

Morningstar, Inc.
Form 10-Q
October 29, 2015

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 September 30, 2015

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 October 23, 2015, there were 44,216,841 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 Income for the three and nine months ended September 30, 2015 and 2014 | <u>4</u> |
| | Unaudited Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014 | <u>5</u> |
| | Unaudited Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014 | <u>6</u> |
| | Unaudited Condensed Consolidated Statement of Equity for the nine months ended September 30, 2015 | <u>7</u> |
| | Unaudited Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014 | <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>19</u> |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | <u>32</u> |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | <u>33</u> |
| <u>PART 2</u> | <u>OTHER INFORMATION</u> | <u>34</u> |
| <u>Item 1.</u> | <u>Legal Proceedings</u> | <u>34</u> |
| <u>Item 1A.</u> | <u>Risk Factors</u> | <u>34</u> |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>35</u> |
| <u>Item 6.</u> | <u>Exhibits</u> | <u>35</u> |
| | <u>SIGNATURE</u> | <u>36</u> |
| | <u>EXHIBIT INDEX</u> | <u>37</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 Income

| (in millions except per share amounts) | Three months ended September | | Nine months ended September | |
|---|------------------------------|---------|-----------------------------|---------|
| | 30 2015 | 2014 | 30 2015 | 2014 |
| Revenue | \$195.3 | \$193.1 | \$587.2 | \$563.7 |
| Operating expense: | | | | |
| Cost of revenue | 83.4 | 80.0 | 245.2 | 237.4 |
| Sales and marketing | 23.3 | 26.8 | 73.8 | 83.1 |
| General and administrative | 26.0 | 26.4 | 79.9 | 82.9 |
| Depreciation and amortization | 16.4 | 14.6 | 47.8 | 40.3 |
| Litigation settlement | — | — | — | 61.0 |
| Total operating expense | 149.1 | 147.8 | 446.7 | 504.7 |
| Operating income | 46.2 | 45.3 | 140.5 | 59.0 |
| Non-operating income (expense): | | | | |
| Interest income, net | 0.2 | 0.5 | 0.5 | 1.7 |
| Gain on sale of investments, reclassified from other comprehensive income | — | 0.2 | 0.4 | 0.5 |
| Holding gain upon acquisition of additional ownership of equity and cost method investments | — | — | — | 5.2 |
| Other income (expense), net | 1.2 | (1.0) | 0.8 | (0.9) |
| Non-operating income (expense), net | 1.4 | (0.3) | 1.7 | 6.5 |
| Income before income taxes and equity in net income of unconsolidated entities | 47.6 | 45.0 | 142.2 | 65.5 |
| Equity in net income of unconsolidated entities | 0.5 | 0.3 | 1.5 | 1.4 |
| Income tax expense | 14.6 | 15.1 | 48.2 | 20.2 |
| Consolidated net income | 33.5 | 30.2 | 95.5 | 46.7 |
| Net (income) loss attributable to the noncontrolling interest | — | — | (0.2) | 0.1 |
| Net income attributable to Morningstar, Inc. | \$33.5 | \$30.2 | \$95.3 | \$46.8 |
| Net income per share attributable to Morningstar, Inc.: | | | | |
| Basic | \$0.76 | \$0.67 | \$2.15 | \$1.04 |
| Diluted | \$0.76 | \$0.67 | \$2.15 | \$1.04 |
| Dividends per common share: | | | | |
| Dividends declared per common share | \$0.19 | \$0.17 | \$0.57 | \$0.51 |

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

| | | | | |
|--------------------------------------|--------|--------|--------|--------|
| Dividends paid per common share | \$0.19 | \$0.17 | \$0.57 | \$0.51 |
| Weighted average shares outstanding: | | | | |
| Basic | 44.2 | 44.7 | 44.3 | 44.8 |
| Diluted | 44.3 | 44.9 | 44.4 | 45.0 |

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Comprehensive Income

| (in millions) | Three months ended September | | Nine months ended September | |
|---|------------------------------|---------|-----------------------------|---------|
| | 30 2015 | 2014 | 30 2015 | 2014 |
| Consolidated net income | \$33.5 | \$30.2 | \$95.5 | \$46.7 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustment | (12.8 |) (18.8 |) (23.8 |) (13.5 |
| Unrealized gains (losses) on securities, net of tax: | | | | |
| Unrealized holding gains (losses) arising during period | (0.8 |) (0.3 |) (1.3 |) 0.2 |
| Reclassification gains included in net income | (0.5 |) (0.1 |) (0.2 |) (0.3 |
| Other comprehensive loss | (14.1 |) (19.2 |) (25.3 |) (13.6 |
| Comprehensive income | 19.4 | 11.0 | 70.2 | 33.1 |
| Comprehensive (income) loss attributable to noncontrolling interest | (0.2 |) 0.1 | (0.4 |) 0.1 |
| Comprehensive income attributable to Morningstar, Inc. | \$19.2 | \$11.1 | \$69.8 | \$33.2 |

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

| | As of September 30 2015 | As of December 31 2014 |
|--|-------------------------------|---------------------------|
| (in millions except share amounts) | | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$223.7 | \$ 185.2 |
| Investments | 39.3 | 39.4 |
| Accounts receivable, less allowance of \$2.1 and \$1.5, respectively | 124.1 | 136.7 |
| Deferred tax asset, net | 10.5 | 9.0 |
| Income tax receivable | — | 6.9 |
| Other current assets | 22.5 | 22.6 |
| Total current assets | 420.1 | 399.8 |
| Property, equipment, and capitalized software, less accumulated depreciation and amortization of \$160.1 and \$132.9, respectively | 124.3 | 117.6 |
| Investments in unconsolidated entities | 35.4 | 28.8 |
| Goodwill | 359.9 | 370.1 |
| Intangible assets, net | 77.1 | 95.9 |
| Other assets | 6.8 | 7.1 |
| Total assets | \$1,023.6 | \$ 1,019.3 |
| Liabilities and equity | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$34.4 | \$ 34.3 |
| Accrued compensation | 68.0 | 80.5 |
| Income tax payable | 12.0 | — |
| Deferred revenue | 155.1 | 146.0 |
| Short-term debt | — | 30.0 |
| Other current liabilities | 3.5 | 3.0 |
| Total current liabilities | 273.0 | 293.8 |
| Accrued compensation | 8.5 | 7.9 |
| Deferred tax liability, net | 24.8 | 26.0 |
| Deferred rent | 26.2 | 26.4 |
| Other long-term liabilities | 11.0 | 10.8 |
| Total liabilities | 343.5 | 364.9 |
| Equity: | | |
| Morningstar, Inc. shareholders' equity: | | |
| Common stock, no par value, 200,000,000 shares authorized, of which 44,225,177 and 44,345,763 shares were outstanding as of September 30, 2015 and December 31, 2014, respectively | — | — |
| Treasury stock at cost, 8,635,779 and 8,257,214 shares as of September 30, 2015 and December 31, 2014, respectively | (553.0) | (524.3) |
| Additional paid-in capital | 571.7 | 561.1 |
| Retained earnings | 711.4 | 641.5 |
| Accumulated other comprehensive loss: | | |
| Currency translation adjustment | (49.1) | (25.1) |

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

| | | | |
|---|-----------|-----------|---|
| Unrealized gain on available-for-sale investments | (1.2 |) 0.3 | |
| Total accumulated other comprehensive loss | (50.3 |) (24.8 |) |
| Total Morningstar, Inc. shareholders' equity | 679.8 | 653.5 | |
| Noncontrolling interests | 0.3 | 0.9 | |
| Total equity | 680.1 | 654.4 | |
| Total liabilities and equity | \$1,023.6 | \$1,019.3 | |

See notes to unaudited condensed consolidated financial statements.

