	\$(449,054)	\$539,507	\$594,626	\$5,173	\$1,033	\$691,290
Net income (loss)		—	—	—	16,607	—	(35)	16,572
Other comprehensive income (loss):								
Unrealized gain on available-for-sale investments, net of income tax of \$219		—	—	—	—	396	—	396
Reclassification of adjustments for gains included in net income, net of income tax of \$129		—	—	—	—	(218)	—	(218)
Foreign currency translation adjustment, net		—	—	—	—	5,313	20	5,333
Other comprehensive income, net		—	—	—	—	5,491	20	5,511
Issuance of common stock related to stock-option exercises and vesting of restricted stock units, net	238,015	—	1,214	(4,145)	—	—	—	(2,931)
Stock-based compensation		—	—	8,302	—	—	—	8,302
Excess tax benefit derived from stock-option exercises and vesting of restricted stock units		—	—	1,913	—	—	—	1,913
Common shares repurchased	(489,801)	—	(36,720)	—	—	—	—	(36,720)
Dividends declared — common shares outstanding		—	—	—	(15,211)	—	—	(15,211)
Dividends declared — restricted stock units		—	—	47	(111)	—	—	(64)
Balance as of June 30, 2014	44,715,637	\$5	\$(484,560)	\$545,624	\$595,911	\$10,664	\$1,018	\$668,662

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)	Six months ended June 30	
	2014	2013
Operating activities		
Consolidated net income	\$16,572	\$60,675
Adjustments to reconcile consolidated net income to net cash flows from operating activities:		
Depreciation and amortization	25,778	22,601
Deferred income taxes	(2,638	) (38
Stock-based compensation expense	8,302	7,737
Provision for bad debts	(326	) 461
Equity in net income of unconsolidated entities	(1,096	) (857
Excess tax benefits from stock-option exercises and vesting of restricted stock units	(1,913	) (3,842
Holding gain upon acquisition of additional ownership of equity method investments	(5,168	) (3,713
Other, net	(703	) 688
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(19,340	) 524
Other assets	163	(3,465
Accounts payable and accrued liabilities	61,196	638
Accrued compensation	(8,687	) (19,581
Income taxes—current	(12,169	) 13,693
Deferred revenue	8,802	11,023
Deferred rent	(996	) (872
Other liabilities	(1,089	) (537
Cash provided by operating activities	66,688	85,135
Investing activities		
Purchases of investments	(7,715	) (82,299
Proceeds from maturities and sales of investments	95,499	96,128
Capital expenditures	(30,799	) (18,881
Acquisitions, net of cash acquired	(64,447	) (11,125
Proceeds from sale of a business	—	957
Purchases of equity- and cost-method investments	—	(909
Other, net	259	436
Cash used for investing activities	(7,203	) (15,693
Financing activities		
Proceeds from stock-option exercises	2,072	2,810
Employee taxes withheld for restricted stock units	(5,003	) (5,157
Excess tax benefits from stock-option exercises and vesting of restricted stock units	1,913	3,842
Common shares repurchased	(36,720	) (53,937
Dividends paid	(15,309	) (5,889
Other, net	14	(50
Cash used for financing activities	(53,033	) (58,381
Effect of exchange rate changes on cash and cash equivalents	1,642	(5,140

Edgar Filing: Morningstar, Inc. - Form 10-Q

Net increase in cash and cash equivalents	8,094	5,921
Cash and cash equivalents—beginning of period	168,160	163,889
Cash and cash equivalents—end of period	\$176,254	\$169,810
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$19,891	\$14,511
Supplemental information of non-cash investing and financing activities:		
Unrealized gain on available-for-sale investments	\$270	\$418
Equipment obtained under long-term financing arrangement	\$—	\$4,860

See notes to unaudited condensed consolidated financial statements.

8

Table of ContentsMORNINGSTAR, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation of Interim Financial Information

The accompanying condensed consolidated financial statements of Morningstar, Inc. and subsidiaries (Morningstar, we, our, the Company) have been prepared to conform to the rules and regulations of the Securities and Exchange Commission (SEC). The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue, and expenses. Actual results could differ from those estimates. In the opinion of management, the statements reflect all adjustments, which are of a normal recurring nature, necessary to present fairly our financial position, results of operations, equity, and cash flows. These financial statements and notes are unaudited and should be read in conjunction with our Audited Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on February 28, 2014.

Certain prior period amounts have been reclassified to conform to our current period's presentation. We now include development expense in the cost of revenue category. We have reclassified development expense to include it in cost of revenue for all periods presented. We previously reported development expense as a separate operating expense category.

Separately, as a result of our recent reorganization (including new positions created, changes in focus for some existing roles, and the refinement of employee cost categorizations as we moved to a more centralized structure), approximately 180 net positions shifted from the general and administrative and sales and marketing categories to cost of revenue. For the first six months of 2014 as compared with the same period in 2013, changes related to our more centralized organizational structure added \$14 million of compensation expense to cost of revenue, and reduced the compensation expense in our sales and marketing and general and administrative expense categories by \$8 million and \$6 million, respectively. These changes did not affect our total operating expense or operating income for any of the periods presented.

The acronyms that appear in the Notes to our Unaudited Condensed Consolidated Financial Statements refer to the following:

ASC: Accounting Standards Codification
ASU: Accounting Standards Update
FASB: Financial Accounting Standards Board

2. Correction

In 2014, we identified and corrected an immaterial classification error related to the current and long-term balance for deferred rent included on our Consolidated Balance Sheets as of December 31, 2013. The correcting entries had the effect of decreasing accounts payable and accrued liabilities by \$10.7 million and increasing deferred rent (long-term) by the same amount. The financial statements have been corrected to reduce the current balance and increase the long-term balance as shown in the table below:

(\$000)	As of December 31, 2013		
	Previously Reported	Correction	As Corrected
Accounts payable and accrued liabilities	\$52,877	\$(10,746)	) \$42,131
Deferred rent	\$13,192	\$10,746	\$23,938

Table of Contents

3. Summary of Significant Accounting Policies

We discuss our significant accounting policies in Note 2 of our Audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on February 28, 2014.

In addition, effective January 1, 2014, we adopted FASB ASU No. 2013-05, Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or an Investment in a Foreign Entity (a consensus of the FASB Emerging Issues Task Force). ASU No. 2013-05 specifies that when a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity, the parent is required to apply the guidance in Subtopic 830-30 to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. Additionally, the amendments in this update clarify that the sale of an investment in a foreign entity includes both (1) events that result in the loss of a controlling financial interest in a foreign entity and (2) events that results in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date (sometimes referred to as a step acquisition). The currency translation adjustment should be released into net income upon the occurrence of those events. The adoption of ASU No. 2013-05 did not have a material effect on our consolidated financial statements.

We also adopted FASB ASU No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force), effective January 1, 2014. This update requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss (NOL) carryforward, or similar tax loss or tax credit carryforward, rather than as a liability when (1) the uncertain tax position would reduce the NOL or other carryforward under the tax law of the applicable jurisdiction and (2) the entity intends to use the deferred tax asset for that purpose. The update does not require new recurring disclosures. The adoption of ASU No. 2013-11 did not have a material effect on our consolidated financial statements.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for us on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

Table of Contents

4. Acquisitions, Goodwill and Other Intangible Assets

Acquisitions

Increased Ownership Interest in HelloWallet Holdings, Inc.

In June 2014, we acquired an additional 81.3% interest in HelloWallet Holdings, Inc. (HelloWallet), increasing our ownership to 100% from 18.7%. HelloWallet combines behavioral economics and the psychology of decision-making with sophisticated technology to provide personalized, unbiased financial guidance to U.S. workers and their families through their employer benefit plans. We began consolidating the financial results of this acquisition in our Consolidated Financial Statements on June 3, 2014.

HelloWallet's total preliminary estimated fair value of \$54,006,000 includes \$40,525,000 in cash paid to acquire the remaining 81.3% interest in HelloWallet and pay off HelloWallet's indebtedness as well as \$13,481,000 related to the 18.7% of HelloWallet we previously held. We recorded a preliminary non-cash holding gain of \$5,168,000 for the difference between the fair value and the book value of our previously held investment. The gain is included in non-operating income in our Unaudited Condensed Consolidated Statement of Income.

The preliminary allocation of the purchase price will be finalized upon the completion of the fair value analysis of the acquired assets and liabilities, including the preliminary intangible assets. We have not yet obtained all of the information related to the fair value of the acquired assets and liabilities related to the acquisition to finalize the purchase price allocation. The primary areas of the preliminary purchase price allocation that are not yet finalized relate to the valuation of the identifiable intangible assets and income taxes.

The following table summarizes our preliminary allocation of the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition, all of which are preliminary pending receipt of the final valuation:

	(\$000)	
Cash and cash equivalents	\$3,739	
Accounts receivable and other current assets	150	
Other current and non-current assets	318	
Deferred tax asset	7,340	
Intangible assets	9,460	
Goodwill	40,472	
Deferred revenue	(2,897)
Deferred tax liability	(3,595)
Other current and non-current liabilities	(981)
Total fair value of HelloWallet	\$54,006	

The preliminary allocation includes \$9,460,000 of acquired intangible assets, as follows:

	(\$000)	Weighted Average Useful Life (years)
Technology based assets	6,670	5
Intellectual property (trademarks and trade names)	169	3
Non-competition agreement	2,621	5
Total intangible assets	\$9,460	5

We recognized a preliminary deferred tax liability of \$3,595,000 mainly because the amortization expense related to certain intangible assets is not deductible for income tax purposes. The fair value of the acquired intangible assets and

the deferred tax liability are preliminary pending receipt of the final valuation for these intangible assets.

We recognized a preliminary deferred tax asset of \$7,340,000 mainly because of net operating losses of HelloWallet which will become available to Morningstar.

Table of Contents

Preliminary goodwill of \$40,472,000 represents the premium over the fair value of the net tangible and intangible assets acquired with this acquisition. We paid this premium for a number of reasons, including the opportunity to bring together HelloWallet's comprehensive financial wellness expertise with Morningstar's independent, research-based retirement advice to create a holistic retirement savings and advice offering.

ByAllAccounts, Inc.

In April 2014, we acquired ByAllAccounts, Inc. (ByAllAccounts), a provider of innovative data aggregation technology for financial applications, for \$27,949,000 in cash. ByAllAccounts uses a knowledge-based process, including patented artificial intelligence technology, to collect, consolidate, and enrich financial account data and deliver it to virtually any platform. We began including the financial results of this acquisition in our Consolidated Financial Statements on April 1, 2014.

The preliminary allocation of the purchase price will be finalized upon the completion of the fair value analysis of the acquired assets and liabilities, including the preliminary intangible assets. We have not yet obtained all of the information related to the fair value of the acquired assets and liabilities related to the acquisition to finalize the purchase price allocation. The primary areas of the preliminary purchase price allocation that are not yet finalized relate to the valuation of the identifiable intangible assets and income taxes.

