

Morningstar, Inc.
Form 10-Q
May 04, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED March 31, 2011

OR

o **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)

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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)

60602

(Zip Code)

(312) 696-6000

(Registrant's Telephone Number, Including Area 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 ☒

As of April 29, 2011, there were 50,265,946 shares of the Company's common stock, no par value, outstanding.

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(in thousands except per share amounts)		Three months ended March 31		
		2011		2010
Revenue	\$	151,767	\$	128,290
Operating expense (1):				
Cost of goods sold		40,669		34,316
Development		11,988		10,889
Sales and marketing		26,482		22,561
General and administrative		30,617		20,643
Depreciation and amortization		10,202		8,939
Total operating expense		119,958		97,348
Operating income		31,809		30,942
Non-operating income (expense):				
Interest income, net		524		587
Other income (expense), net		250		(766)
Non-operating income (expense), net		774		(179)
Income before income taxes and equity in net income of unconsolidated entities		32,583		30,763
Income tax expense		10,518		10,995
Equity in net income of unconsolidated entities		374		389
Consolidated net income		22,439		20,157
Net loss attributable to the noncontrolling interest		98		31
Net income attributable to Morningstar, Inc.	\$	22,537	\$	20,188
Net income per share attributable to Morningstar, Inc.:				
Basic	\$	0.45	\$	0.41
Diluted	\$	0.44	\$	0.40
Weighted average shares outstanding:				
Basic		49,800		48,828
Diluted		50,953		50,332

Three months ended March 31

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	2011		2010	
(1) Includes stock-based compensation expense of:				
Cost of goods sold	\$	879	\$	715
Development		471		393
Sales and marketing		422		403
General and administrative		1,877		1,426
Total stock-based compensation expense	\$	3,649	\$	2,937

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)	March 31 2011	December 31 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 193,374	\$ 180,176
Investments	191,886	185,240
Accounts receivable, less allowance of \$951 and \$1,056, respectively	115,259	110,891
Deferred tax asset, net	2,648	2,860
Income tax receivable, net	9,361	10,459
Other	15,450	17,654
Total current assets	527,978	507,280
Property, equipment, and capitalized software, net	62,364	62,105
Investments in unconsolidated entities	24,664	24,262
Goodwill	325,318	317,661
Intangible assets, net	162,569	169,023
Other assets	7,335	5,971
Total assets	\$ 1,110,228	\$ 1,086,302
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 40,528	\$ 42,680
Accrued compensation	36,799	62,404
Deferred revenue	157,660	146,267
Other	1,446	1,373
Total current liabilities	236,433	252,724
Accrued compensation	5,071	4,965
Deferred tax liability, net	18,503	19,975
Other long-term liabilities	26,468	27,213
Total liabilities	286,475	304,877
Equity:		
Morningstar, Inc. shareholders' equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 50,234,935 and 49,874,392 shares were outstanding as of March 31, 2011 and December 31, 2010, respectively	5	5
Treasury stock at cost, 276,073 shares as of March 31, 2011 and 279,456 shares as of December 31, 2010	(6,561)	(6,641)
Additional paid-in capital	471,079	458,426
Retained earnings	343,402	323,408
Accumulated other comprehensive income:		
Currency translation adjustment	13,819	4,503
Unrealized gain on available-for-sale securities	1,012	615
Total accumulated other comprehensive income	14,831	5,118
Total Morningstar, Inc. shareholders' equity	822,756	780,316
Noncontrolling interest	997	1,109
Total equity	823,753	781,425
Total liabilities and equity	\$ 1,110,228	\$ 1,086,302

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statement of Equity and Comprehensive Income (Loss)
For the Three Months Ended March 31, 2011