6

Table of Contents

Morningstar, Inc. and Subsidiaries
 Unaudited Condensed Consolidated Statement of Equity
 For the nine months ended September 30, 2015

| (in millions, except share amounts) | Morningstar, Inc. Shareholders' Equity | | | | | | | |
|--|--|--------------|-------------------|----------------------------------|----------------------|---|----------------------------------|-----------------|
| | Common Stock Shares Outstanding | Par Value | Treasury Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Non- Controlling Interests | Total Equity |
| Balance as of December 31, 2014 | 44,345,763 | \$— | \$(524.3) | \$561.1 | \$641.5 | \$ (24.8) | \$0.9 | \$654.4 |
| Net income | | — | — | — | 95.3 | — | 0.2 | 95.5 |
| Other comprehensive loss: | | | | | | | | |
| Unrealized gain on available-for-sale investments, net of income tax of \$0.5 | | — | — | — | — | (1.3) | — | (1.3) |
| Reclassification of adjustments for gains included in net income, net of income tax of \$0.1 | | — | — | — | — | (0.2) | — | (0.2) |
| Foreign currency translation adjustment, net | | — | — | — | — | (24.0) | 0.2 | (23.8) |
| Other comprehensive loss, net | | — | — | — | — | (25.5) | 0.2 | (25.3) |
| Issuance of common stock related to stock-option exercises and vesting of restricted stock units, net | 275,845 | — | 1.4 | (2.6) | — | — | — | (1.2) |
| Stock-based compensation | | — | — | 13.5 | — | — | — | 13.5 |
| Excess tax benefit derived from stock-option exercises and vesting of restricted stock units | | — | — | 2.1 | — | — | — | 2.1 |
| Common shares repurchased | (396,431) | — | (30.1) | — | — | — | — | (30.1) |
| Dividends declared — common shares outstanding | | — | — | — | (25.3) | — | — | (25.3) |
| Dividends declared — restricted stock units | | — | — | — | (0.1) | — | — | (0.1) |
| Purchase of remaining interest in majority-owned investment | | — | — | (2.4) | — | — | (1.0) | (3.4) |
| Balance as of September 30, 2015 | 44,225,177 | \$— | \$(553.0) | \$571.7 | \$711.4 | \$ (50.3) | \$0.3 | \$680.1 |

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

| (in millions) | Nine months ended September | |
|---|-----------------------------|--------|
| | 2015 | 2014 |
| Operating activities | | |
| Consolidated net income | \$95.5 | \$46.7 |
| Adjustments to reconcile consolidated net income to net cash flows from operating activities: | | |
| Depreciation and amortization | 47.8 | 40.3 |
| Deferred income taxes | (2.7) | (5.4) |
| Stock-based compensation expense | 13.5 | 13.3 |
| Provision for bad debts | 0.6 | 0.3 |
| Equity in net income of unconsolidated entities | (1.5) | (1.4) |
| Excess tax benefits from stock-option exercises and vesting of restricted stock units | (2.1) | (2.9) |
| Holding gain upon acquisition of additional ownership of equity and cost method investments | — | (5.2) |
| Other, net | (0.5) | 0.2 |
| Changes in operating assets and liabilities, net of effects of acquisitions: | | |
| Accounts receivable | 9.0 | (12.6) |
| Other assets | (1.1) | (3.3) |
| Accounts payable and accrued liabilities | 1.3 | (1.2) |
| Accrued compensation | (7.3) | 3.4 |
| Income taxes—current | 20.5 | 3.5 |
| Deferred revenue | 13.1 | 0.5 |
| Other liabilities | 0.4 | (0.9) |
| Cash provided by operating activities | 186.5 | 75.3 |
| Investing activities | | |
| Purchases of investments | (28.3) | (10.6) |
| Proceeds from maturities and sales of investments | 24.8 | 103.1 |
| Capital expenditures | (39.9) | (42.8) |
| Acquisitions, net of cash acquired | (3.4) | (64.4) |
| Other, net | (6.5) | 0.2 |
| Cash used for investing activities | (53.3) | (14.5) |
| Financing activities | | |
| Common shares repurchased | (30.1) | (42.1) |
| Dividends paid | (25.3) | (22.9) |
| Proceeds from short-term debt | 15.0 | 30.0 |
| Repayment of short-term debt | (45.0) | — |
| Proceeds from stock-option exercises | 3.7 | 3.8 |
| Employee taxes withheld for restricted stock units | (4.9) | (5.1) |
| Excess tax benefits from stock-option exercises and vesting of restricted stock units | 2.1 | 2.9 |
| Other, net | 0.1 | — |
| Cash used for financing activities | (84.4) | (33.4) |

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

| | | | |
|--|---------|----------|---|
| Effect of exchange rate changes on cash and cash equivalents | (10.3 |) (6.3 |) |
| Net increase in cash and cash equivalents | 38.5 | 21.1 | |
| Cash and cash equivalents—beginning of period | 185.2 | 168.2 | |
| Cash and cash equivalents—end of period | \$223.7 | \$189.3 | |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for income taxes | \$27.3 | \$22.0 | |
| Supplemental information of non-cash investing and financing activities: | | | |
| Unrealized gain (loss) on available-for-sale investments | \$(2.2 |) \$(0.3 |) |
| Equipment obtained under long-term financing arrangement | \$1.3 | \$— | |

See notes to unaudited condensed consolidated financial statements.

8

Table of Contents

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 (U.S. GAAP) 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, 2014, filed with the SEC on February 27, 2015.

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. Summary of Significant Accounting Policies

We discuss our significant accounting policies in Note 3 of our Audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC on February 27, 2015.

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, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU No. 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.

3. Credit Arrangements

In July 2015, we renewed our \$75.0 million, single-bank revolving credit facility. On July 20, 2015, we repaid the outstanding principal balance of \$35.0 million, leaving full availability of the facility as of September 30, 2015.

4. Goodwill and Other Intangible Assets

Goodwill

The following table shows the changes in our goodwill balances from December 31, 2014 to September 30, 2015:

(in millions)

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

| | | |
|----------------------------------|---------|---|
| Balance as of December 31, 2014 | \$370.1 | |
| Foreign currency translation | (10.2 |) |
| Balance as of September 30, 2015 | \$359.9 | |

We did not record any impairment losses in the first nine months of 2015 or 2014. We perform our annual impairment reviews in the fourth quarter.

9

Table of Contents

Intangible Assets

The following table summarizes our intangible assets:

| (in millions) | As of September 30, 2015 | | | Weighted Average Useful Life (years) | As of December 31, 2014 | | | Weighted Average Useful Life (years) |
|---------------------------|--------------------------|-----------------------------|--------|--|-------------------------|-----------------------------|--------|--|
| | Gross | Accumulated Amortization | Net | | Gross | Accumulated Amortization | Net | |
| Intellectual property | \$28.1 | \$ (26.0) | \$2.1 | 9 | \$29.0 | \$ (25.0) | \$4.0 | 9 |
| Customer-related assets | 137.7 | (90.0) | 47.7 | 12 | 141.5 | (83.6) | 57.9 | 12 |
| Supplier relationships | 0.2 | (0.1) | 0.1 | 20 | 0.2 | (0.1) | 0.1 | 20 |
| Technology-based assets | 87.6 | (62.4) | 25.2 | 8 | 88.8 | (57.4) | 31.4 | 8 |
| Non-competition agreement | 4.2 | (2.2) | 2.0 | 5 | 4.4 | (1.9) | 2.5 | 5 |
| Total intangible assets | \$257.8 | \$ (180.7) | \$77.1 | 10 | \$263.9 | \$ (168.0) | \$95.9 | 10 |

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

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | |
|----------------------|---------------------------------|-------|--------------------------------|--------|
| | 2015 | 2014 | 2015 | 2014 |
| Amortization expense | \$5.5 | \$6.0 | \$16.4 | \$16.6 |

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

We expect intangible amortization expense for the remainder of 2015 and subsequent years as follows:

| | (in millions) |
|--|---------------|
| Remainder of 2015 (from October 1 through December 31) | \$5.4 |
| 2016 | 17.3 |
| 2017 | 12.3 |
| 2018 | 10.2 |
| 2019 | 7.8 |
| Thereafter | 24.1 |

