

Morningstar, Inc.  
Form 10-Q  
August 09, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

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**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006**

**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**

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**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)

**225 West Wacker Drive**  
**Chicago, Illinois**  
**60606-6303**

(Address of Principal Executive Offices)

**(312) 696-6000**

(Registrant's Telephone Number, Including Area Code)

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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 is a large accelerated filer, accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 August 2, 2006, there were 41,390,901 shares of the Company's common stock, no par value, outstanding.

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**MORNINGSTAR, INC. AND SUBSIDIARIES**

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**PART 1: FINANCIAL INFORMATION****Item 1: Unaudited Condensed Consolidated Financial Statements****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	
	2006	2005	2006	2005
Revenue	\$ 76,257	\$ 56,243	\$ 146,317	\$ 109,447
Operating expense (1):				
Cost of goods sold	22,052	15,674	40,725	31,586
Development	7,306	4,593	13,397	9,742
Sales and marketing	11,880	9,845	23,540	19,630
General and administrative	13,793	11,135	25,825	24,219
Depreciation and amortization	3,767	1,852	6,173	4,248
Total operating expense	58,798	43,099	109,660	89,425
Operating income	17,459	13,144	36,657	20,022
Non-operating income:				
Interest income, net	858	605	1,917	1,054
Other income (expense), net	(186)	(200)	(312)	60
Non-operating income, net	672	405	1,605	1,114
Income before income taxes, equity in net income of unconsolidated entities, and cumulative effect of accounting change	18,131	13,549	38,262	21,136
Income tax expense	7,624	4,600	15,222	8,660
Equity in net income of unconsolidated entities	658	549	1,305	1,029
Income before cumulative effect of accounting change	11,165	9,498	24,345	13,505
Cumulative effect of accounting change, net of income tax expense of \$171			259	
Net income	\$ 11,165	\$ 9,498	\$ 24,604	\$ 13,505
Basic income per share				
Income before cumulative effect of accounting change	\$ 0.27	\$ 0.24	\$ 0.60	\$ 0.35
Cumulative effect of accounting change			0.01	
Net income	\$ 0.27	\$ 0.24	\$ 0.61	\$ 0.35
Diluted income per share				

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Income before cumulative effect of accounting change	\$	0.24	\$	0.22	\$	0.52	\$	0.31
Cumulative effect of accounting change						0.01		
Net income	\$	0.24	\$	0.22	\$	0.53	\$	0.31

Weighted average shares outstanding:

Basic		40,925		39,064		40,641		38,758
Diluted		46,684		43,742		46,535		42,994

	Three Months Ended June 30		Six Months Ended June 30					
	2006	2005	2006	2005				
(1) Includes stock-based compensation expense of:								
Cost of goods sold	\$	285	\$	264	\$	557	\$	928
Development		131		105		245		380
Sales and marketing		137		128		263		453
General and administrative		1,526		1,441		2,948		5,064
Total stock-based compensation expense	\$	2,079	\$	1,938	\$	4,013	\$	6,825

See notes to unaudited condensed consolidated financial statements.