The following table summarizes our preliminary allocation of the purchase price to the estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition:

	(\$000)	
Cash and cash equivalents	\$287	
Accounts receivable and other current assets	152	
Deferred tax asset	3,685	
Other non-current assets	257	
Intangible assets	8,681	
Goodwill	18,778	
Deferred revenue	(79)
Deferred tax liability	(3,299)
Other current and non-current liabilities	(513)
Total purchase price	\$27,949	

The preliminary allocation includes \$8,681,000 of acquired intangible assets, as follows:

	(\$000)	Weighted Average Useful Life (years)
Customer-related assets	\$5,506	24
Technology-based assets	3,020	4.5
Intellectual property (trademarks and trade names)	47	1
Non-competition agreement	108	3
Total intangible assets	\$8,681	19

We recognized a preliminary deferred tax liability of \$3,299,000 mainly because the amortization expense related to certain intangible assets is not deductible for income tax purposes. The fair value of the acquired intangible assets and

the deferred tax liability are preliminary pending receipt of the final valuation for these intangible assets.

We recognized a preliminary deferred tax asset of \$3,685,000 mainly because of net operating losses of ByAllAccounts which will become available to Morningstar.

Table of Contents

Preliminary goodwill value of \$18,778,000 represents the premium we paid over the fair value of the acquired net tangible and intangible assets. We paid this premium for a number of reasons, including the opportunity to integrate the service into our offerings as well as expand and develop ByAllAccounts' third-party distribution relationships.

Goodwill

The following table shows the changes in our goodwill balances from December 31, 2013 to June 30, 2014:

	(\$000)
Balance as of December 31, 2013	\$326,450
Acquisitions of HelloWallet and ByAllAccounts	59,250
Foreign currency translation	3,137
Balance as of June 30, 2014	\$388,837

We did not record any impairment losses in the first six months of 2014 or 2013. We perform our annual impairment reviews in the fourth quarter.

Intangible Assets

The following table summarizes our intangible assets:

(\$000)	As of June 30, 2014			Weighted Average Useful Life (years)	As of December 31, 2013			Weighted Average Useful Life (years)
	Gross	Accumulated Amortization	Net		Gross	Accumulated Amortization	Net	
Intellectual property	\$30,177	\$ (24,741)	\$5,436	9	\$29,477	\$ (23,128)	\$6,349	9
Customer-related assets	148,000	(80,782)	67,218	12	141,833	(74,311)	67,522	12
Supplier relationships	240	(114)	126	20	240	(108)	132	20
Technology-based assets	90,979	(54,729)	36,250	9	80,489	(50,673)	29,816	9
Non-competition agreement	4,428	(1,679)	2,749	5	1,661	(1,571)	90	4
Total intangible assets	\$273,824	\$ (162,045)	\$111,779	11	\$253,700	\$ (149,791)	\$103,909	10

The following table summarizes our amortization expense related to intangible assets:

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Amortization expense	\$5,501	\$5,337	\$10,643	\$10,962

We amortize intangible assets using the straight-line method over their expected economic useful lives.

We expect intangible amortization expense for 2014 and subsequent years as follows:

(\$000)

Edgar Filing: Morningstar, Inc. - Form 10-Q

2014	\$22,493
2015	22,669
2016	18,071
2017	13,406
2018	11,190
Thereafter	34,593

13

Table of Contents

Our estimates of future amortization expense for intangible assets may be affected by additional acquisitions, divestitures, changes in the estimated average useful life, and currency translations.

14

Table of Contents

5. Income Per Share

The following table shows how we reconcile our net income and the number of shares used in computing basic and diluted income per share:

(in thousands, except per share amounts)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Basic net income (loss) per share attributable to Morningstar, Inc.:				
Net income (loss) attributable to Morningstar, Inc.:	\$(9,769	) \$31,121	\$16,607	\$60,739
Less: Distributed earnings available to participating securities	(1	) (2	) (4	) (5
Less: Undistributed earnings available to participating securities	3	(9	) —	(18
Numerator for basic net income (loss) per share — undistributed and distributed earnings available to common shareholders	\$(9,767	) \$31,110	\$16,603	\$60,716
Weighted average common shares outstanding	44,777	46,400	44,778	46,403
Basic net income (loss) per share attributable to Morningstar, Inc.	\$(0.22	) \$0.67	\$0.37	\$1.31
Diluted net income (loss) per share attributable to Morningstar, Inc.:				
Numerator for basic net income (loss) per share — undistributed and distributed earnings available to common shareholders	\$(9,767	) \$31,110	\$16,603	\$60,716
Add: Undistributed earnings allocated to participating securities	(3	) 9	—	18
Less: Undistributed earnings reallocated to participating securities	3	(9	) —	(17
Numerator for diluted net income per share — undistributed and distributed earnings available to common shareholders	\$(9,767	) \$31,110	\$16,603	\$60,717
Weighted average common shares outstanding	44,777	46,400	44,778	46,403
Net effect of dilutive stock options and restricted stock units	—	453	261	353
Weighted average common shares outstanding for computing diluted income per share	44,777	46,853	45,039	46,756
Diluted net income (loss) per share attributable to Morningstar, Inc.	\$(0.22	) \$0.66	\$0.37	\$1.30

Edgar Filing: Morningstar, Inc. - Form 10-Q

Because of our net loss for the quarter ended June 30, 2014, the assumed exercise of stock options and vesting of restricted stock units outstanding would have had an anti-dilutive effect and were therefore excluded from the computation of diluted net loss per share.

The following table shows the number of weighted average stock options, restricted stock units, performance share awards, and restricted stock excluded from our calculation of diluted earnings per share because their inclusion would have been anti-dilutive:

15

Table of Contents

(in thousands)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Weighted average stock options	160	—	—	—
Weighted average restricted stock units	108	2	18	22
Weighted average performance share awards	10	—	—	—
Weighted average restricted stock	3		6	
Total	281	2	24	22

These stock options, restricted stock units and performance share awards could be included in the calculation in the future.

6. Segment, Enterprise-Wide, and Geographical Area Information

Segment Information

Beginning with the third quarter of 2013, we revised our segment structure to reflect our shift to a more centralized organizational structure. We now report our results in a single reportable segment, which reflects how our chief operating decision maker allocates resources and evaluates our financial results.

Because we have one reportable segment, all required financial segment information can be found directly in the Unaudited Condensed Consolidated Financial Statements.

The accounting policies for our single reportable segment are the same as those described in “Note 2. Summary of Significant Accounting Policies” included in our Annual Report on Form 10-K for the year ended December 31, 2013. We evaluate the performance of our reporting segment based on revenue and operating income.

Products and Services Information

We derive revenue from two product groups. The investment information product group includes all of our data, software, and research products and services. These products are typically sold through subscriptions or license agreements. The investment management product group includes all of our asset management operations, which earn the majority of their revenue from asset-based fees. The table below summarizes our revenue by product group:

External revenue by product group

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Investment information	\$ 149,527	\$ 140,031	\$ 290,797	\$ 275,116
Investment management	39,858	35,397	79,753	69,168
Consolidated revenue	\$ 189,385	\$ 175,428	\$ 370,550	\$ 344,284

Table of Contents

Geographical Area Information

The tables below summarize our revenue and long-lived assets by geographical area:

External revenue by geographical area

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
United States	\$136,453	\$126,335	\$266,405	\$247,748
United Kingdom	15,544	14,015	30,882	27,168
Continental Europe	15,921	13,993	31,547	27,160
Australia	9,233	9,176	17,401	18,528
Canada	7,542	7,812	15,209	15,548
Asia	3,888	3,449	7,597	6,873
Other	804	648	1,509	1,259
Total International	52,932	49,093	104,145	96,536
Consolidated revenue	\$189,385	\$175,428	\$370,550	\$344,284

Long-lived assets by geographical area

(\$000)	As of June 30	As of December 31
	2014	2013
United States	\$90,924	\$84,321
United Kingdom	6,720	6,873
Continental Europe	1,591	1,873
Australia	977	1,051
Canada	1,041	1,275
Asia	8,548	9,479
Other	99	114
Total International	18,976	20,665
Consolidated property, equipment, and capitalized software, net	\$109,900	\$104,986

Table of Contents

7. Investments and Fair Value Measurements

We account for our investments in accordance with FASB ASC 320, Investments—Debt and Equity Securities. We classify our investments in three categories: available-for-sale, held-to-maturity, and trading. We monitor the concentration, diversification, maturity, and liquidity of our investment portfolio, which is primarily invested in fixed-income securities, and classify our investment portfolio as shown below:

(\$000)	As of June 30 2014	As of December 31 2013
Available-for-sale	\$16,015	\$91,461
Held-to-maturity	20,422	31,214
Trading securities	8,259	7,732
Total	\$44,696	\$130,407

The following table shows the cost, unrealized gains (losses), and fair values related to investments classified as available-for-sale and held-to-maturity:

(\$000)	As of June 30, 2014				As of December 31, 2013			
	Cost	Unrealized Gain	Unrealized Loss	Fair Value	Cost	Unrealized Gain	Unrealized Loss	Fair Value
Available-for-sale:								
Government obligations	\$3,396	\$2	\$—	\$3,398	\$19,693	\$8	\$(3)	\$19,698
Corporate bonds	—	—	—	—	49,913	22	(124)	49,811
Foreign obligations	—	—	—	—	505	—	(2)	503
Commercial paper	—	—	—	—	9,482	7	—	9,489
Equity securities and exchange-traded funds	9,311	1,100	(118)	10,293	8,872	1,011	(141)	9,742
Mutual funds	2,137	276	(89)	2,324	2,095	221	(98)	2,218
Total	\$14,844	\$1,378	\$(207)	\$16,015	\$90,560	\$1,269	\$(368)	\$91,461
Held-to-maturity:								
Certificates of deposit	\$20,422	\$—	\$—	\$20,422	\$31,214	\$—	\$—	\$31,214

As of June 30, 2014 and December 31, 2013, investments with unrealized losses for greater than a 12-month period were not material to the Condensed Consolidated Balance Sheets and were not deemed to have other than temporary declines in value.

Table of Contents

The table below shows the cost and fair value of investments classified as available-for-sale and held-to-maturity based on their contractual maturities as of June 30, 2014 and December 31, 2013. The expected maturities of certain fixed-income securities may differ from their contractual maturities because some of these holdings have call features that allow the issuers the right to prepay obligations without penalties.

(\$000)	As of June 30, 2014		As of December 31, 2013	
	Cost	Fair Value	Cost	Fair Value
Available-for-sale:				
Due in one year or less	\$3,396	\$3,398	\$45,486	\$45,402
Due in one to two years	—	—	34,107	34,099
Equity securities, exchange-traded funds, and mutual funds	11,448	12,617	10,967	11,960
Total	\$14,844	\$16,015	\$90,560	\$91,461
Held-to-maturity:				
Due in one year or less	\$20,417	\$20,417	\$31,210	\$31,210
Due in one to three years	5	5	4	4
Total	\$20,422	\$20,422	\$31,214	\$31,214

As of June 30, 2014 and December 31, 2013, held-to-maturity investments included a \$1,500,000 certificate of deposit held primarily as collateral against bank guarantees for our office leases, primarily in Australia.

The following table shows the realized gains and losses arising from sales of our investments classified as available-for-sale recorded in our Condensed Consolidated Statements of Income:

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Realized gains	\$417	\$662	\$578	\$2,226
Realized losses	(46	) (239	) (231	) (1,078
Realized gains, net	\$371	\$423	\$347	\$1,148

We determine realized gains and losses using the specific identification method.