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

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 net income per share:

| (in millions, except per share amounts) | Three months ended September | | Nine months ended September | |
|--|------------------------------|--------|-----------------------------|--------|
| | 30 2015 | 2014 | 30 2015 | 2014 |
| Basic net income per share attributable to Morningstar, Inc.: | | | | |
| Net income attributable to Morningstar, Inc.: | \$33.5 | \$30.2 | \$95.3 | \$46.8 |
| Less: Distributed earnings available to participating securities | — | — | — | — |
| Less: Undistributed earnings available to participating securities | — | — | — | — |
| Numerator for basic net income per share — undistributed and distributed earnings available to common shareholders | \$33.5 | \$30.2 | \$95.3 | \$46.8 |
| Weighted average common shares outstanding | 44.2 | 44.7 | 44.3 | 44.8 |
| Basic net income per share attributable to Morningstar, Inc. | \$0.76 | \$0.67 | \$2.15 | \$1.04 |
| Diluted net income per share attributable to Morningstar, Inc.: | | | | |
| Numerator for basic net income per share — undistributed and distributed earnings available to common shareholders | \$33.5 | \$30.2 | \$95.3 | \$46.8 |
| Add: Undistributed earnings allocated to participating securities | — | — | — | — |
| Less: Undistributed earnings reallocated to participating securities | — | — | — | — |
| Numerator for diluted net income per share — undistributed and distributed earnings available to common shareholders | \$33.5 | \$30.2 | \$95.3 | \$46.8 |
| Weighted average common shares outstanding | 44.2 | 44.7 | 44.3 | 44.8 |
| Net effect of dilutive stock options, restricted stock units, and performance share awards | 0.1 | 0.2 | 0.1 | 0.2 |
| Weighted average common shares outstanding for computing diluted income per share | 44.3 | 44.9 | 44.4 | 45.0 |
| Diluted net income per share attributable to Morningstar, Inc. | \$0.76 | \$0.67 | \$2.15 | \$1.04 |

Table of Contents

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

| (in thousands) | Three months ended September 30 | | Nine months ended September 30 | |
|---|---------------------------------|------|--------------------------------|------|
| | 2015 | 2014 | 2015 | 2014 |
| Weighted average restricted stock units | 45 | 83 | 41 | 34 |
| Weighted average performance share awards | 5 | 9 | 7 | 7 |
| Total | 50 | 92 | 48 | 41 |

Stock options and restricted stock could be included in the calculation in the future.

6. Segment and Geographical Area Information

Segment Information

We 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 3. Summary of Significant Accounting Policies” included in our Annual Report on Form 10-K for the year ended December 31, 2014. We evaluate the performance of our reporting segment based on revenue and operating income.

Geographical Area Information

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

External revenue by geographical area

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | |
|----------------------|---------------------------------|---------|--------------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| United States | \$145.2 | \$141.3 | \$437.3 | \$407.7 |
| United Kingdom | 15.6 | 15.1 | 46.4 | 46.1 |
| Continental Europe | 14.7 | 15.6 | 43.4 | 47.1 |
| Australia | 7.5 | 8.9 | 23.2 | 26.3 |
| Canada | 6.6 | 7.4 | 20.6 | 22.6 |
| Asia | 4.6 | 3.9 | 13.4 | 11.5 |
| Other | 1.1 | 0.9 | 2.9 | 2.4 |
| Total International | 50.1 | 51.8 | 149.9 | 156.0 |
| Consolidated revenue | \$195.3 | \$193.1 | \$587.2 | \$563.7 |

Table of Contents

Long-lived assets by geographical area

| | As of September 30 2015 | As of December 31 2014 |
|---|-------------------------------|---------------------------|
| (in millions) | | |
| United States | \$106.5 | \$98.1 |
| United Kingdom | 8.6 | 8.1 |
| Continental Europe | 2.1 | 2.1 |
| Australia | 0.9 | 0.8 |
| Canada | 0.7 | 0.9 |
| Asia | 5.4 | 7.5 |
| Other | 0.1 | 0.1 |
| Total International | 17.8 | 19.5 |
| Consolidated property, equipment, and capitalized software, net | \$124.3 | \$117.6 |

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 into three categories: available-for-sale, held-to-maturity, and trading securities. Our investment portfolio consists of stocks, bonds, options, mutual funds, money market funds, or exchange-traded products that replicate the model portfolios and strategies created by Morningstar. These investment accounts may also include exchange-traded products where Morningstar is an index provider. We classify our investment portfolio as shown below:

| | As of September 30 2015 | As of December 31 2014 |
|--------------------|----------------------------|---------------------------|
| (in millions) | | |
| Available-for-sale | \$16.8 | \$13.2 |
| Held-to-maturity | 13.9 | 17.9 |
| Trading securities | 8.6 | 8.3 |
| Total | \$39.3 | \$39.4 |

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

| (in millions) | As of September 30, 2015 | | | | As of December 31, 2014 | | | |
|--|--------------------------|--------------------|--------------------|---------------|-------------------------|--------------------|--------------------|---------------|
| | Cost | Unrealized Gain | Unrealized Loss | Fair Value | Cost | Unrealized Gain | Unrealized Loss | Fair Value |
| Available-for-sale: | | | | | | | | |
| Equity securities and exchange-traded funds | \$17.2 | \$0.1 | \$(1.7) |) \$15.6 | \$11.4 | \$0.8 | \$(0.3) |) \$11.9 |
| Mutual funds | 1.2 | 0.1 | (0.1) |) 1.2 | 1.2 | 0.2 | (0.1) |) 1.3 |
| Total | \$18.4 | \$0.2 | \$(1.8) |) \$16.8 | \$12.6 | \$1.0 | \$(0.4) |) \$13.2 |
| Held-to-maturity: | | | | | | | | |
| | \$13.9 | \$— | \$— | \$13.9 | \$17.9 | \$— | \$— | \$17.9 |

Certificates of
deposit

13

Table of Contents

As of September 30, 2015 and December 31, 2014, 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.

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 September 30, 2015 and December 31, 2014. 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.

| (in millions) | As of September 30, 2015 | | As of December 31, 2014 | |
|--|--------------------------|------------|-------------------------|------------|
| | Cost | Fair Value | Cost | Fair Value |
| Available-for-sale: | | | | |
| Equity securities, exchange-traded funds, and mutual funds | \$18.4 | \$16.8 | \$12.6 | \$13.2 |
| Total | \$18.4 | \$16.8 | \$12.6 | \$13.2 |
| Held-to-maturity: | | | | |
| Due in one year or less | \$13.9 | \$13.9 | \$17.9 | \$17.9 |
| Total | \$13.9 | \$13.9 | \$17.9 | \$17.9 |

As of September 30, 2015 and December 31, 2014, held-to-maturity investments included a \$1.5 million 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 Operations:

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | |
|---------------------|---------------------------------|-------|--------------------------------|--------|
| | 2015 | 2014 | 2015 | 2014 |
| Realized gains | \$0.1 | \$0.2 | \$1.0 | \$0.7 |
| Realized losses | (0.1 |) — | (0.6 |) (0.2 |
| Realized gains, net | \$— | \$0.2 | \$0.4 | \$0.5 |

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

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

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | |
|------------------------|---------------------------------|----------|--------------------------------|----------|
| | 2015 | 2014 | 2015 | 2014 |
| Unrealized losses, net | \$(0.7 |) \$(0.3 |) \$(1.0 |) \$(0.1 |

Table of Contents

The table below shows the fair value of our assets subject to fair value measurements 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:

| (in millions) | Fair Value as of September 30, 2015 | Fair Value Measurements as of September 30, 2015 Using Fair Value Hierarchy | | |
|--|---|--|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Available-for-sale investments: | | | | |
| Equity securities and exchange-traded funds | \$15.6 | \$15.6 | \$— | \$— |
| Mutual funds | 1.2 | 1.2 | — | — |
| Trading securities | 8.6 | 8.6 | — | — |
| Cash equivalents | 0.4 | 0.4 | — | — |
| Total | \$25.8 | \$25.8 | \$— | \$— |

| (in millions) | Fair Value as of December 31, 2014 | Fair Value Measurements as of December 31, 2014 Using Fair Value Hierarchy | | |
|--|---|---|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Available-for-sale investments: | | | | |
| Equity securities and exchange-traded funds | \$11.9 | \$11.9 | \$— | \$— |
| Mutual funds | 1.3 | 1.3 | — | — |
| Trading securities | 8.3 | 8.3 | — | — |
| Cash equivalents | 0.5 | 0.5 | — | — |
| Total | \$22.0 | \$22.0 | \$— | \$— |

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. We did not hold any securities categorized as Level 2 or Level 3 as of September 30, 2015 and December 31, 2014.