## Morningstar, Inc. and Subsidiaries

## Unaudited Condensed Consolidated Balance Sheets

(in thousands except share amounts)	June 30 2006	December 31 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 83,259	\$ 92,367
Investments	38,182	60,823
Accounts receivable, less allowance of \$850 and \$418, respectively	56,924	47,530
Income tax receivable, net	4,555	
Other	6,911	5,495
Total current assets	189,831	206,215
Property, equipment, and capitalized software, net of accumulated depreciation of \$44,296 and \$40,687, respectively	17,040	17,355
Investments in unconsolidated entities	17,238	16,355
Goodwill	64,582	17,500
Intangible assets, net	60,474	7,251
Deferred tax asset, net	8,283	29,729
Other assets	2,330	1,906
Total assets	\$ 359,778	\$ 296,311
<b>Liabilities and shareholders equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 17,417	\$ 13,664
Accrued compensation	22,021	26,463
Income tax payable		1,259
Deferred revenue	90,733	71,155
Deferred tax liability, net	711	833
Other	2,487	2,467
Total current liabilities	133,369	115,841
Accrued compensation	3,201	4,458
Other long-term liabilities	3,484	2,298
Total liabilities	140,054	122,597
Shareholders equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 41,277,019 and 40,284,513 shares were outstanding as of June 30, 2006 and December 31, 2005, respectively	4	4
Treasury stock at cost, 233,334 shares as of June 30, 2006 and December 31, 2005	(3,280)	(3,280)
Additional paid-in capital	247,535	226,593
Accumulated deficit	(26,004)	(50,608)
Accumulated other comprehensive income:		
Currency translation adjustment	1,596	1,130
Unrealized losses on available for sale securities	(127)	(125)
Total accumulated other comprehensive income	1,469	1,005
Total shareholders equity	219,724	173,714
Total liabilities and shareholders equity	\$ 359,778	\$ 296,311

See notes to unaudited condensed consolidated financial statements.



## Morningstar, Inc. and Subsidiaries

## Unaudited Condensed Consolidated Statement of Shareholders' Equity and Comprehensive Income

For the Six Months Ended June 30, 2006

(in thousands, except share amounts)	Common Stock Shares Outstanding	Par Value	Treasury Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Shareholders Equity
<b>Balance, December 31, 2005</b>	40,284,513	\$ 4	\$ (3,280)	\$ 226,593	\$ (50,608)	\$ 1,005	\$ 173,714
Comprehensive income:							
Net income					24,604		24,604
Unrealized loss on investments, net of income tax benefit						(2)	(2)
Foreign currency translation adjustment						466	466
Total comprehensive income					24,604	464	25,068
Issuance of common stock related to stock option exercises, net	992,506			10,851			10,851
Stock-based compensation				4,013			4,013
Cumulative effect of accounting change				(430)			(430)
Tax benefit derived from stock option exercises				6,508			6,508
<b>Balance, June 30, 2006</b>	41,277,019	\$ 4	\$ (3,280)	\$ 247,535	\$ (26,004)	\$ 1,469	\$ 219,724

See notes to unaudited condensed consolidated financial statements.

## Morningstar, Inc. and Subsidiaries

## Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)	Six Months Ended June 30	
	2006	2005
<b>Operating activities</b>		
Net income	\$ 24,604	\$ 13,505
Adjustments to reconcile net income to net cash flows from operating activities:		
Cumulative effect of accounting change, net of tax	(259)	
Depreciation and amortization	6,173	4,248
Deferred income tax benefit	(717)	(1,277)
Stock-based compensation expense	4,013	6,825
Provision for bad debt	328	114
Equity in net income of unconsolidated entities	(1,305)	(1,029)
Foreign exchange loss	452	60
Excess tax benefits from stock option exercises	(6,508)	
Other, net	36	(48)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(2,758)	(6,477)
Other assets	455	401
Accounts payable and accrued liabilities	(245)	106
Accrued compensation	(7,174)	(6,683)
Income taxes payable	13,467	(1,069)
Deferred revenue	8,425	4,067
Other liabilities	442	(1,094)
Cash provided by operating activities	39,429	11,649
<b>Investing activities</b>		
Purchases of investments	(37,783)	(29,941)
Proceeds from sale of investments	60,454	40,410
Capital expenditures	(2,023)	(2,327)
Acquisitions, net of cash acquired	(86,363)	(8,157)
Other, net	(294)	18
Cash (used for) provided by investing activities	(66,009)	3
<b>Financing activities</b>		
Payments of long-term debt and capital lease obligations		(18)
Proceeds from initial public offering		18,108
Proceeds from stock options exercises	10,851	1,392
Excess tax benefits from stock option exercises	6,508	
Other	(4)	