The following table shows the net unrealized gains (losses) on trading securities as recorded in our Condensed Consolidated Statements of Income:

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Unrealized gains (losses), net	\$(224	) \$(45	) \$(155	) \$273

Table of Contents

The fair value of our assets subject to fair value measurements and that are measured at fair value on a recurring basis using the fair value hierarchy and the necessary disclosures under FASB ASC 820, Fair Value Measurement, are as follows:

(\$000)	Fair Value as of June 30, 2014	Fair Value Measurements as of June 30, 2014 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Available-for-sale investments:				
Government obligations	\$3,398	\$—	\$3,398	\$—
Corporate bonds	—	—	—	—
Foreign obligations	—	—	—	—
Commercial paper	—	—	—	—
Equity securities and exchange-traded funds	10,293	10,293	—	—
Mutual funds	2,324	2,324	—	—
Trading securities	8,259	8,259	—	—
Cash equivalents	2,691	2,691	—	—
Total	\$26,965	\$23,567	\$3,398	\$—

(\$000)	Fair Value as of December 31, 2013	Fair Value Measurements as of December 31, 2013 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Available-for-sale investments:				
Government obligations	\$19,698	\$—	\$19,698	\$—
Corporate bonds	49,811	—	49,811	—
Foreign obligations	503	—	503	—
Commercial paper	9,489	—	9,489	—
Equity securities and exchange-traded funds	9,742	9,742	—	—
Mutual funds	2,218	2,218	—	—
Trading securities	7,732	7,732	—	—
Cash equivalents	925	925	—	—
Total	\$100,118	\$20,617	\$79,501	\$—

Level 1: Valuations based on quoted prices in active markets for identical assets or liabilities that we have the ability to access.

Level 2: Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3: Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Based on our analysis of the nature and risks of our investments in equity securities and mutual funds, we have determined that presenting each of these investment categories in the aggregate is appropriate.

We measure the fair value of money market funds, mutual funds, equity securities, and exchange-traded funds based on quoted prices in active markets for identical assets or liabilities. All other financial instruments were valued either based on recent trades of securities in inactive markets or based on quoted market prices of similar instruments and other significant inputs derived from observable market data. We did not hold any securities categorized as Level 3 as

of June 30, 2014 and December 31, 2013.

Table of Contents

8. Investments in Unconsolidated Entities

Our investments in unconsolidated entities consist primarily of the following:

	As of June 30	As of December 31
(\$000)	2014	2013
Investment in MJKK	\$22,173	\$21,782
Other equity method investments	5,788	6,166
Investments accounted for using the cost method	2,326	10,766
Total investments in unconsolidated entities	\$30,287	\$38,714

Morningstar Japan K.K. Morningstar Japan K.K. (MJKK) develops and markets products and services customized for the Japanese market. MJKK's shares are traded on the Tokyo Stock Exchange under the ticker 47650. We account for our investment in MJKK using the equity method. The following table summarizes our ownership percentage in MJKK and the market value of this investment based on MJKK's publicly quoted share price:

	As of June 30	As of December 31		
	2014	2013		
Morningstar's approximate ownership of MJKK	34	% 34		%
Approximate market value of Morningstar's ownership in MJKK:				
Japanese yen (¥000)	¥7,567,560	¥9,824,068		
Equivalent U.S. dollars (\$000)	\$74,616	\$94,999		

Other Equity Method Investments. As of June 30, 2014 and December 31, 2013, other equity method investments consist of our investment in Inquiry Financial Europe AB (Inquiry Financial) and YCharts, Inc. (YCharts). Inquiry Financial is a provider of sell-side consensus estimate data. Our ownership interest in Inquiry Financial was approximately 34% as of June 30, 2014 and December 31, 2013. YCharts is a technology company that provides stock research and analysis. Our ownership interest in YCharts was approximately 22% as of June 30, 2014 and December 31, 2013.

We did not record any impairment losses on our equity method investments in the first six months of 2014 or 2013.

Cost Method Investments. As of June 30, 2014 and December 31, 2013, our cost method investments consist of a minority investment in Pitchbook Data, Inc. (Pitchbook). Pitchbook offers detailed data and information about private equity transactions, investors, companies, limited partners, and service providers.

As of December 31, 2013, our cost method investments also included a minority investment in HelloWallet LLC (HelloWallet). In June 2014, we purchased the remaining interest in HelloWallet. See Note 4 for additional information concerning our acquisition of HelloWallet.

We did not record any impairment losses on our cost method investments in the first six months of 2014 or 2013.

9. Stock-Based Compensation

Stock-Based Compensation Plans

Our shareholders approved the Morningstar 2011 Stock Incentive Plan (the 2011 Plan) on May 17, 2011. As of that date, we stopped granting awards under the Morningstar 2004 Stock Incentive Plan (the 2004 Plan). The 2004 Plan amended and restated the Morningstar 1993 Stock Option Plan, the Morningstar 2000 Stock Option Plan, and the Morningstar 2001 Stock Option Plan.

The 2011 Plan provides for a variety of stock-based awards, including, among other things, stock options, performance share awards, restricted stock units, and restricted stock. We granted stock options, restricted stock units, and restricted stock under the 2004 Plan.

All of our employees and our non-employee directors are eligible for awards under the 2011 Plan.

Table of Contents

Grants awarded under the 2011 Plan or the 2004 Plan that are forfeited, canceled, settled, or otherwise terminated without a distribution of shares, or shares withheld by us in connection with the exercise of options, will be available for awards under the 2011 Plan. Any shares subject to awards under the 2011 Plan, but not under the 2004 Plan, that are withheld by us in connection with the payment of any required income tax withholding will be available for awards under the 2011 Plan.

The following table summarizes the number of shares available for future grants under our 2011 Plan:

	As of June 30
(in thousands)	2014
Shares available for future grants	4,248

Accounting for Stock-Based Compensation Awards

The following table summarizes our stock-based compensation expense and the related income tax benefit we recorded:

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
(\$000)				
Restricted stock units	\$3,983	\$3,734	\$7,675	\$7,297
Restricted stock	97	97	194	194
Performance share awards	173	—	200	—
Stock options	110	123	233	246
Total stock-based compensation expense	\$4,363	\$3,954	\$8,302	\$7,737
Income tax benefit related to the stock-based compensation expense	\$1,283	\$1,068	\$2,362	\$2,098

The following table summarizes the amount of unrecognized stock-based compensation expense as of June 30, 2014 and the expected number of months over which the expense will be recognized:

	Unrecognized stock-based compensation expense (\$000)	Expected amortization period (months)
Restricted stock units	\$39,567	36
Restricted stock	323	10
Performance share awards	1,716	30
Stock options	353	11
Total unrecognized stock-based compensation expense	\$41,959	35

In accordance with FASB ASC 718, Compensation—Stock Compensation, we estimate forfeitures of employee stock-based awards and recognize compensation cost only for those awards expected to vest. Our largest annual equity grants typically have vesting dates in the second quarter. We adjust the stock-based compensation expense annually in the third quarter to reflect those awards that ultimately vested and update our estimate of the forfeiture rate that will be applied to awards not yet vested.

Restricted Stock Units

Restricted stock units represent the right to receive a share of Morningstar common stock when that unit vests. Restricted stock units to employees vest ratably over a four-year period. Restricted stock units granted to non-employee directors vest ratably over a three-year period. For restricted stock units granted through December 31, 2008, employees could elect to defer receipt of the Morningstar common stock issued upon vesting of the restricted stock unit.

Table of Contents

We measure the fair value of our restricted stock units on the date of grant based on the closing market price of the underlying common stock on the day prior to the grant. We amortize that value to stock-based compensation expense, net of estimated forfeitures, ratably over the vesting period.

The following table summarizes restricted stock unit activity during the first six months of 2014:

Restricted Stock Units (RSUs)	Unvested	Vested but Deferred	Total	Weighted Average Grant Date Value per RSU
RSUs outstanding—December 31, 2013	680,002	16,682	696,684	\$ 62.02
Granted	245,350	—	245,350	73.11
Dividend equivalents	1,528	76	1,604	57.50
Vested	(231,500	) —	(231,500	) 57.48
Issued	—	(2,054	) (2,054	) 53.54
Forfeited	(17,874	) —	(17,874	) 57.22
RSUs Outstanding - June 30, 2014	677,506	14,704	692,210	\$ 67.37

Restricted Stock

In conjunction with our acquisition of Realpoint LLC in May 2010, we issued 199,174 shares of restricted stock to the selling employee-shareholders under the 2004 Stock Incentive Plan. The restricted stock vests ratably over a five-year period from the acquisition date and may be subject to forfeiture if the holder terminates his or her employment during the vesting period.

Because of the terms of the restricted stock agreements prepared in conjunction with the Realpoint acquisition, we account for the grant of restricted stock as stock-based compensation expense and not as part of the acquisition consideration.

We measured the fair value of the restricted stock on the date of grant based on the closing market price of our common stock on the day prior to the grant. We amortize the fair value of \$9,363,000 to stock-based compensation expense over the vesting period. We have assumed that all of the remaining restricted stock will ultimately vest, and therefore have not incorporated a forfeiture rate for purposes of determining the stock-based compensation expense.

Performance Share Awards

In 2014, executive officers, other than Joe Mansueto, were granted performance share awards pursuant to which each executive becomes entitled to a number of shares of Morningstar common stock equal to the number of notional performance shares that become vested. Each award specifies a number of performance shares that will vest if pre-established target performance goals are attained. The number of performance shares that actually vest may be more or less than the specified number of performance shares to the extent Morningstar exceeds or fails to achieve, respectively, the target performance goals over a three-year performance period.

The performance conditions are not considered in the determination of the grant date fair value for these awards. We measure the fair value of our performance share awards on the date of grant based on the closing market price of the underlying common stock on the day prior to the grant date. We amortize that value to stock-based compensation expense, based on the satisfaction of the performance condition that is most likely to be satisfied over the three-year service period ratably over the vesting period.

Edgar Filing: Morningstar, Inc. - Form 10-Q

Information as of June 30, 2014 regarding the Company's target performance share awards granted and shares that would be issued at current performance levels for performance share awards granted during the first six months of 2014 is as follows:

23

Table of Contents

	As of June 30, 2014
Target performance share awards granted	23,685
Fair value (1)	\$80.91
Number of shares that would be issued based on current performance levels	23,685
Unamortized expense, based on current performance levels	\$1,716,000

(1) Represents the closing market price of Morningstar's stock on March 14, 2014, which is the last closing price prior to the grant date.

Stock Options

Stock options granted to employees vest ratably over a four-year period. Grants to our non-employee directors vest ratably over a three-year period. All grants expire 10 years after the date of grant. Almost all of the options granted under the 2004 Stock Incentive Plan have a premium feature in which the exercise price increases over the term of the option at a rate equal to the 10-year Treasury bond yield as of the date of grant. Options granted under the 2011 Plan have an exercise price equal to the fair market value on the grant date.

The following tables summarize stock option activity in the first six months of 2014 for our various stock option grants. The first table includes activity for options granted at an exercise price below the fair value per share of our common stock on the grant date; the second table includes activity for all other option grants.