8. 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.

Accounting for Stock-Based Compensation Awards

The following table summarizes the stock-based compensation expense included in each of our operating expense categories:

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | |
|--|---------------------------------|-------|--------------------------------|--------|
| | 2015 | 2014 | 2015 | 2014 |
| Cost of revenue | \$2.1 | \$2.2 | \$6.2 | \$5.9 |
| Sales and marketing | 0.6 | 0.6 | 1.7 | 1.6 |
| General and administrative | 1.9 | 2.2 | 5.6 | 5.8 |
| Total stock-based compensation expense | \$4.6 | \$5.0 | \$13.5 | \$13.3 |

The following table summarizes the amount of unrecognized stock-based compensation expense as of September 30, 2015 and the expected number of months over which the expense will be recognized:

| | Unrecognized stock-based compensation expense (in millions) | Expected amortization period (months) |
|---|---|---------------------------------------|
| Restricted stock units | \$33.8 | 32 |
| Performance share awards | 3.2 | 26 |
| Total unrecognized stock-based compensation expense | \$37.0 | 32 |

9. Income Taxes

Effective Tax Rate

The following table shows our effective tax rate for the three and nine months ended September 30, 2015 and September 30, 2014:

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | | |
|--|---------------------------------|--------|--------------------------------|--------|---|
| | 2015 | 2014 | 2015 | 2014 | |
| Income before income taxes and equity in net income of unconsolidated entities | \$47.6 | \$45.0 | \$142.2 | \$65.5 | |
| Equity in net income of unconsolidated entities | 0.5 | 0.3 | 1.5 | 1.4 | |
| Net (income) loss attributable to the noncontrolling interest | — | — | (0.2) | 0.1 | |
| Total | \$48.1 | \$45.3 | \$143.5 | \$67.0 | |
| Income tax expense | \$14.6 | \$15.1 | \$48.2 | \$20.2 | |
| Effective tax rate | 30.4 | % 33.4 | % 33.6 | % 30.1 | % |

Our effective tax rate in the third quarter of 2015 was 30.4%, a decrease of 3.0 percentage points compared with 33.4% in the prior-year period. During the third quarter of 2015, we recognized additional tax benefits for credits and incentives. We also recognized a deferred tax asset for net operating losses for certain of our foreign operations that we expect will be utilized over time based upon recent financial performance and forecasted taxable income. Both of these items reduced our effective tax rate in the third quarter of 2015.

Table of Contents

Our effective tax rate for the first nine months of 2015 was 33.6%, which was higher than the 30.1% rate for the comparable period a year ago 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 September 30, 2015 and December 31, 2014, as well as the effect these gross unrecognized tax benefits would have on our income tax expense, if they were recognized.

| (in millions) | As of September 30 2015 | As of December 31 2014 |
|--|----------------------------|---------------------------|
| Gross unrecognized tax benefits | \$ 14.2 | \$ 11.9 |
| Gross unrecognized tax benefits that would affect income tax expense | \$ 12.1 | \$ 11.9 |
| Decrease in income tax expense upon recognition of gross unrecognized tax benefits | \$ 10.9 | \$ 10.6 |

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

| Liabilities for Unrecognized Tax Benefits (in millions) | As of September 30 2015 | As of December 31 2014 |
|---|----------------------------|---------------------------|
| Current liability | \$ 5.8 | \$ 5.1 |
| Non-current liability | 6.1 | 6.6 |
| Total liability for unrecognized tax benefits | \$ 11.9 | \$ 11.7 |

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, 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 2015. It is not possible to estimate the effect of current audits on previously recorded unrecognized tax benefits.

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 65% of our cash, cash equivalents, and investments balance as of September 30, 2015 was held by our operations outside of the United States. 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 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.

Table of Contents

10. Contingencies

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 the result of any of these matters will have a material adverse effect on our business, operating results, or financial position.

11. 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 \$700.0 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 September 30, 2015, we had repurchased a total of 8,538,441 shares for \$556.6 million under this authorization, leaving approximately \$143.4 million available for future repurchases.

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 maintain and protect our brand, independence, and reputation;
- 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;
- liability related to our storage of personal information related to individuals as well as portfolio and account-level information;
- compliance failures, regulatory action, or changes in laws applicable to our investment advisory or credit rating operations;
- downturns in the financial sector, global financial markets, and global economy;
- the effect of market volatility on revenue from asset-based fees;
- a prolonged outage of our database, technology-based products and services, or network facilities;
- challenges faced by our operations outside the United States, including the concentration of data and development work at our offshore facilities in China and India; and
- trends in the mutual fund industry, including the increasing popularity of passively managed investment vehicles.

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, 2014. 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.

Industry Overview

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

Concerns about economic woes in China, potential changes in the Federal Reserve's policy, and lower commodity prices dragged down equity market returns in the third quarter of 2015. The Morningstar U.S. Market Index, a broad market benchmark, was down 7.0% for the quarter, while the Global Ex-U.S. Index finished the quarter down 9.3%.

Table of Contents

U.S. mutual fund assets stood at \$15.6 trillion as of August 31, 2015, based on data from the Investment Company Institute (ICI), compared with \$15.9 trillion as of August 31, 2014. Based on Morningstar's estimated asset flow data, net flows to long-term open-end funds were negative for the three months ended September 30, 2015, with investors pulling about \$23.0 billion in aggregate from all long-term fund categories. Net inflows to all long-term fund categories were positive for the first nine months of the year, but U.S. equity funds had net outflows totaling about \$76.0 billion.

Assets in exchange-traded funds (ETFs) rose to \$2.0 trillion as of August 31, 2015, compared with \$1.9 trillion as of August 31, 2014, based on data from the ICI.

We believe the business environment for the financial services industry remains mixed. While longer-term equity market returns have generally been positive, asset management firms have been facing increasing regulatory burdens and have been under pressure to reduce fees.