Morningstar, Inc. Shareholders' Equity								
(in thousands, except share amounts)	Common Stock	Par	Treasury	Additional	Retained	Accumulated	Non	Total
	Shares Outstanding	Value	Stock	Paid-in Capital	Earnings	Other Comprehensive Income (Loss)	Controlling Interests	Equity
Balance as of December 31, 2010	49,874,392	\$ 5	\$ (6,641)	\$ 458,426	\$ 323,408	\$ 5,118	\$ 1,109	\$ 781,425
Comprehensive income (loss):								
Net income (loss)					22,537		(98)	22,439
Unrealized gain on available-for-sale investments, net of income tax of \$211						397		397
Foreign currency translation adjustment, net						9,316	(14)	9,302
Total comprehensive income (loss)					22,537	9,713	(112)	32,138
Issuance of common stock related to stock-option exercises and vesting of restricted stock units, net	360,543		80	4,841				4,921
Stock-based compensation restricted stock units				2,785				2,785
Stock-based compensation restricted stock				864				864
Excess tax benefit derived from stock-option exercises and vesting of restricted stock units				4,122				4,122
Dividends declared common shares outstanding					(2,502)			(2,502)
Dividends declared restricted stock units				41	(41)			
Balance as of March 31, 2011	50,234,935	\$ 5	\$ (6,561)	\$ 471,079	\$ 343,402	\$ 14,831	\$ 997	\$ 823,753

See notes to unaudited condensed consolidated financial statements.

[Table of Contents](#)**Morningstar, Inc. and Subsidiaries****Unaudited Condensed Consolidated Statements of Cash Flows**

(in thousands)	Three months ended March 31		
	2011		2010
Operating activities			
Consolidated net income	\$	22,439	\$ 20,157
Adjustments to reconcile consolidated net income to net cash flows from operating activities:			
Depreciation and amortization		10,202	8,939
Deferred income tax benefit		(677)	(1,287)
Stock-based compensation expense		3,649	2,937
Provision for bad debt		285	162
Equity in net income of unconsolidated entities		(374)	(389)
Excess tax benefits from stock-option exercises and vesting of restricted stock units		(4,122)	(3,048)
Other, net		(512)	792
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable		(3,357)	(4,867)
Other assets		1,453	(480)
Accounts payable and accrued liabilities		(2,600)	1,174
Accrued compensation		(26,876)	(22,516)
Income taxes payable		5,297	3,681
Deferred revenue		9,847	10,430
Deferred rent		(399)	(392)
Other liabilities		91	(843)
Cash provided by operating activities		14,346	14,450
Investing activities			
Purchases of investments		(67,352)	(50,964)
Proceeds from maturities and sales of investments		62,359	87,934
Capital expenditures		(5,037)	(1,650)
Acquisitions, net of cash acquired			(738)
Other, net		(14)	
Cash provided by (used for) investing activities		(10,044)	34,582
Financing activities			
Proceeds from stock-option exercises		4,921	3,494
Excess tax benefits from stock-option exercises and vesting of restricted stock units		4,122	3,048
Dividends paid		(2,494)	
Other, net		(214)	315
Cash provided by financing activities		6,335	6,857
Effect of exchange rate changes on cash and cash equivalents			
		2,561	(1,032)
Net increase in cash and cash equivalents		13,198	54,857
Cash and cash equivalents beginning of period		180,176	130,496
Cash and cash equivalents end of period	\$	193,374	\$ 185,353
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	\$	6,962	\$ 8,565
Supplemental information of non-cash investing and financing activities:			
Unrealized gain on available-for-sale investments	\$	609	\$ 46

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See notes to unaudited condensed consolidated financial statements.

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MORNINGSTAR, 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 should be read in conjunction with our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on February 28, 2011.

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

ASC: Accounting Standards Codification

ASU: Accounting Standards Update

EITF: Emerging Issues Task Force

FASB: Financial Accounting Standards Board

SEC: Securities and Exchange Commission

2. Summary of Significant Accounting Policies

We discuss our significant accounting policies in Note 3 of our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the SEC on February 28, 2011.

In addition, effective January 1, 2011, we adopted FASB ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*. ASU 2009-13 supersedes EITF Issue 00-21, *Revenue Arrangements with Multiple Deliverables* and establishes the accounting and reporting guidance for arrangements when a vendor performs multiple revenue-generating activities, addresses how to separate deliverables, and specifies how to measure and allocate arrangement consideration. We are applying this guidance for revenue arrangements entered into or materially modified from January 1, 2011. The adoption of ASU 2009-13 does not significantly affect either the timing or amount of our revenue recognition.