Options Granted At an Exercise Price Below the Fair Value Per Share on the Grant Date	Underlying Shares	Weighted Average Exercise Price
Options outstanding—December 31, 2013	179,559	\$21.47
Granted	—	—
Canceled	—	—
Exercised	(26,420	) 21.67
Options outstanding—June 30, 2014	153,139	21.91
Options exercisable—June 30, 2014	153,139	\$21.91
All Other Option Grants, Excluding Activity Shown Above	Underlying Shares	Weighted Average Exercise Price
Options outstanding—December 31, 2013	253,972	\$36.48
Granted	—	—
Canceled	—	—
Exercised	(47,898	) 30.58
Options outstanding—June 30, 2014	206,074	38.27
Options exercisable—June 30, 2014	189,604	\$36.58

Table of Contents

The following table summarizes the total intrinsic value (difference between the market value of our stock on the date of exercise and the exercise price of the option) of options exercised:

(\$000)	Six months ended June 30	
	2014	2013
Intrinsic value of options exercised	\$3,760	\$8,170

The table below shows additional information for options outstanding and exercisable as of June 30, 2014:

Range of Exercise Prices	Options Outstanding				Options Exercisable			
	Number of Options	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Weighted Aggregate Intrinsic Value (\$000)	Exercisable Shares	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Weighted Aggregate Intrinsic Value (\$000)
\$21.61 - \$26.96	280,732	0.62	\$24.20	\$13,364	280,732	0.62	\$24.20	\$13,364
\$39.68 - \$49.92	6,806	1.43	48.18	161	6,806	1.43	48.18	161
\$57.28 - \$59.35	71,675	7.02	57.46	1,029	55,205	7.02	57.39	758
\$21.61 - \$59.35	359,213	1.91	\$31.29	\$14,554	342,743	1.67	\$30.03	\$14,283
Vested or Expected to Vest								
\$21.61 - \$59.35	359,213	1.91	\$31.29	\$14,554				

The aggregate intrinsic value in the table above represents the total pretax intrinsic value all option holders would have received if they had exercised all outstanding options on June 30, 2014. The intrinsic value is based on our closing stock price of \$71.81 on that date.

Excess Tax Benefits Related to Stock-Based Compensation

FASB ASC 718, Compensation—Stock Compensation, requires that we classify the cash flows that result from excess tax benefits as financing cash flows. Excess tax benefits correspond to the portion of the tax deduction taken on our income tax return that exceeds the amount of tax benefit related to the compensation cost recognized in our Condensed Consolidated Statements of Operations. The following table summarizes our excess tax benefits:

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Excess tax benefits related to stock-based compensation	\$1,340	\$2,255	\$1,913	\$3,842

Table of Contents

10. Income Taxes

Effective Tax Rate

The following table shows our effective income tax rate for the three and six months ended June 30, 2014 and June 30, 2013:

(\$000)	Three months ended June 30		Six months ended June 30		
	2014	2013	2014	2013	
Income (loss) before income taxes and equity in net income of unconsolidated entities	\$(18,882	) \$46,695	\$20,515	\$88,200	
Equity in net income of unconsolidated entities	497	360	1,096	857	
Net loss attributable to the noncontrolling interest	5	21	35	64	
Total	\$(18,380	) \$47,076	\$21,646	\$89,121	
Income tax expense (benefit)	\$(8,611	) \$15,955	\$5,039	\$28,382	
Effective tax rate	46.8	% 33.9	% 23.3	% 31.8	%

Our effective tax rate in the second quarter of 2014 was 46.8%, an increase of 12.9 percentage points compared with the prior-year period. During the second quarter of 2014, we reported a loss before income taxes and equity in net income of unconsolidated entities of \$18.9 million, which included a litigation settlement expense of \$61.0 million that is deductible for tax purposes. In the same period, we realized a \$5.2 million non-taxable gain in connection with the purchase of the remaining ownership interest in HelloWallet. Because of these two items, we reported an income tax benefit of \$8.6 million, which is equivalent to a 46.8% effective tax rate.

Our effective tax rate for the first six months of 2014 was 23.3%, which is lower than the statutory rate mainly because of the non-taxable gain of \$5.2 million recorded in connection with purchasing the remaining ownership interest in HelloWallet.

Unrecognized Tax Benefits

The table below provides information concerning our gross unrecognized tax benefits as of June 30, 2014 and December 31, 2013. The table also provides the effect these gross unrecognized tax benefits would have on our income tax expense, if they were recognized.

(\$000)	As of June 30	As of December 31
	2014	2013
Gross unrecognized tax benefits	\$11,476	\$12,958
Gross unrecognized tax benefits that would affect income tax expense	\$11,476	\$10,557
Decrease in income tax expense upon recognition of gross unrecognized tax benefits	\$9,961	\$9,262

Our Condensed Consolidated Balance Sheets include the following liabilities for unrecognized tax benefits. These amounts include interest and penalties, less any associated tax benefits.

As of June 30

Edgar Filing: Morningstar, Inc. - Form 10-Q

		As of December
		31
Liabilities for Unrecognized Tax Benefits (\$000)	2014	2013
Current liability	\$4,490	\$6,211
Non-current liability	6,712	6,012
Total liability for unrecognized tax benefits	\$11,202	\$12,223

We conduct business globally and, as a result, we file income tax returns in U.S. federal, state, local, and foreign jurisdictions. We are currently under audit by federal and various state and local tax authorities in the United States,

Table of Contents

as well as tax authorities in certain non-U.S. jurisdictions. It is possible, though not likely, that the examination phase of some of these audits will conclude in 2014. It is not possible to estimate the effect of current audits on previously recorded unrecognized tax benefits.

Table of Contents

We have not provided federal and state income taxes on accumulated undistributed earnings of certain foreign subsidiaries because these earnings have been permanently reinvested. Approximately 69% of our cash, cash equivalents, and investments as of June 30, 2014 was held by our operations outside of the United States. As such, we believe that our cash balances and investments in the United States, along with cash generated from our U.S. operations, will be sufficient to meet our U.S. operating and cash needs for the foreseeable future, without requiring us to repatriate earnings from these foreign subsidiaries. It is not reasonably practical to determine the amount of the unrecognized deferred tax liability related to the undistributed earnings.

Certain of our non-U.S. operations have incurred net operating losses (NOLs) which may become deductible to the extent these operations become profitable. For each of our operations, we evaluate whether it is more likely than not that the tax benefits related to NOLs will be realized. As part of this evaluation, we consider evidence such as tax planning strategies, historical operating results, forecasted taxable income, and recent financial performance. In the year that certain non-U.S. operations record a loss, we do not recognize a corresponding tax benefit, thus increasing our effective tax rate. Upon determining that it is more likely than not that the NOLs will be realized, we reduce the tax valuation allowances related to these NOLs, which results in a reduction to our income tax expense and our effective tax rate in the period.

11. Contingencies

Life's Good S.T.A.B.L. Hedge Fund

In September 2011, three individual investors in Life's Good S.T.A.B.L. Mortgage hedge fund (LG), Marta Klass, Gregory Martin, and Richard Roellig, filed a complaint in the United States District Court for the Eastern District of Pennsylvania against LG, its principal Robert Stinson, and several other parties, including Morningstar, Inc. (the Klass Matter). The plaintiffs claim that Morningstar committed fraud and aided and abetted the other defendants' breach of fiduciary duty through the 5-star rating LG obtained from Morningstar. The plaintiffs seek unspecified damages. Hedge fund managers self-report their performance data to Morningstar. More than a year before the Klass Matter, in June 2010, the SEC filed suit against LG and other entities claiming they were part of a Ponzi scheme operated by Stinson. As a result, LG and the other entities were placed in court-appointed receivership. Morningstar was not part of the SEC suit or receivership. Since that time, the Receiver, as part of his duties, has been investigating whether to assert claims against third parties. Morningstar is aware of 14 lawsuits filed by the Receiver seeking to recover money for the fund.

In November 2011, Morningstar filed a motion to dismiss the Klass Matter. On behalf of the entities in receivership, the Receiver filed a motion to stay the proceedings because the Receivership Order does not permit suits against the entities in receivership without court permission. The court granted the Receiver's motion and stayed the Klass Matter. In April 2012, the Receiver filed a complaint against Morningstar, in which the Receiver claims that Morningstar is liable for contribution and aiding and abetting Stinson's breach of fiduciary duty and fraud through the 5-star rating LG obtained from Morningstar. The same day the Receiver filed his complaint, Morningstar sought leave from the court to file a countersuit against Stinson and two of his entities-Keystone State Capital Corporation and LG for, among other things, fraud, misrepresentation, and breach of user agreements. In June 2012, the court denied Morningstar's motion for leave to file suit. The court took no position on the merits of Morningstar's claims, and did not preclude us from renewing our motion to file a complaint at a later time, but deferred to the Receiver's request not to subject the receivership estate to additional litigation at this early point in the receivership. A bench trial related to the Receiver's claims against Morningstar was held between January 13 and January 28, 2014. At trial, the Receiver claimed that Morningstar is liable under a contribution theory for all or part of a \$14.5 million disgorgement judgment that the SEC obtained against the entities and individuals in receivership. Morningstar contested liability and damages

at trial and believes it is not liable for any amount. The parties filed post-trial proposed findings of fact and conclusions of law on March 14, 2014. It is not known when the court will issue its decision.

We believe the allegations against Morningstar by the Klass plaintiffs and the Receiver have no legal or factual basis, and we plan to continue to vigorously contest the claims. We also intend to refile our affirmative claims against Stinson, Keystone, and LG at a later time consistent with the court's order. We cannot predict the outcome of the proceedings.

We have not provided an estimate of loss or range of loss in connection with this matter because no such estimate can reasonably be made.

Table of Contents

Business Logic Holding Corporation

In November 2009, Business Logic Holding Corporation (Business Logic) filed a complaint in the Circuit Court of Cook County, Illinois against Ibbotson Associates, Inc., one of our wholly owned subsidiaries, and Morningstar, Inc. relating to Ibbotson's prior commercial relationship with Business Logic. Business Logic alleged breach of contract and trade secret misappropriation in connection with Ibbotson's development of a proprietary web-service software and user interface that connects plan participant data with the Ibbotson Wealth Forecasting Engine. Ibbotson and Morningstar answered the complaint, and Ibbotson asserted a counterclaim against Business Logic alleging trade secret misappropriation and breach of contract, also seeking damages and injunctive relief.

On July 17, 2014, Morningstar and Ibbotson entered into a settlement agreement with Business Logic relating to this litigation (the Settlement Agreement). Pursuant to the Settlement Agreement, among other things, Morningstar or Ibbotson will pay Business Logic \$61.0 million and Business Logic (i) will dismiss with prejudice all claims asserted in the Litigation; (ii) grants releases to Morningstar, Ibbotson, and their clients; and (iii) grants to Morningstar, its affiliates, Ibbotson and their clients an irrevocable license to use the intellectual property at issue in the litigation. In late July 2014, Morningstar paid \$15.0 million of the amount owed to Business Logic under the Settlement Agreement and the case was dismissed with prejudice. The Settlement Agreement provides that the remaining \$46.0 million be paid on or before August 17, 2014.