Table of Contents

Supplemental Operating Metrics

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

| | As of September 30 | | Change | | | | | |
|--|---------------------------------|-----------|--------|--------------------------------|---------|---------|------|-------|
| | 2015 | 2014 | | | | | | |
| Our business | | | | | | | | |
| Morningstar.com Premium Membership subscriptions (U.S.) | 121,802 | 122,275 | (0.4 |)% | | | | |
| Morningstar.com registered users (U.S.) | 8,452,445 | 8,097,864 | 4.4 | % | | | | |
| Advisor Workstation clients (U.S.) | 186 | 171 | 8.8 | % | | | | |
| Morningstar Office licenses (U.S.) | 4,256 | 4,188 | 1.6 | % | | | | |
| Morningstar Direct licenses | 11,111 | 9,648 | 15.2 | % | | | | |
| Assets under advisement and management (approximate) (\$bil) | | | | | | | | |
| Investment Advisory services (1) Retirement Solutions | \$76.0 | \$81.0 | (3) | (6.2) % | | | | |
| Managed Accounts (2) | \$39.4 | \$36.5 | 7.9 | % | | | | |
| Plan Sponsor Advice | 28.6 | 27.3 | 4.8 | % | | | | |
| Custom Models | 17.7 | 12.9 | 37.2 | % | | | | |
| Retirement Solutions (total) | \$85.7 | \$76.7 | 11.7 | % | | | | |
| Morningstar Managed Portfolios | \$12.2 | \$12.0 | (3) | 1.7 % | | | | |
| Our employees (approximate) | | | | | | | | |
| Worldwide headcount | 3,830 | 3,800 | 0.8 | % | | | | |
| Number of equity and credit analysts | 190 | 170 | 11.8 | % | | | | |
| Number of manager research analysts | 110 | 120 | (4) | (8.3) % | | | | |
| | | | | | | | | |
| | Three months ended September 30 | | | Nine months ended September 30 | | | | |
| (in millions) | 2015 | 2014 | Change | 2015 | 2014 | Change | | |
| Key product revenue (5) | | | | | | | | |
| Morningstar Data | \$35.6 | \$34.4 | (6) | 3.5 % | \$106.0 | \$104.3 | (6) | 1.6 % |
| Morningstar Advisor Workstation | 26.5 | 25.5 | 3.9 | % | 78.9 | 74.9 | 5.3 | % |
| Morningstar Direct | 25.4 | 23.6 | 7.6 | % | 75.0 | 68.0 | 10.3 | % |
| Retirement Solutions | 16.2 | 14.1 | 14.9 | % | 48.2 | 41.6 | 15.9 | % |
| Morningstar.com | 13.8 | 13.3 | 3.8 | % | 43.1 | 41.9 | 2.9 | % |
| Other Metrics | | | | | | | | |
| Average assets under management and advisement (\$bil) | \$177.0 | \$169.2 | 4.6 | % | \$175.9 | \$167.3 | 5.1 | % |
| Number of commercial mortgage-backed securities (CMBS) new-issue ratings | 17 | 19 | (10.5 |)% | 45 | 34 | 32.4 | % |

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

completed

| | | | | | | | | |
|---|--------|--------|---|---|--------|--------|------|---|
| Asset value of CMBS new-issue ratings (\$bil) | \$13.5 | \$13.5 | — | % | \$38.0 | \$24.0 | 58.3 | % |
|---|--------|--------|---|---|--------|--------|------|---|

(1) 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.

21

Table of Contents

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.

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.

(2) 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.

(3) Revised to include Ibbotson Australia and a minor classification change.

(4) Revised.

(5) Key product revenue includes the effect of foreign currency translations.

(6) Revised to include a minor classification change.

Table of Contents

Three and Nine Months Ended September 30, 2015 vs. Three and Nine Months Ended September 30, 2014

Consolidated Results

| Key Metrics (in millions) | Three months ended September 30 | | | Nine months ended September 30 | | |
|---------------------------------------|---------------------------------|----------|---------|--------------------------------|---------|-------------|
| | 2015 | 2014 | Change | 2015 | 2014 | Change |
| Revenue | \$195.3 | \$193.1 | 1.1 % | \$587.2 | \$563.7 | 4.2 % |
| Operating income | \$46.2 | \$45.3 | 2.2 % | \$140.5 | \$59.0 | (1) 138.2 % |
| Operating margin | 23.7 % | 23.4 % | 0.3 pp | 23.9 % | 10.5 % | 13.4 pp |
| Cash provided by operating activities | \$75.6 | \$8.6 | 779.1 % | \$186.5 | \$75.3 | (1) 147.7 % |
| Capital expenditures | (12.3) | (12.0) | 2.5 % | (39.9) | (42.8) | (6.8)% |
| Free cash flow | \$63.3 | \$(3.4) | NMF | \$146.6 | \$32.5 | (1) 351.1 % |

pp — percentage points

NMF - not meaningful

(1) Operating income and free cash flow for the first nine months of 2014 includes a \$61.0 million litigation settlement expense and corresponding cash outflow.

To supplement our consolidated financial statements presented in accordance with U.S. Generally Accepted Accounting Principles (GAAP), we use the following non-GAAP measures: consolidated revenue excluding acquisitions and the effect of 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 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 GAAP.

Consolidated Revenue

| (in millions) | Three months ended September 30 | | | Nine months ended September 30 | | |
|----------------------|---------------------------------|---------|--------|--------------------------------|---------|--------|
| | 2015 | 2014 | Change | 2015 | 2014 | Change |
| Consolidated revenue | \$195.3 | \$193.1 | 1.1 % | \$587.2 | \$563.7 | 4.2 % |

In the third quarter of 2015, consolidated revenue increased 1.1% to \$195.3 million. Currency movements were a major factor in our third quarter results, as continued strength in the U.S. dollar reduced revenue from our international operations when translated into U.S. dollars. This has been an ongoing trend for several quarters and during the third quarter and first nine months of 2015 reduced revenue by \$7.3 million and \$21.4 million, respectively.

Some of the main contributors to the increase in consolidated revenue were Morningstar Retirement Solutions, Morningstar Direct, Morningstar Data, and Morningstar Advisor Workstation (including Morningstar Office). Positive

results for these products were partially offset by decreases in Morningstar Enterprise Components, Morningstar Credit Ratings (our structured credit and research and ratings business), and Principia.

Morningstar Retirement Solutions' revenue increased \$2.1 million. Assets under management and advisement for Retirement Solutions rose about 11.7% year over year, mainly reflecting growth in custom models. Morningstar Direct revenue rose \$1.8 million, reflecting strong growth in additional licenses for both new and existing clients.

Table of Contents

While new issuance volume remained strong, revenue from Morningstar Credit Ratings decreased \$0.9 million as a result of continued market volatility. Revenue from Morningstar Principia and a few other legacy software products declined \$2.4 million because we've been migrating subscribers to newer workflow solutions.

For the first nine months of 2015, consolidated revenue was up 4.2% to \$587.2 million, compared with \$563.7 million in the same period of 2014. Morningstar Direct, Morningstar Credit Ratings, Morningstar Retirement Solutions, Morningstar Advisor Workstation (including Morningstar Office), and Morningstar Managed Portfolios were the main positive contributors, partially offset by lower revenue for Morningstar Enterprise Components and Principia.

Revenue from asset-based fees made up approximately 15% of consolidated revenue in the third quarter and first nine months of 2015, compared with approximately 13% of consolidated revenue for the same periods in 2014.

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. As mentioned above, foreign currency translations had a \$7.3 million unfavorable effect, and organic revenue rose 4.9% in the third quarter of 2015.

For the first nine months of 2015, we had \$4.0 million of incremental revenue from our acquisitions of ByAllAccounts and HelloWallet. Foreign currency translations had a \$21.4 million unfavorable effect, and organic revenue increased 7.3% for the nine-month period.

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

| (in millions) | Three months ended September 30 | | | Nine months ended September 30 | | | |
|---|---------------------------------|---------|--------|--------------------------------|---------|--------|---|
| | 2015 | 2014 | Change | 2015 | 2014 | Change | |
| Consolidated revenue | \$195.3 | \$193.1 | 1.1 | % \$587.2 | \$563.7 | 4.2 | % |
| Less: acquisitions | — | — | — | (4.0 |) — | NMF | |
| Less: divestitures | — | — | — | — | — | — | |
| Unfavorable effect of foreign currency translations | 7.3 | — | NMF | 21.4 | — | NMF | |
| Organic revenue | \$202.6 | \$193.1 | 4.9 | % \$604.6 | \$563.7 | 7.3 | % |

Revenue by region

| (in millions) | Three months ended September 30 | | | Nine months ended September 30 | | | |
|---------------------|---------------------------------|---------|--------|--------------------------------|---------|--------|----|
| | 2015 | 2014 | Change | 2015 | 2014 | Change | |
| United States | \$145.2 | \$141.3 | 2.8 | % \$437.3 | \$407.7 | 7.3 | % |
| United Kingdom | 15.6 | 15.1 | 3.3 | % 46.4 | 46.1 | 0.7 | % |
| Continental Europe | 14.7 | 15.6 | (5.8) |)% 43.4 | 47.1 | (7.9) |)% |
| Australia | 7.5 | 8.9 | (15.7) |)% 23.2 | 26.3 | (11.8) |)% |
| Canada | 6.6 | 7.4 | (10.8) |)% 20.6 | 22.6 | (8.8) |)% |
| Asia | 4.6 | 3.9 | 17.9 | % 13.4 | 11.5 | 16.5 | % |
| Other | 1.1 | 0.9 | 22.2 | % 2.9 | 2.4 | 20.8 | % |
| Total International | 50.1 | 51.8 | (3.3) |)% 149.9 | 156.0 | (3.9) |)% |

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

| | | | | | | | | |
|----------------------|---------|---------|-----|---|---------|---------|-----|---|
| Consolidated revenue | \$195.3 | \$193.1 | 1.1 | % | \$587.2 | \$563.7 | 4.2 | % |
|----------------------|---------|---------|-----|---|---------|---------|-----|---|

24

Table of Contents

International revenue made up about 26% of our consolidated revenue in the first nine months of 2015, compared with 28% in the first nine months of 2014. About 60% of this amount is from Continental Europe and the United Kingdom, with most of the remainder from Australia, Canada, and Asia.