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In conjunction with the adoption of ASU 2009-13, we have updated our disclosures concerning revenue recognition, as follows:

Revenue recognition: We recognize revenue in accordance with SEC SAB 104, *Revenue Recognition*, ASC 605-25, *Revenue Recognition: Multiple Element Arrangements*, and ASC 985-605, *Software: Revenue Recognition*.

We recognize revenue when all of the following conditions are met:

- There is persuasive evidence of an arrangement, as evidenced by a signed contract;
- Delivery of our products and services is a prerequisite for recognition of revenue. If arrangements include an acceptance provision, we generally begin recognizing revenue upon the receipt of customer acceptance;
- The amount of fees to be paid by the customer is fixed or determinable; and
- The collectibility of the fees is reasonably assured.

We generate revenue through sales of Licensed Data, Morningstar Advisor Workstation, including Morningstar Office, Morningstar Direct, Morningstar Equity Research, Premium membership fees for Morningstar.com, and a variety of other investment-related products and services. The revenue arrangements for these offerings are generally structured as licenses or subscriptions. We recognize revenue from licenses and subscription sales ratably as the product or service is delivered and over the service obligation period defined by the terms of the customer contract.

We also generate revenue from Internet advertising, primarily from impression-based contracts. For advertisers who use our cost-per-impression pricing, we charge fees each time their ads are displayed on our site.

Investment Consulting represents a broad range of services. Pricing for the consulting services is based on the scope of work and the level of service required, and includes asset-based fees for work we perform that involves investment management or acting as a subadvisor to investment portfolios. In arrangements that involve asset-based fees, we generally invoice clients quarterly in arrears based on average assets for the quarter. We recognize asset-based fees once the fees are fixed and determinable assuming all other revenue recognition criteria are met.

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Our Retirement Advice offerings help retirement plan participants plan and invest for retirement. We offer these services both through retirement plan providers (typically third-party asset management companies that offer proprietary mutual funds) and directly to plan sponsors (employers that offer retirement plans to their employees). For our Retirement Advice offerings, we provide both a hosted solution as well as proprietary installed software advice solution. The installed customized software can be integrated with a client's existing systems to help investors accumulate wealth, transition into retirement, and manage income during retirement. The revenue arrangements for Retirement Advice generally extend over multiple years. Our contracts may include one-time setup fees, implementation fees, technology licensing and maintenance fees, asset-based fees for managed retirement accounts, fixed and variable fees for advice and guidance, or a combination of these fee structures. Upon customer acceptance, we recognize revenue ratably over the term of the agreement. We recognize asset-based fees and variable fees in excess of any minimum once the value is fixed and determinable.

Some of our revenue arrangements with our customers combine multiple products and services. These products and services may be provided at different points in time or over different time periods within the same arrangement. We allocate fees to the separate deliverables based on the deliverables' relative selling price. This relative selling price is generally based on the price we charge when the same deliverable is sold separately.

We record taxes imposed on revenue-producing transactions (such as sales, use, value-added, and some excise taxes) on a net basis; therefore, such taxes are excluded from revenue in our Consolidated Statements of Income.

Deferred revenue represents the portion of subscriptions billed or collected in advance of the service being provided, which we expect to recognize to revenue in future periods. Certain arrangements may have cancellation or refund provisions. If we make a refund, it typically reflects the amount collected from a customer for which services have not yet been provided. The refund therefore results in a reduction of deferred revenue.

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3. Acquisitions, Goodwill, and Other Intangible Assets

2011 Acquisitions

We did not complete any acquisitions in the first quarter of 2011.

2010 Acquisitions

The table below summarizes the acquisitions completed during 2010. Some of the purchase price allocations related to these acquisitions are preliminary as they relate to tax-related balances and values of certain intangible assets. Additional information concerning these acquisitions can be found in the Notes to our Consolidated Financial Statements included in our Annual Report on Form 10-K filed with the SEC on February 28, 2011.

Acquisition	Description	Date of Acquisition	Purchase Price*
Footnoted business of Financial Fineprint Inc.	Footnoted is a highly regarded blog for professional money managers, analysts, and sophisticated individual investors. Footnoted Pro, a service for institutional investors, provides insight on actionable items and trends in SEC filings.	February 1, 2010	&nbs