Other Proceedings

In addition to these proceedings, we are involved in legal proceedings and litigation that have arisen in the normal course of our business. Although the outcome of a particular proceeding can never be predicted, we do not believe that the result of any of these other matters will have a material adverse effect on our business, operating results, or financial position.

12. Share Repurchase Program

We have an ongoing authorization, originally approved by our board of directors in September 2010, and subsequently amended, to repurchase up to \$700 million in shares of our outstanding common stock. The authorization expires on December 31, 2015. We may repurchase shares from time to time at prevailing market prices on the open market or in private transactions in amounts that we deem appropriate.

As of June 30, 2014, we had repurchased a total of 7,557,807 shares for \$486.5 million under this authorization.

13. Subsequent Events

On July 17, 2014, Morningstar and Ibbotson entered into a settlement agreement with Business Logic Holding Corporation (Business Logic). Pursuant to the settlement agreement, Morningstar will pay Business Logic \$61.0 million. In July 2014, Morningstar paid \$15.0 million of the amount owed to Business Logic under the settlement agreement and the case was dismissed with prejudice. This obligation was accrued as of June 30, 2014 and the corresponding expense is reported as "Litigation settlement" in our Unaudited Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2014. See Note 11, Contingencies, for additional information. Separately, in July 2014, we established a \$75 million single-bank revolving credit facility. The line of credit allows for borrowings from time to time of up to \$75 million for general corporate purposes.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The discussion included in this section, as well as other sections of this Quarterly Report on Form 10-Q, contains forward-looking statements as that term is used in the Private Securities Litigation Reform Act of 1995. These statements are based on our current expectations about future events or future financial performance. Forward-looking statements by their nature address matters that are, to different degrees, uncertain, and often contain words such as "may," "could," "expect," "intend," "plan," "seek," "anticipate," "believe," "estimate," "predict," "potential," or "continue." They involve known and unknown risks and uncertainties that may cause the events we discuss not to occur or to differ significantly from what we expect. For us, these risks and uncertainties include, among others:

- liability for any losses that result from an actual or claimed breach of our fiduciary duties;
- failing to differentiate our products and continuously create innovative, proprietary research tools;
- failing to respond to technological change, keep pace with new technology developments, or adopt a successful technology strategy
- a prolonged outage of our database and network facilities;
- any failures or disruptions in our electronic delivery systems and the Internet;
- liability and/or damage to our reputation as a result of some of our pending litigation;
- liability related to the storage of personal information about our users;
- general industry conditions and competition, including global financial uncertainty, trends in the mutual fund industry, and continued growth in passively managed investment vehicles;
- the effect of market volatility on revenue from asset-based fees;
- failing to maintain and protect our brand, independence, and reputation;
- changes in laws applicable to our investment advisory or credit rating operations, compliance failures, or regulatory action; and
- challenges faced by our operations outside the United States, including the concentration of development work at our offshore facilities in China and India.

A more complete description of these risks and uncertainties can be found in our other filings with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the year ended December 31, 2013. If any of these risks and uncertainties materialize, our actual future results may vary significantly from what we expect. We do not undertake to update our forward-looking statements as a result of new information or future events.

All dollar and percentage comparisons, which are often accompanied by words such as "increase," "decrease," "grew," "declined," "was up," "was down," "was flat," or "was similar" refer to a comparison with the same period in the previous year unless otherwise stated.

Understanding our Company

Our Business

Our mission is to create great products that help investors reach their financial goals. We offer an extensive line of products and services for financial advisors, asset managers, retirement plan providers and sponsors, and individual investors. Many of our products are sold through subscriptions or license agreements. As a result, we typically generate recurring revenue.

In the third quarter of 2013, we revised our segment structure to reflect our shift to a more centralized organization. We now report our results in a single segment, which is consistent with how management allocates resources and evaluates our financial results.

Industry Overview

We monitor developments in the economic and financial information industry to help inform our company strategy, product development plans, and marketing initiatives.

After a strong rally in 2013, equity markets continued to generate gains in the second quarter of 2014. The Morningstar U.S. Market Index, a broad market benchmark, gained 5.0% in the quarter, while the Global Ex-U.S. Index finished the quarter with a total return of 5.2%.

U.S. mutual fund assets stood at \$15.7 trillion as of June 30, 2014, based on data from the Investment Company Institute (ICI), compared with \$13.6 trillion as of June 30, 2013. Based on Morningstar's estimated asset flow data, investors added about \$200 billion to long-term open-end funds during the first six months of 2014 and pulled \$147 billion from money market funds. Both equity and fixed-income funds had positive net inflows for the first half of 2014.

Assets in exchange-traded funds (ETFs) rose to \$1.8 trillion as of June 30, 2014, compared with \$1.4 trillion as of June 30, 2013, based on data from the ICI.

Despite generally positive market trends, we believe the business environment for the financial services industry remains challenging. Asset management firms have been facing increasing regulatory burdens, which are leading to higher costs and more cautious spending in other areas. Further, the historically low interest rate environment has put pressure on the margins of many firms, most notably those in the variable annuity space. As a result, we expect there will be further pressure on revenue from clients in this area.

Table of Contents

Supplemental Operating Metrics

The tables below summarize our key product metrics and other supplemental data.

	As of June 30		Change	
	2014	2013		
Our business				
Morningstar.com Premium Membership subscriptions (U.S.)	122,736	123,881	(0.9)%
Registered users for Morningstar.com (U.S.)	8,021,734	7,690,300	4.3	%
U.S. Advisor Workstation Clients (1)	170	151	12.6	%
U.S. Morningstar Office Licenses (1)	4,201	3,985	5.4	%
Principia subscriptions	14,805	22,464	(34.1)%
Morningstar Direct licenses	9,222	7,960	(2) 15.9	%
Assets under advisement and management (approximate) (\$bil)				
Investment Advisory services (3)	\$82.7	\$101.4	(18.4)%
Retirement Solutions				
Managed Retirement Accounts (4)	\$36.8	\$27.9	31.9	%
Other assets	37.6	28.0	34.3	%
Total Retirement Solutions	\$74.4	\$55.9	33.1	%
Morningstar Managed Portfolios	\$8.6	\$5.9	45.8	%
Ibbotson Australia	\$3.3	\$2.9	13.8	%
Our employees (approximate)				
Worldwide headcount	3,800	3,425	10.9	%
Number of worldwide equity and credit analysts	175	150	16.7	%
Number of worldwide fund analysts	100	105	(4.8)%
	Three months ended June 30			
	2014	2013	Change	
Average assets under management and advisement (\$bil)	166.3	161.6	2.9	%
Number of new commercial mortgage-backed securities (CMBS) new-issue ratings completed	9	8	12.5	%
Rated balance for CMBS new-issue ratings (\$bil)	\$4.7	\$6.8	(30.9)%

(1) Beginning in the second quarter of 2014, we changed our reporting to show the number of enterprise clients for Morningstar Advisor Workstation instead of the number of individual licenses. We believe this is a more meaningful indicator of underlying business trends because per-user pricing varies significantly depending on the scope of the license. We also began disclosing the number of licenses for Morningstar Office as a separate line item.

(2) Revised to reflect a minor calculation change.

(3) The decline in assets under advisement as of June 30, 2014 reflects difficult market conditions for companies that offer variable annuities. Some of our clients have been managing their funds-of-funds portfolios in-house instead of using outside subadvisors. Because of this trend, assets under advisement as of June 30, 2014 were \$18.7 billion lower versus the same date in 2013.

The asset totals include relationships for which we receive basis-point fees, including consulting arrangements and other agreements where we act as a portfolio construction manager for a mutual fund or variable annuity. We also provide Investment Advisory services for some assets for which we receive a flat fee; we do not include these assets in

the total reported above.

Excluding changes related to new contracts and cancellations, changes in the value of assets under advisement can come from two primary sources: gains or losses related to overall trends in market performance, and net inflows or outflows caused when investors add to or redeem shares from these portfolios.

31

Table of Contents

We cannot separately quantify cash inflows and outflows for these portfolios because we do not have custody of the assets in the majority of our investment management businesses. The information we receive from many of our clients does not separately identify the effect of cash inflows and outflows on asset balances for each period. We also cannot precisely quantify the effect of market appreciation or depreciation because the majority of our clients have discretionary authority to implement their own portfolio allocations.

(4) We cannot separately quantify the factors affecting assets under management and advisement for our managed retirement accounts. These factors primarily consist of employer and employee contributions, plan administrative fees, market movements, and participant loans and hardship withdrawals. We cannot quantify the effect of these other factors because the information we receive from the plan providers does not separately identify these transactions or the changes in balances caused by market movement.

Three and Six Months Ended June 30, 2014 vs. Three and Six Months Ended June 30, 2013

Consolidated Results

Key Metrics (\$000)	Three months ended June 30			Six months ended June 30		
	2014	2013	Change	2014	2013	Change
Revenue	\$189,385	\$175,428	8.0 %	\$370,550	\$344,284	7.6 %
Operating income (loss)	\$(24,780)	\$43,584	(156.9)%	\$13,752	\$84,144	(83.7)%
Operating margin	(13.1)%	24.8 %	(37.9) pp	3.7 %	24.4 %	(20.7) pp
Cash used for investing activities	\$(58,685)	\$(64,925)	(9.6)%	\$(7,203)	\$(15,693)	(54.1)%
Cash used for financing activities	\$(25,531)	\$(46,731)	(45.4)%	\$(53,033)	\$(58,381)	(9.2)%
Cash provided by operating activities	\$54,804	\$58,462	(6.3)%	\$66,688	\$85,135	(21.7)%
Capital expenditures	(10,006)	(9,763)	2.5 %	(30,799)	(18,881)	63.1 %
Free cash flow	\$44,798	\$48,699	(8.0)%	\$35,889	\$66,254	(45.8)%

pp — percentage points

To supplement our consolidated financial statements presented in accordance with U.S. Generally Accepted Accounting Principles (GAAP), we use the following measures considered as non-GAAP by the U.S. Securities and Exchange Commission: consolidated revenue excluding acquisitions and foreign currency translations (organic revenue), consolidated operating income excluding the litigation settlement (adjusted operating income), consolidated operating margin excluding the litigation settlement (adjusted operating margin), and free cash flow. These non-GAAP measures may not be comparable to similarly titled measures reported by other companies.

We present consolidated revenue excluding acquisitions and foreign currency translations (organic revenue) because the company believes this non-GAAP measure helps investors better compare period-over-period results.

We define free cash flow as cash provided by or used for operating activities less capital expenditures. We present free cash flow solely as supplemental disclosure to help investors better understand how much cash is available after we

spend money to operate our business. Our management team uses free cash flow to evaluate our business. Free cash flow is not equivalent to any measure required to be reported under U.S. generally accepted accounting principles (GAAP). Also, the free cash flow definition we use may not be comparable to similarly titled measures used by other companies.