Revenue from international operations decreased \$1.7 million, or 3.3%, in the third quarter but international organic revenue increased 10.8%. Our operations in the United Kingdom and Continental Europe were the main contributors to the increase, followed by Japan and Australia.

For the first nine months of 2015, revenue from international operations was down \$6.1 million, or 3.9%, but international organic revenue increased 9.8%. Our operations in Continental Europe and the United Kingdom were the main contributors to the increase, followed by Japan 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):

| (in millions) | Three months ended September 30 | | | Nine months ended September 30 | | |
|---|---------------------------------|--------|---------|--------------------------------|---------|---------|
| | 2015 | 2014 | Change | 2015 | 2014 | Change |
| International revenue | \$50.1 | \$51.8 | (3.3)% | \$149.9 | \$156.0 | (3.9)% |
| Less: acquisitions | — | — | — | — | — | — |
| Less: divestitures | — | — | — | — | — | — |
| Unfavorable effect of foreign currency translations | 7.3 | — | NMF | 21.4 | — | NMF |
| International organic revenue | \$57.4 | \$51.8 | 10.8 % | \$171.3 | \$156.0 | 9.8 % |

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

| (in millions) | Three months ended September 30 | | | | Nine months ended September 30 | | | |
|-------------------------------|---------------------------------|--------|---------|------|--------------------------------|---------|---------|------|
| | 2015 | 2014 | Change | | 2015 | 2014 | Change | |
| Cost of revenue | \$83.4 | \$80.0 | 3.8 | % | \$245.2 | \$237.4 | 3.3 | % |
| % of consolidated revenue | 42.7 | % 41.4 | % 1.3 | pp | 41.8 | % 42.1 | % (0.3) |) pp |
| Sales and marketing | 23.3 | 26.8 | (12.8) |)% | 73.8 | 83.1 | (11.2) |)% |
| % of consolidated revenue | 11.9 | % 13.9 | % (2.0) |) pp | 12.6 | % 14.7 | % (2.1) |) pp |
| General and administrative | 26.0 | 26.4 | (1.3) |)% | 79.9 | 82.9 | (3.6) |)% |
| % of consolidated revenue | 13.3 | % 13.7 | % (0.4) |) pp | 13.6 | % 14.7 | % (1.1) |) pp |
| Depreciation and amortization | 16.4 | 14.6 | 12.6 | % | 47.8 | 40.3 | 18.6 | % |
| % of consolidated revenue | 8.4 | % 7.6 | % 0.8 | pp | 8.1 | % 7.1 | % 1.0 | pp |
| Litigation settlement | — | — | — | | — | 61.0 | NMF | |

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

| | | | | | | | |
|---------------------------|----------|----------|----------|---------|----------|-----------|----------|
| % of consolidated revenue | — | % — | % — | pp — | % 10.8 | % NMF | |
| Total operating expense | \$ 149.1 | \$ 147.8 | 0.8 | % | \$ 446.7 | \$ 504.7 | (11.5)% |
| % of consolidated revenue | 76.3 | % 76.5 | % (0.2) | pp 76.1 | % 89.5 | % (13.4) | pp |

Consolidated operating expense increased \$1.3 million, or 0.8%, in the third quarter of 2015, and decreased \$58.0 million, or 11.5%, in the first nine months of 2015. The decrease in operating expense in the first nine months mainly reflects the \$61.0 million litigation settlement expense incurred in the second quarter of 2014 that did not recur in 2015. In addition, as a result of the continued strength in the U.S. dollar, foreign currency translations had a favorable effect of \$6.1 million and \$18.1 million on operating expense during the third quarter and first nine months of 2015, respectively.

Table of Contents

Sales commission expense decreased \$3.9 million in the third quarter and \$9.6 million in the first nine months of 2015. In the first quarter of 2014, we changed to a new sales commission structure that requires a different accounting treatment. We now expense sales commissions as incurred instead of amortizing them over the term of the underlying contracts but continue to amortize the prepaid commission balance from the previous commission plan. This amortization triggered an additional \$2.5 million and \$0.8 million of sales commission cost in the third quarter of 2014 and 2015, respectively. In the first nine months of 2014 and 2015, this amortization triggered an additional \$8.0 million and \$2.9 million of sales commission cost, respectively.

Legal and other professional fees were down \$0.7 million in the third quarter of 2015 and \$5.4 million in the first nine months of 2015 as a result of litigation-related legal fees in the third quarter and first nine months of 2014 that did not recur in 2015.

Also reducing operating expense was an increase in capitalized software development. For the first nine months of 2015, we capitalized \$16.4 million of software development expense, including \$14.0 million for ongoing enhancements of key platforms and an additional \$2.4 million for new development of upgraded software platforms. In comparison, we capitalized a total of \$13.6 million of software development expense in the first nine months of 2014.

Compensation expense (including salaries, bonus, and other company-sponsored benefits) decreased \$0.1 million in the third quarter of 2015 and increased \$3.4 million in the first nine months of 2015. While headcount has remained relatively flat during the first nine months of 2015, we continue to see opportunities to invest in our key growth initiatives.

Depreciation, advertising and marketing, rent, and production expense were also higher during the third quarter and first nine months of 2015, as described more fully below.

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. We include compensation expense for approximately 80% of our employees in this category.

Cost of revenue increased \$3.4 million in the third quarter of 2015, mainly because of higher production expense and bonus expense. Professional fees and salary expense also contributed to the increase in this category.

For the first nine months of 2015, cost of revenue was up \$7.8 million. Higher salary expense of \$4.9 million was the primary contributor to the increase as a result of additional hires to support the growth of our business. Annual merit increases also contributed to the increase in salary expense. Higher expense for bonus, production expense, and professional fees also contributed to the change in this category.

Partially offsetting these increases was an increase in capitalized software development, which reduced cost of revenue during the first nine months of 2015. We capitalized \$16.4 million associated with software development activities in the first nine months of 2015. In comparison, we capitalized \$13.6 million in the first nine months of 2014. During the third quarter of 2015, we capitalized \$5.0 million associated with software development activities, a slight decrease from the third quarter of 2014 when we capitalized \$5.1 million.

As a percentage of revenue, cost of revenue increased by 1.3 percentage points in the third quarter and decreased by 0.3 percentage points in the first nine months of 2015.

Sales and marketing

Sales and marketing expense decreased \$3.5 million in the third quarter of 2015. Lower sales commission expense of \$3.5 million (mainly reflecting the change in sales commission structure discussed above) as well as lower salary expense of \$1.0 million were the primary contributors to the decrease. Partly offsetting these decreases was an increase in advertising and marketing expense of \$1.6 million.