Overview of Consolidated Results

Our consolidated revenue increased by about 8% for both the second quarter and first six months of 2014. During the second quarter of 2014, we recorded an expense of \$61.0 million—approximately \$38.2 million after taxes, or 85 cents per share—related to a previously announced litigation settlement with Business Logic Holding Corp. As a

Table of Contents

result, we reported a consolidated operating loss of \$24.8 million in the second quarter of 2014, compared with operating income of \$43.6 million in the same period a year ago. For the first six months of 2014, we reported operating income of \$13.8 million, compared with \$84.1 million in the first six months of 2013.

Excluding the litigation settlement, our adjusted operating income declined in both the second quarter and first six months of 2014, mainly because of higher compensation expense from additional headcount, reflecting new hires as well as acquisitions. We discuss these trends in more detail in the Consolidated Operating Expense section that follows.

Consolidated Revenue

(\$000)	Three months ended June 30			Six months ended June 30				
	2014	2013	Change	2014	2013	Change		
Investment information	\$149,527	\$140,031	6.8	% \$290,797	\$275,116	5.7	%	
Investment management	39,858	35,397	12.6	% 79,753	69,168	15.3	%	
Consolidated revenue	\$189,385	\$175,428	8.0	% \$370,550	\$344,284	7.6	%	

In the second quarter of 2014, our consolidated revenue increased 8.0% to \$189.4 million, compared with \$175.4 million in the second quarter of 2013. Some of the main contributors to the increase were Morningstar Direct, Morningstar Retirement Solutions, and Morningstar Data. Positive results for these products were partially offset by a \$2.4 million decline for Principia. We have been migrating some Principia clients to Morningstar Advisor Workstation and other products. Revenue for Investment Advisory services was down \$1.5 million, reflecting the ongoing effect of clients moving to in-house management for fund-of-funds portfolios in the variable annuity industry.

For the first six months of 2014, our consolidated revenue was up 7.6% to \$370.6 million, compared with \$344.3 million in the same period of 2013. Morningstar Direct, Morningstar Retirement Solutions and Morningstar Data were the main positive contributors, partially offset by lower revenue for Principia and, to a lesser extent, Investment Advisory services.

Investment information revenue

Investment information revenue, which makes up about 80% of our consolidated revenue, increased \$9.5 million, or 6.8%, in the second quarter of 2014. Morningstar Direct revenue rose \$3.4 million, and Morningstar Data was up \$2.6 million. Revenue for Morningstar Advisor Workstation (including Morningstar Office) rose \$2.0 million, which was offset by a \$2.4 million drop in revenue for Principia.

For the first six months of 2014, investment information revenue increased \$15.7 million, or 5.7%, mainly because of higher revenue for Morningstar Direct and Morningstar Data. Revenue for Morningstar Advisor Workstation (including Morningstar Office) also increased, but was offset by lower revenue for Principia.

Investment management revenue

Investment management revenue, which makes up about 20% of consolidated revenue, was up \$4.5 million, or 12.6%, in the second quarter of 2014, driven by higher revenue for Retirement Solutions and Morningstar Managed Portfolios. Assets under management and advisement for Retirement Solutions rose 33.1% year over year, while assets under management for Morningstar Managed Portfolios rose 45.8%. These increases reflect positive market

returns over the past 12 months as well as additional net inflows.

Companies that offer variable annuities have continued to face difficult market conditions, which has prompted some of our clients to begin managing their fund-of-funds portfolios in-house instead of using outside subadvisors. Because of this trend, assets under advisement for our Investment Advisory services as of June 30, 2014 were \$18.7 billion lower versus the same date in 2013.

Table of Contents

For the first six months of 2014, investment management revenue increased \$10.6 million, or 15.3%, with growth driven mainly by Morningstar Retirement Solutions and Morningstar Managed Portfolios. In addition, we recognized an additional \$1.7 million of revenue in the first quarter of 2014 because of a change in accounting estimates involving revenue recognition for certain investment management contracts with minimum fee features.

Revenue from asset-based fees made up about 12% of total consolidated revenue in the second quarter and first six months of both of 2014 and 2013.

Organic revenue

To allow for more meaningful comparisons of our results in different periods, we provide information about organic revenue, which reflects our underlying business excluding acquisitions, divestitures, and the effect of foreign currency translations. We had \$2.6 million of incremental revenue in the second quarter of 2014 from acquisitions, primarily from ByAllAccounts, as well as a slight benefit from foreign currency translations. Excluding these two factors, organic revenue rose 6.0% in the second quarter of 2014.

For the first six months of 2014, we had \$4.1 million of incremental revenue from acquisitions, primarily from ByAllAccounts and purchasing the remaining ownership interest in Morningstar Sweden. Currency translations had close to no effect, and organic revenue increased about 6.4% for the six-month period.

The table below reconciles consolidated revenue with organic revenue (revenue excluding acquisitions, divestitures, and the effect of foreign currency translations):

(\$000)	Three months ended June 30			Six months ended June 30			
	2014	2013	Change	2014	2013	Change	
Consolidated revenue	\$189,385	\$175,428	8.0	%\$370,550	\$344,284	7.6	%
Less: acquisitions	(2,594)	—	NMF	(4,071)	—	NMF	
Less: divestitures	—	—	NMF	—	—	NMF	
Effect of foreign currency translations	(885)	—	NMF	(79)	—	NMF	
Organic revenue	\$185,906	\$175,428	6.0	%\$366,400	\$344,284	6.4	%

NMF - not meaningful

Organic revenue (revenue excluding acquisitions, divestitures, and the effect of foreign currency translations) is considered a non-GAAP financial measure. The definition of organic revenue we use may not be the same as similarly titled measures used by other companies. Organic revenue should not be considered an alternative to any measure of performance as promulgated under GAAP.

Revenue by region

(\$000)	Three months ended June 30			Six months ended June 30			
	2014	2013	Change	2014	2013	Change	
United States	\$136,453	\$126,335	8.0	%\$266,405	\$247,748	7.5	%
United Kingdom	15,544	14,015	10.9	%30,882	27,168	13.7	%
Continental Europe	15,921	13,993	13.8	%31,547	27,160	16.2	%
Australia	9,233	9,176	0.6	%17,401	18,528	(6.1))%
Canada	7,542	7,812	(3.5)	)%15,209	15,548	(2.2))%
Asia	3,888	3,449	12.7	%7,597	6,873	10.5	%

Edgar Filing: Morningstar, Inc. - Form 10-Q

Other	804	648	24.1	%	1,509	1,259	19.9	%
Total International	52,932	49,093	7.8	%	104,145	96,536	7.9	%
Consolidated revenue	\$189,385	\$175,428	8.0	%	\$370,550	\$344,284	7.6	%

34

Table of Contents

International revenue made up about 28% of our consolidated revenue in the first six months of both 2014 and 2013. About 60% of this amount is from Continental Europe and the United Kingdom; we also generate significant international revenue from Australia and Canada.

Revenue from international operations rose \$3.8 million, or 7.8%, in the second quarter. Excluding acquisitions and foreign currency translations, revenue from international operations increased 5.1%. Our operations in Continental Europe and Australia were the main contributors to the increase.

For the first six months of 2014, revenue from international operations was up \$7.6 million, or 7.9%. Excluding acquisitions and the negative effect of foreign currency translations, revenue from international operations increased 5.8%. Our operations in the United Kingdom and Continental Europe were the main contributors to the increase, followed by Canada and Australia.

The table below presents a reconciliation from international revenue to international organic revenue (international revenue excluding acquisitions, divestitures, and the effect of foreign currency translations):

(\$000)	Three months ended June 30			Six months ended June 30			Change	
	2014	2013	Change	2014	2013	Change		
International revenue	\$52,932	\$49,093	7.8	% \$104,145	\$96,536	7.9	%	
Less: acquisitions	(472)	) —	NMF	(1,949)	) —	NMF		
Less: divestitures	—	—	NMF	—	—	NMF		
Favorable effect of foreign currency translations	(885)	) —	NMF	(79)	) —	NMF		
International organic revenue	\$51,575	\$49,093	5.1	% \$102,117	\$96,536	5.8	%	

International organic revenue (international revenue excluding acquisitions, divestitures, and the effect of foreign currency translations) is considered a non-GAAP financial measure. The definition we use for this measure may not be the same as similarly titled measures used by other companies. International organic revenue should not be considered an alternative to any measure of performance as promulgated under GAAP.

Consolidated Operating Expense

(\$000)	Three months ended June 30				Six months ended June 30			
	2014	2013	Change		2014	2013	Change	
Cost of revenue (1)	\$81,387	\$64,427	26.3	%	\$157,101	\$126,077	24.6	%
% of revenue	43.0	% 36.7	% 6.3	pp	42.4	% 36.6	% 5.8	pp
Sales and marketing	27,949	28,035	(0.3)	)%	56,377	56,015	0.6	%
% of revenue	14.8	% 16.0	% (1.2)	) pp	15.2	% 16.3	% (1.1)	) pp
General and administrative	30,438	28,120	8.2	%	56,542	55,447	2.0	%
% of revenue	16.1	% 16.0	% 0.1	pp	15.3	% 16.1	% (0.8)	) pp
Depreciation and amortization	13,391	11,262	18.9	%	25,778	22,601	14.1	%
% of revenue	7.1	% 6.4	% 0.7	pp	7.0	% 6.6	% 0.4	pp
Litigation settlement	61,000	—	—		61,000	—	—	
% of revenue	32.2	% —	% 32.2	pp	16.5	% —	% 16.5	pp
	\$214,165	\$131,844	62.4	%	\$356,798	\$260,140	37.2	%

Total operating expense

(2) (3)

% of revenue	113.1	% 75.2	% 37.9	pp 96.3	% 75.6	% 20.7	pp
--------------	-------	--------	--------	---------	--------	--------	----

(1) We now include development expense in the cost of revenue category, which we previously referred to as cost of goods sold. We have reclassified development expense to include it in cost of revenue for all periods presented. We previously reported development expense as a separate operating expense category.

Separately, as a result of moving to a more centralized structure in 2013 (including new positions created, changes in focus for some existing roles, and the refinement of employee cost categorizations), approximately 180 net positions shifted from the

35

Table of Contents

general and administrative and sales and marketing categories to cost of revenue. For the second quarter of 2014 compared with the same period in 2013, changes related to our more centralized organizational structure added approximately \$7 million of compensation expense to cost of revenue, and reduced the compensation expense in our sales and marketing and general and administrative expense categories by approximately \$4 million and \$3 million, respectively. These changes did not affect our total operating expense or operating income for any of the periods presented.

(2) Includes stock-based compensation expense of:

(\$000)	Three months ended June 30				Six months ended June 30					
	2014	2013	Change		2014	2013	Change			
Stock-based compensation expense	\$4,363	\$3,954	10.3	%	\$8,302	\$7,737	7.3	%		
% of revenue	2.3	% 2.3	%	—	pp	2.2	% 2.2	%	—	pp

(3) Includes bonus expense of:

(\$000)	Three months ended June 30				Six months ended June 30			
	2014	2013	Change		2014	2013	Change	
Bonus expense	\$13,037	\$9,628	35.4	%	\$25,519	\$20,154	26.6	%
% of revenue	6.9	% 5.5	% 1.4	pp	6.9	% 5.9	% 1.0	pp

Consolidated operating expense increased \$82.3 million, or 62.4%, in the second quarter of 2014, and \$96.7 million, or 37.2%, in the first six months of the year. The \$61.0 million litigation settlement expense recorded in connection with our agreement with Business Logic Holding Corporation (the "litigation settlement") contributed the majority of the change in operating expense for both periods.

Higher compensation expense (including salaries, bonus, and other company-sponsored benefits) also contributed to expense growth in both periods. We had approximately 3,800 employees worldwide as of June 30, 2014, compared with 3,425 as of June 30, 2013. We hired about 275 additional employees year over year, including for product and technology roles in the United States as well as data analysts based in India to support our existing business and new initiatives. Headcount also increased because of the ByAllAccounts and HelloWallet acquisitions, which accounted for about 100 additional employees combined.

Commission expense rose \$2.1 million in the second quarter and \$5.0 million in the first half of 2014, mainly because we changed to a new sales commission structure that requires a different accounting treatment. We now expense commissions as incurred instead of amortizing them over the term of the underlying contracts. However, we are continuing to amortize the prepaid commission balance from our previous commission plan. We expect to incur additional commission expense for the next several quarters because of this change.

Professional fees were up \$1.6 million in the second quarter and \$3.6 million in the first half of 2014, mainly because of higher legal expense and consulting costs.

The expense growth in both periods was partially offset by a step up in capitalized software development, which reduced operating expense. In the second quarter of 2014, we capitalized \$2.2 million of software development costs related to ongoing enhancements for some of our key platforms, including Morningstar Direct, Morningstar Advisor Workstation, and Morningstar.com, as well as an additional \$2.2 million of expense for new development of special projects. For the first six months of 2014, we capitalized \$8.5 million of software development expense, including \$4.3 million for ongoing enhancements of key platforms and an additional \$4.2 million for new development of special projects.

Cost of revenue

Cost of revenue is our largest category of operating expense, representing about one-half of our total operating expense. Our business relies heavily on human capital, and cost of revenue includes the compensation expense for employees who produce our products and services. Compensation expense for approximately 80% of our employees is included in this category. We now include development expense in this category. We have reclassified development expense to include it in cost of revenue for all periods presented.

Cost of revenue increased \$17.0 million in the second quarter of 2014. Higher salary expense of \$11.4 million was the primary contributor to the increase (including an increase of approximately \$7 million from the shift in expense

Table of Contents

categories as a result of our recent reorganization). Higher expense for bonus, other compensation, and employee benefits driven by higher headcount also contributed to the change in this category.

For the first six months of 2014, cost of revenue was up \$31.0 million. Higher salary expense of \$21.1 million was the primary contributor to the increase (including an increase of approximately \$14 million from the shift in expense categories as a result of our recent reorganization). Higher expense for bonus, other compensation, and production driven by higher headcount also contributed to the change in this category.

Partially offsetting these increases was an increase in capitalized software development, which reduced cost of revenue in both periods compared to prior periods. We capitalized \$4.4 million of compensation associated with software development activities in the second quarter of 2014 and \$8.5 million in the first six months of 2014. For comparison, we capitalized \$2.2 million of expense in the second quarter of 2013 and \$3.8 million in the first six months of 2013.

As a percentage of revenue, cost of revenue increased by about six percentage points in both the second quarter and first six months of 2014, mainly because of additional employees included in this category as a result of our reorganization as well as new hires.

Sales and marketing

Sales and marketing expense decreased slightly in the second quarter of 2014. While sales commission expense increased (mainly because of the change in sales commission plan discussed above), this was offset by lower salary expense included in this category as well as a reduction in costs for travel, training, telephone, and conferences.

For the first six months of 2014, sales and marketing was up about \$0.4 million, as higher sales commission expense was almost entirely offset by lower salary expense included in this category as well as lower costs for travel, training, telephone, and conferences.

As a percentage of revenue, sales and marketing expense decreased by about one percentage point in both periods.

General and administrative

General and administrative (G&A) expense increased \$2.3 million in the second quarter of 2014. Benefit costs and professional fees both increased, but that was partially offset by a \$0.7 million reduction in salary expense from the shift in expense categories as a result of our recent reorganization.

For the first six months of 2014, general and administrative expense was up \$1.1 million. The increase mainly reflects higher costs for professional fees, which was partially offset by lower salary costs included in this category. In addition, we recorded a credit of \$1.5 million for damages received in connection with a litigation settlement in the first quarter of 2014, which partially offset increases in legal and other professional fees.

As a percentage of revenue, G&A expense increased slightly in the second quarter of 2014 and decreased by 0.8 percentage points in the first six months of the year, mainly because of the shift in expense categories.

Depreciation and amortization

Intangible amortization expense increased slightly in the second quarter of 2014, as additional amortization expense for the intangible assets of HelloWallet and ByAllAccounts was largely offset by the completed amortization of

certain intangible assets from some of our earlier acquisitions. However, depreciation expense rose \$2.0 million in the quarter, primarily driven by higher capital expenditures for computer software and incremental capitalized software development costs for our operations in the United States.

For the first six months of 2014, intangible amortization expense was down about \$0.3 million, as certain intangible assets from some of our earlier acquisitions are now fully amortized. Depreciation expense increased by \$3.5 million, largely driven by the same factors that contributed to growth in depreciation in the second quarter of 2014.

Table of Contents

We expect that amortization of intangible assets will be an ongoing cost for the remaining lives of the assets. We estimate that aggregate amortization expense for intangible assets will be approximately \$22.5 million in 2014 and \$22.7 million in 2015. Our estimates of future amortization expense for intangible assets may be affected by additional acquisitions, dispositions, changes in the estimated average useful lives, and currency translations.

As a percentage of revenue, depreciation and amortization expense increased slightly in both the second quarter and first six months of 2014.

Litigation settlement

As mentioned above, we recorded a \$61.0 million litigation settlement in the second quarter of 2014 related to the agreement with Business Logic.

The litigation settlement contributed the majority of the increase in operating expense for both the second quarter and first six months of 2014.

Consolidated Operating Income (Loss)

(\$000)	Three months ended June 30			Six months ended June 30		
	2014	2013	Change	2014	2013	Change
Operating income (loss)	\$ (24,780)	\$ 43,584	(156.9)%	\$ 13,752	\$ 84,144	(83.7)%
% of revenue	(13.1)%	24.8 %	(37.9) pp	3.7 %	24.4 %	(20.7) pp

Consolidated operating income (loss) decreased \$68.4 million in the second quarter of 2014 as revenue increased \$14.0 million and operating expense increased \$82.3 million. Operating margin was (13.1)%, down 37.9 percentage points compared with the second quarter of 2013.

Consolidated operating income decreased \$70.4 million in the first six months of 2014 as revenue increased \$26.3 million and operating expense increased \$96.7 million. Operating margin was 3.7%, down 20.7 percentage points compared with the first half of 2013.

The \$61.0 million litigation settlement was the primary contributor to the decline in operating income and operating margin in both the second quarter and first six months of 2014. We also had higher salary and other compensation-related expense from additional headcount, reflecting both new hires and employees added through the ByAllAccounts and HelloWallet acquisitions.

Excluding the litigation settlement, we reported adjusted operating income of \$36.2 million in the second quarter of 2014, a decrease of 16.9%, and \$74.8 million for the first six months of 2014, a decrease of 11.2%. Adjusted operating income is a non-GAAP measure; the table below shows a reconciliation to the comparable GAAP measure.

We present adjusted operating income (operating income excluding the litigation settlement) to show the effect of this charge, better reflect period-over-period comparisons, and improve overall understanding of our current and future financial performance.

(\$000)	Three months ended June 30			Six months ended June 30		
	2014	2013	Change	2014	2013	Change
Operating income (loss)	\$ (24,780)	\$ 43,584	(156.9)%	\$ 13,752	\$ 84,144	(83.7)%

Edgar Filing: Morningstar, Inc. - Form 10-Q

Less: litigation settlement	61,000	—	—	61,000	—	—
Adjusted operating income	\$36,220	\$43,584	(16.9)%	\$74,752	\$84,144	(11.2)%

Excluding the litigation settlement, we reported an adjusted operating margin of 19.1% in the second quarter of 2014, a decrease of 5.7 percentage points, and 20.2% for the first six months of 2014, a decrease of 4.2 percentage points. Adjusted operating margin is a non-GAAP measure; the table below shows a reconciliation to the comparable GAAP measure.

Table of Contents

We present adjusted operating margin (operating margin excluding the litigation settlement) to show the effect of this charge, better reflect period-over-period comparisons, and improve overall understanding of our current and future financial performance.

(\$000)	Three months ended June 30			Six months ended June 30			
	2014	2013	Change	2014	2013	Change	
Operating margin	(13.1)	)% 24.8	% (37.9)	)pp 3.7	% 24.4	% (20.7)	)pp
Less: litigation settlement	32.2	% —	% 32.2	pp 16.5	% —	% 16.5	pp
Adjusted operating margin	19.1	% 24.8	% (5.7)	)pp 20.2	% 24.4	% (4.2)	)pp

Equity in Net Income of Unconsolidated Entities, Non-Operating Income (Expense), and Income Tax Expense (Benefit)

Equity in net income of unconsolidated entities

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Equity in net income of unconsolidated entities	\$497	\$360	\$1,096	\$857

Equity in net income of unconsolidated entities includes our portion of the net income (loss) of Morningstar Japan K.K. (MJKK), YCharts, Inc., and Inquiry Financial Europe AB. In the first four months of 2013, this category also included our portion of the net income (loss) of Morningstar Sweden. In May 2013, we acquired an additional 76% interest in Morningstar Sweden, increasing our ownership interest to 100% to become sole owner. Because Morningstar Sweden is now a wholly owned subsidiary, we no longer account for our investment using the equity method.

Equity in net income of unconsolidated entities is primarily from our position in MJKK.

Non-operating income (expense)

(\$000)	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Interest income	\$715	\$750	\$1,363	\$1,508
Interest expense	(81)	) (86)	) (144)	) (103)
Gain (loss) on sale of investments, net	371	423	347	1,148
Holding gain upon acquisition of additional ownership of equity and cost method investments	5,168	3,713	5,168	3,713
Other income (expense), net	(275)	) (1,689)	) 29	(2,210)
Non-operating income, net	\$5,898	\$3,111	\$6,763	\$4,056

Interest income mainly reflects interest from our investment portfolio.

Non-operating income for both the second quarter and first six months of 2014 reflects the \$5.2 million gain we recorded in connection with our purchase of the remaining ownership interest in HelloWallet, which was previously a minority investment. Non-operating income for both the second quarter and first six months of 2013 reflects the \$3.7 million gain we recorded in connection with our purchase of the remaining ownership interest in Morningstar Sweden,

which was previously a minority investment.

Other income (expense), net also includes foreign currency exchange gains and losses arising from the ordinary course of business related to our U.S. and non-U.S. operations and royalty income from MJKK.