Table of Contents

For the first nine months of 2015, sales and marketing expense was down about \$9.3 million. Lower sales commission expense of \$9.2 million (mainly reflecting of the change in sales commission plan discussed above) and lower salary expense of \$2.1 million, as well as lower travel and conference expense of \$1.0 million, were the primary contributors to the decrease. Partly offsetting these decreases was an increase in advertising and marketing expense of \$3.5 million.

As a percentage of revenue, sales and marketing expense decreased 2.0 percentage points in the third quarter of 2015 and 2.1 percentage points in the first nine months of the year.

General and administrative

General and administrative expense decreased \$0.4 million in the third quarter of 2015. Legal fees decreased \$0.7 million as a result of litigation-related legal fees in the third quarter of 2014 that did not recur in the third quarter of 2015. This decrease was partially offset by an increase of \$0.6 million in rent and utilities expense, mainly because of new and expanded office space in New York and London.

For the first nine months of 2015, general and administrative expense was down \$3.0 million. Legal professional fees decreased \$4.4 million as a result of litigation-related legal fees in the first nine months of 2014 that did not recur in the first nine months of 2015. Other professional fees as well as salary, travel, training, and conference expense also decreased during the first nine months of the year. These decreases were partially offset by an increase of \$2.8 million in rent and utilities expense, mainly because of new and expanded office space in New York and London.

As a percentage of revenue, general and administrative expense decreased 0.4 percentage points in the third quarter of 2015 and 1.1 percentage points in the first nine months of 2015.

Depreciation and amortization

Depreciation expense rose \$2.3 million in the third quarter, primarily driven by higher capital expenditures for computer software and incremental capitalized software development costs for our operations in the United States. Intangible amortization expense decreased \$0.4 million in the third quarter of 2015.

For the first nine months of 2015, depreciation expense was up \$7.7 million, largely driven by the same factors that contributed to growth in depreciation in the third quarter of 2015. Intangible amortization expense was down \$0.2 million, as certain intangible assets from some of our earlier acquisitions are now fully amortized.

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 \$5.4 million for the remainder of 2015 and \$17.3 million in 2016. These estimates 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 0.8 percentage points in the third quarter and 1.0 percentage point in the first nine months of 2015.

Litigation settlement

We recorded a \$61.0 million litigation settlement expense in the second quarter of 2014 that did not recur in 2015. This expense is included in our results of operations for the nine months ended September 30, 2014.

Consolidated Operating Income

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

| (in millions) | Three months ended September 30 | | | | Nine months ended September 30 | | | |
|------------------|---------------------------------|--------|--------|----|--------------------------------|--------|--------|----|
| | 2015 | 2014 | Change | | 2015 | 2014 | Change | |
| Operating income | \$46.2 | \$45.3 | 2.2 | % | \$140.5 | \$59.0 | 138.2 | % |
| % of revenue | 23.7 | % 23.4 | % 0.3 | pp | 23.9 | % 10.5 | % 13.4 | pp |

27

Table of Contents

Consolidated operating income increased \$0.9 million in the third quarter of 2015, as revenue increased \$2.2 million and operating expense increased \$1.3 million. Operating margin was 23.7%, up 0.3 percentage points compared with the third quarter of 2014.

For the first nine months of 2014, consolidated operating expense included the \$61.0 million litigation settlement expense referenced above, which had a corresponding negative effect on operating income. This did not recur in 2015.

As a result, consolidated operating income increased \$81.5 million in the first nine months of 2015 as revenue increased \$23.5 million and operating expense decreased \$58.0 million. Operating margin was 23.9%, up 13.4 percentage points compared with the first nine months of 2014.

| (in millions) | Three months ended September 30 | | | Nine months ended September 30 | | | | |
|-----------------------------|---------------------------------|--------|--------|--------------------------------|---------|--------|---|--|
| | 2015 | 2014 | Change | 2015 | 2014 | Change | | |
| Operating income | \$46.2 | \$45.3 | 2.2 | % \$140.5 | \$59.0 | 138.2 | % | |
| Less: litigation settlement | — | — | — | — | 61.0 | NMF | | |
| Adjusted operating income | \$46.2 | \$45.3 | 2.2 | % \$140.5 | \$120.0 | 17.1 | % | |

Excluding the litigation settlement, we reported adjusted operating income of \$120.0 million for the first nine months of 2014. Adjusted operating income is a non-GAAP measure; the table above 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.

| | Three months ended September 30 | | | | Nine months ended September 30 | | | |
|-----------------------------|---------------------------------|--------|--------|----|--------------------------------|--------|--------|----|
| | 2015 | 2014 | Change | | 2015 | 2014 | Change | |
| Operating margin | 23.7 | % 23.4 | % 0.3 | pp | 23.9 | % 10.5 | % 13.4 | pp |
| Less: litigation settlement | — | % — | % — | pp | — | % 10.8 | % NMF | |
| Adjusted operating margin | 23.7 | % 23.4 | % 0.3 | pp | 23.9 | % 21.3 | % 2.6 | pp |

Excluding the litigation settlement, we reported an adjusted operating margin of 21.3% for the first nine months of 2014. Adjusted operating margin is a non-GAAP measure; the table above shows a reconciliation to the comparable GAAP measure.

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.

Table of Contents

Non-Operating Income, Equity in Net Income of Unconsolidated Entities, and Effective Tax Rate and Income Tax Expense

Non-operating income

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | |
|---|---------------------------------|--------|--------------------------------|--------|
| | 2015 | 2014 | 2015 | 2014 |
| Interest income | \$0.3 | \$0.7 | \$1.0 | \$2.0 |
| Interest expense | (0.1 |) (0.2 |) (0.5 |) (0.3 |
| Gain on sale of investments, net | — | 0.2 | 0.4 | 0.5 |
| Holding gain upon acquisition of additional ownership of equity and cost method investments | — | — | — | 5.2 |
| Other income (expense), net | 1.2 | (1.0 |) 0.8 | (0.9 |
| Non-operating income (loss), net | \$1.4 | \$(0.3 |) \$1.7 | \$6.5 |

Interest income mainly reflects interest from our investment portfolio.

Non-operating income for the first nine 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.

Other income (expense), net primarily includes foreign currency exchange gains and losses arising from the ordinary course of business related to our operations.

Equity in net income of unconsolidated entities

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | |
|---|---------------------------------|-------|--------------------------------|-------|
| | 2015 | 2014 | 2015 | 2014 |
| Equity in net income of unconsolidated entities | \$0.5 | \$0.3 | \$1.5 | \$1.4 |

Equity in net income of unconsolidated entities primarily reflects Morningstar Japan K.K. (MJKK).

Effective tax rate and income tax expense

| (in millions) | Three months ended September 30 | | Nine months ended September 30 | |
|--|---------------------------------|--------|--------------------------------|--------|
| | 2015 | 2014 | 2015 | 2014 |
| Income before income taxes and equity in net income of unconsolidated entities | \$47.6 | \$45.0 | \$142.2 | \$65.5 |
| Equity in net income of unconsolidated entities | 0.5 | 0.3 | 1.5 | 1.4 |
| Net income (loss) attributable to the noncontrolling interest | — | — | (0.2 |) 0.1 |
| Total | \$48.1 | \$45.3 | \$143.5 | \$67.0 |
| Income tax expense | \$14.6 | \$15.1 | \$48.2 | \$20.2 |
| Effective tax rate | 30.4 | % 33.4 | % 33.6 | % 30.1 |

Our effective tax rate was 30.4% in the third quarter of 2015 and 33.6% in the first nine months of 2015. During the third quarter of 2015, we recognized additional tax benefits for credits and incentives. We also recognized a deferred tax asset for net operating losses for certain of our foreign operations that we expect will be utilized over time based upon recent financial performance and forecasted taxable income. Both of these items reduced our effective tax rate.

Table of Contents

Our effective tax rate for the first nine months of 2015 was 33.6%, which was higher than the 30.1% rate for the comparable period a year ago 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 and our line of credit, 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. We maintain a conservative investment policy for our investments. We invest a portion of our investments balance (approximately \$25.3 million, or 64% of our total investments balance as of September 30, 2015) in stocks, bonds, options, mutual funds, money market funds, or exchange-traded products that replicate the model portfolios and strategies created by Morningstar. These investment accounts may also include exchange-traded products where Morningstar is an index provider.