Income tax expense (benefit)

The following table shows our effective tax rate:

39

Table of Contents

(\$000)	Three months ended June 30		Six months ended June 30		
	2014	2013	2014	2013	
Income (loss) before income taxes and equity in net income of unconsolidated entities	\$ (18,882	) \$ 46,695	\$ 20,515	\$ 88,200	
Equity in net income of unconsolidated entities	497	360	1,096	857	
Net loss attributable to the noncontrolling interest	5	21	35	64	
Total	\$ (18,380	) \$ 47,076	\$ 21,646	\$ 89,121	
Income tax expense (benefit)	\$ (8,611	) \$ 15,955	\$ 5,039	\$ 28,382	
Effective tax rate	46.8	% 33.9	% 23.3	% 31.8	%

During the second quarter of 2014, we reported a loss before income taxes and equity in net income of unconsolidated entities of \$18.9 million, which included litigation settlement expense of \$61.0 million that is deductible for tax purposes. In the same period, we realized a \$5.2 million non-taxable gain in connection with the purchase of the remaining ownership interest in HelloWallet. Because of these two items, we reported an income tax benefit of \$8.6 million, which is equivalent to a 46.8% effective tax rate.

Our effective tax rate for the first six months of 2014 was 23.3%, which is lower than the statutory rate mainly because of the non-taxable gain of \$5.2 million recorded in connection with purchasing the remaining ownership interest in HelloWallet.

Liquidity and Capital Resources

We believe our available cash balances and investments, along with cash generated from operations, will be sufficient to meet our operating and cash needs for at least the next 12 months. We invest our cash reserves in cash equivalents and investments, consisting primarily of fixed-income securities. We maintain a conservative investment policy for our investments and invest a portion of these assets in government obligations and corporate bonds with high-quality stand-alone credit ratings. Investments in our portfolio have a maximum maturity of two years; the weighted average maturity is approximately one year. We also invest a portion of our investments balance (approximately \$21.6 million, or 48% of our total investments balance as of June 30, 2014) in proprietary Morningstar portfolios, exchange-traded funds that seek to track the performance of certain Morningstar proprietary indexes, and various mutual funds. These portfolios may consist of stocks, bonds, options, mutual funds, or exchange-traded funds.

Approximately 31% of our cash, cash equivalents, and investments as of June 30, 2014 was held by our operations in the United States, down from about 51% as of December 31, 2013. We do not expect to repatriate earnings from our foreign subsidiaries in the foreseeable future. We have not recognized deferred tax liabilities for the portion of the outside basis differences (including unremitted earnings) relating to foreign subsidiaries because the investment in these subsidiaries is considered to be permanent in duration. Quantification of the deferred tax liability associated with these outside basis differences is not practicable.

We intend to use our cash, cash equivalents, and investments for general corporate purposes, including working capital and funding future growth.

In July 2014, we established a \$75 million single-bank revolving credit facility in the United States, which we intend to use for general corporate purposes.

Edgar Filing: Morningstar, Inc. - Form 10-Q

In the first six months of 2014, we paid dividends of \$15.3 million. In May 2014, our board of directors approved a payment of a regular quarterly dividend of 17.0 cents per share payable on July 31, 2014 to shareholders of record as of July 11, 2014. We expect to make a recurring quarterly dividend payment of 17.0 cents per share in 2014.

In December 2013, our board approved a \$200 million increase to our share repurchase program, bringing the total amount authorized under the program to \$700 million. We may repurchase shares from time to time at prevailing market prices on the open market or in private transactions in amounts that we deem appropriate. In the first six months of 2014, we repurchased a total of 0.5 million shares for \$36.7 million. As of June 30, 2014, we have

Table of Contents

repurchased a total of 7.6 million shares for \$486.5 million since we announced the share repurchase program in September 2010.

Cash provided by operating activities is our main source of cash. In the first six months of 2014, cash provided by operating activities was \$66.7 million, driven by \$38.8 million of net income, adjusted for non-cash items, partially offset by \$27.9 million in changes from our net operating assets and liabilities.

As of June 30, 2014, we had cash, cash equivalents, and investments of \$221.0 million, a decrease of \$77.6 million compared with \$298.6 million as of December 31, 2013. The decrease reflects \$36.7 million used to repurchase common stock through our share repurchase program, bonus payments of \$39.8 million made during the first quarter of 2014 related to the 2013 bonus, \$64.4 million used for the acquisitions of ByAllAccounts and HelloWallet, and \$30.8 million of capital expenditures. These outflows were partially offset by cash provided by operating activities.

We expect to continue making capital expenditures in 2014, primarily for internally developed software, leasehold improvements for new and existing office locations, and computer hardware and software.

Our cash flows during the third quarter of 2014 will reflect the \$61.0 million payment to Business Logic as part of the July 2014 settlement agreement reached in connection with this litigation matter.

Consolidated Free Cash Flow

As described in more detail above, we define free cash flow as cash provided by or used for operating activities less capital expenditures.

(\$000)	Three months ended June 30			Six months ended June 30		
	2014	2013	Change	2014	2013	Change
Cash provided by operating activities	\$54,804	\$58,462	(6.3)%	\$66,688	\$85,135	(21.7)%
Capital expenditures	(10,006)	(9,763)	2.5 %	(30,799)	(18,881)	63.1 %
Free cash flow	\$44,798	\$48,699	(8.0)%	\$35,889	\$66,254	(45.8)%

We generated free cash flow of \$44.8 million in the second quarter of 2014, a decrease of \$3.9 million compared with free cash flow of \$48.7 million in the second quarter of 2013. The change reflects a \$3.7 million decline in cash provided by operating activities, as well as an \$0.2 million increase in capital expenditures.

In the first six months of 2014, we generated free cash flow of \$35.9 million, a decrease of \$30.4 million compared with free cash flow of \$66.3 million in the same period of 2013. The decrease reflects an \$18.4 million decline in cash provided by operating activities, as well as an \$11.9 million increase in capital expenditures.

Application of Critical Accounting Policies and Estimates

We discuss our critical accounting policies and estimates in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on February 28, 2014. We also discuss our significant accounting policies in Note 2 of our Audited Consolidated Financial Statements included in our Annual Report.

Table of Contents

Rule 10b5-1 Sales Plans

Our directors and executive officers may exercise stock options or purchase or sell shares of our common stock in the market from time to time. We encourage them to make these transactions through plans that comply with Exchange Act Rule 10b5-1(c). Morningstar will not receive any proceeds, other than proceeds from the exercise of stock options, related to these transactions. The following table, which we are providing on a voluntary basis, shows the Rule 10b5-1 sales plans entered into by our directors and executive officers that were in effect as of July 15, 2014:

Name and Position	Date of Plan	Plan Termination Date	Number of Shares to be Sold under the Plan	Timing of Sales under the Plan	Number of Shares Sold under the Plan through July 15, 2014	Projected Beneficial Ownership (1)
Cheryl Francis, Director	5/15/2014	12/31/2014	6,220	Shares to be sold under the plan if the stock reaches specific prices	—	17,023
Steve Kaplan, Director	2/26/2014	12/10/2014	4,000	Shares to be sold under the plan on specified dates	—	49,345
Jack Noonan, Director	11/15/2012	5/2/2015	24,000	Shares to be sold under the plan if the stock reaches specified prices	18,000	60,523
David Williams, Head of Design and Marketing	11/25/2013	4/1/2015	7,500	Shares to be sold under the plan if the stock reaches specified prices	4,500	38,277

During the second quarter of 2014, the previously disclosed Rule 10b5-1 sales plan for Richard Robbins completed in accordance with its terms.

(1) This column reflects an estimate of the number of shares each identified director and executive officer will beneficially own following the sale of all shares under the Rule 10b5-1 sales plans identified above. This information reflects the beneficial ownership of our common stock on June 30, 2014, and includes shares of our common stock subject to options that were then exercisable or that will have become exercisable by August 29, 2014 and restricted stock units that will vest by August 29, 2014. The estimates do not reflect any changes to beneficial ownership that may have occurred since June 30, 2014. Each director and executive officer identified in the table may amend or terminate his or her Rule 10b5-1 sales plan and may adopt additional Rule 10b5-1 plans in the future.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our investment portfolio is actively managed and may suffer losses from fluctuating interest rates, market prices, or adverse security selection. We invest our investment portfolio mainly in high-quality fixed-income securities. As of June 30, 2014, our cash, cash equivalents, and investments balance was \$221.0 million. Based on our estimates, a 100 basis-point change in interest rates would change the fair value of our investment portfolio by approximately \$0.01 million.

As our non-U.S. revenue increases as a percentage of our consolidated revenue, fluctuations in foreign currencies present a greater potential risk. Our European operations are subject to currency risk related to the euro. To date, we have not engaged in currency hedging, and we do not currently have any positions in derivative instruments to hedge our currency risk. Our results could suffer if certain foreign currencies decline relative to the U.S. dollar. In addition, because we use the local currency of our subsidiaries as the functional currency, we are affected by the translation of foreign currencies into U.S. dollars.

Item 4. Controls and Procedures

(a) Evaluation and Disclosure Controls and Procedures

Disclosure controls and procedures are designed to reasonably assure that information required to be disclosed in the reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation,

Table of Contents

controls and procedures designed to reasonably assure that information required to be disclosed in the reports filed under the Exchange Act is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as of June 30, 2014. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported as and when required and is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART 2. OTHER INFORMATION

Item 1. Legal Proceedings

We incorporate by reference the information regarding legal proceedings set forth in Note 11, Contingencies, of the Notes to our Unaudited Condensed Consolidated Financial Statements contained in Part 1, Item 1 of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A—Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2013.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities*

The following table presents information related to repurchases of common stock we made during the three months ended June 30, 2014:

Period:	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced programs (1)	Approximate dollar value of shares that may yet be purchased under the programs (1)
Cumulative through March 31, 2014	7,350,313	\$64.13	7,350,313	\$228,519,472
April 1, 2014 – April 30, 2014	—	—	—	\$228,519,472
May 1, 2014 – May 31, 2014	—	—	—	\$228,519,472
June 1, 2014 – June 30, 2014	207,494	72.40	207,494	\$213,495,903
Total	7,557,807	\$64.36	7,557,807	

* Subject to applicable law, we may repurchase shares at prevailing market prices directly on the open market or in privately negotiated transactions in amounts that we deem appropriate.

We have an ongoing authorization, originally approved by our board of directors in September 2010, and (1) subsequently amended, to repurchase up to \$700 million in shares of our outstanding common stock. The authorization expires on December 31, 2015.

Item 6. Exhibits

Incorporated by reference to Exhibit Index included herewith.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MORNINGSTAR, INC.

Date: July 31, 2014

By: /s/ Stéphane Biehler
Stéphane Biehler
Chief Financial Officer

Table of Contents

EXHIBIT INDEX

Exhibit No	Description of Exhibit
10.1	Settlement Agreement dated as of July 17, 2014 between Morningstar, Ibbotson Associates and Business Logic is incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K that we filed with the SEC on July 17, 2014
31.1†	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2†	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1†	Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2†	Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101†	The following financial information from Morningstar Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, filed with the SEC on July 31, 2014 formatted in XBRL: (i) Condensed Consolidated Statements of Income, (ii) Condensed Consolidated Statements of Comprehensive Income (iii) Condensed Consolidated Balance Sheets, (iv) Condensed Consolidated Statement of Equity, (v) Condensed Consolidated Statements of Cash Flows and (vi) the Notes to Unaudited Condensed Consolidated Financial Statements

† Filed herewith.