Approximately 35% of our cash, cash equivalents, and investments balance as of September 30, 2015 was held by our operations in the United States, up from about 28% as of December 31, 2014. 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 permanent in duration. It is not practical to quantify the deferred tax liability associated with these outside basis differences.

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

As of September 30, 2015, we had cash, cash equivalents, and investments of \$263.0 million, an increase of \$38.4 million compared with \$224.6 million as of December 31, 2014. The increase reflects net income, adjusted for non-cash items, and the net effect of changes in our operating assets and liabilities. These items were partially offset by \$39.9 million of capital expenditures, \$30.1 million used to repurchase common stock through our share repurchase program, bonus payments of \$47.8 million made during the first quarter of 2015, and the \$35.0 million net repayments of the outstanding principal balance under our credit facility.

Cash provided by operating activities is our main source of cash. In the first nine months of 2015, cash provided by operating activities was \$186.5 million, driven by \$150.6 million of net income, adjusted for non-cash items and \$35.9 million in changes from our net operating assets and liabilities.

In July 2015, we renewed our \$75.0 million single-bank revolving credit facility in the United States, which we intend to use for general corporate purposes. The facility is fully available as of September 30, 2015.

In the first nine months of 2015, we also paid dividends of \$25.3 million. In September 2015, our board of directors approved a regular quarterly dividend of 19.0 cents per share payable on October 30, 2015 to shareholders of record as of October 9, 2015. We expect to pay a dividend of approximately \$8.4 million on October 30, 2015.

In December 2013, our board approved a \$200.0 million increase to our share repurchase program, bringing the total amount authorized under the program to \$700.0 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 nine months of 2015, we repurchased a total of 0.4 million shares for \$30.1 million. As of September 30, 2015, we have repurchased a total of 8.5 million shares for \$556.6 million. The company had approximately \$143.4 million available for future repurchases as of September 30, 2015.

We expect to continue making capital expenditures in 2015, primarily for computer hardware and software, internally developed software, and leasehold improvements for new and existing office locations.

Table of Contents

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.

| (in millions) | Three months ended September 30 | | | | Nine months ended September 30 | | | |
|---------------------------------------|---------------------------------|----------|--------|---|--------------------------------|---------|--------|---|
| | 2015 | 2014 | Change | | 2015 | 2014 | Change | |
| Cash provided by operating activities | \$75.6 | \$8.6 | 779.1 | % | \$186.5 | \$75.3 | 147.7 | % |
| Capital expenditures | (12.3) | (12.0) | 2.5 | % | (39.9) | (42.8) | (6.8) | % |
| Free cash flow | \$63.3 | \$(3.4) | NMF | | \$146.6 | \$32.5 | 351.1 | % |

We generated positive free cash flow of \$63.3 million in the third quarter of 2015, an increase of \$66.7 million compared with negative free cash flow of \$3.4 million in the third quarter of 2014. The change reflects a \$67.0 million increase in cash provided by operating activities as well as a \$0.3 million increase in capital expenditures.

In the first nine months of 2015, we generated free cash flow of \$146.6 million, an increase of \$114.1 million compared with free cash flow of \$32.5 million in the same period of 2014. The increase reflects a \$111.2 million increase in cash provided by operating activities as well as a \$2.9 million decrease in capital expenditures. Free cash flow in the prior-year periods included a \$61.0 million payment for a previously announced litigation settlement.

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, 2014, as filed with the SEC on February 27, 2015. We also discuss our significant accounting policies in Note 3 of our Audited Consolidated Financial Statements included in our Annual Report.

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 October 15, 2015:

| 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 October 15, 2015 | Projected Beneficial Ownership (1) |
|-------------------------|--------------|-----------------------|--|--|---|------------------------------------|
| Gail Landis Director | 8/21/2015 | 5/31/2016 | 690 | Shares to be sold under the plan if the stock reaches specified prices | — | 1,782 |
| | 8/21/2015 | 8/30/2016 | 5,000 | | — | 40,203 |

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

David Williams
Head of Design

Shares to be sold under the
plan if the stock reaches
specified prices

During the second quarter of 2015, the previously disclosed Rule 10b5-1 sales plan for Bevin Desmond 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 plan. This information reflects the beneficial ownership of our common stock on September 30, 2015, and includes shares of our common stock subject to options that were then exercisable or that will have become exercisable by November 29, 2015 and restricted stock units that will vest by November 29, 2015. The estimates do not reflect any changes to beneficial ownership that may have occurred since September 30, 2015. 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.

Table of Contents

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. These accounts may consist of stocks, bonds, options, mutual funds, money market funds, or exchange-traded products that replicate the model portfolios and strategies created by Morningstar. These investment accounts may also include exchange-traded products where Morningstar is an index provider. As of September 30, 2015, our cash, cash equivalents, and investments balance was \$263.0 million. Based on our estimates, a 100 basis-point change in interest rates would not have a material effect on the fair value of our investment portfolio.

We are subject to risk from fluctuations in foreign currencies from our operations outside of the United States. 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.

The table below shows our exposure to foreign currency denominated revenue and operating income for the nine months ended September 30, 2015:

| (in millions, except foreign currency rates) | Nine months ended September 30, 2015 | | | |
|---|--------------------------------------|---------------|-------------------|--------------------------|
| | Euro | British Pound | Australian Dollar | Other Foreign Currencies |
| Foreign currency rate in U.S. dollars as of September 30, 2015 | 1.1245 | 1.5167 | 0.6978 | — |
| Foreign currency denominated percentage of revenue | 5.0 | % 8.1 | % 3.8 | % 8.8 |
| Foreign currency denominated percentage of operating income (loss) | 7.0 | % 0.2 | % 2.7 | % (6.2) |
| Estimated effect of a 10% adverse currency fluctuation on revenue | \$(0.9) | \$(1.9) | \$(1.0) | \$(2.0) |
| Estimated effect of a 10% adverse currency fluctuation on operating income (loss) | \$(0.3) | \$— | \$(0.2) | \$0.3 |

The table below shows our exposure to net investment in foreign currencies as of September 30, 2015:

| (in millions) | As of September 30, 2015 | | | |
|--|--------------------------|---------------|-------------------|--------------------------|
| | Euro | British Pound | Australian Dollar | Other Foreign Currencies |
| Assets, net of unconsolidated entities | \$78.9 | \$130.8 | \$65.0 | \$132.9 |
| Liabilities | 32.1 | 38.5 | 45.3 | 49.1 |
| Net currency position | \$46.8 | \$92.3 | \$19.7 | \$83.8 |
| Estimated effect of a 10% adverse currency fluctuation on equity | \$(4.7) | \$(9.2) | \$(2.0) | \$(8.4) |

Table of Contents

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 Securities Exchange Act of 1934 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, 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 September 30, 2015. 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 September 30, 2015 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 10, 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, 2014.

Table of Contents

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 September 30, 2015:

| 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 June 30, 2015 | 8,507,780 | \$65.12 | 8,507,780 | \$145,829,777 |
| July 1, 2015 - July 30, 2015 | — | — | — | \$145,829,777 |
| August 1, 2015 - August 31, 2015 | 8,868 | 77.17 | 8,868 | \$145,145,270 |
| September 1, 2015 - September 30, 2015 | 21,793 | 79.06 | 21,793 | \$143,421,906 |
| Total | 8,538,441 | \$65.17 | 8,538,441 | |

* 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 \$700.0 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: October 29, 2015

By: /s/ Stéphane Biehler

Stéphane Biehler
Chief Financial Officer

Table of Contents

EXHIBIT INDEX

| Exhibit No | Description of Exhibit |
|------------|--|
| 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 September 30, 2015, filed with the SEC on October 29, 2015 formatted in XBRL: (i) Condensed Consolidated Statements of Operations, (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 |