

Morningstar, Inc.
Form 10-Q
August 04, 2009
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009

OR

o

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

For the transition period from to

Commission File Number: 000-51280

MORNINGSTAR, INC.

(Exact Name of Registrant as Specified in its Charter)

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Illinois
(State or Other Jurisdiction of
Incorporation or Organization)

36-3297908
(I.R.S. Employer
Identification Number)

22 West Washington Street
Chicago, Illinois
(Address of Principal Executive Offices)

60602
(Zip Code)

(312) 696-6000

(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

As of July 31, 2009, there were 48,394,783 shares of the Company's common stock, no par value, outstanding.

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SIGNATURE

Table of Contents**PART 1. FINANCIAL INFORMATION****Item 1. Unaudited Condensed Consolidated Financial Statements****Morningstar, Inc. and Subsidiaries****Unaudited Condensed Consolidated Statements of Income**

(in thousands except per share amounts)	Three Months Ended June 30 2009		2008		Six Months Ended June 30 2009		2008	
Revenue	\$	119,533	\$	132,237	\$	236,265	\$	257,681
Operating expense (1):								
Cost of goods sold		30,694		33,164		60,946		66,102
Development		9,438		9,801		18,738		19,916
Sales and marketing		18,010		20,866		35,546		43,090
General and administrative		19,853		20,560		37,006		39,885
Depreciation and amortization		8,850		6,276		16,716		12,433
Total operating expense		86,845		90,667		168,952		181,426
Operating income		32,688		41,570		67,313		76,255
Non-operating income (expense):								
Interest income, net		764		1,381		1,742		2,900
Other income (expense), net		1,208		(234)		764		38
Non-operating income, net		1,972		1,147		2,506		2,938
Income before income taxes and equity in net income (loss) of unconsolidated entities		34,660		42,717		69,819		79,193
Income tax expense		14,024		15,076		24,692		28,580
Equity in net income (loss) of unconsolidated entities		(21)		445		361		797
Consolidated net income		20,615		28,086		45,488		51,410
Net (income) loss attributable to the noncontrolling interest		(71)		(87)		18		(335)
Net income attributable to Morningstar, Inc.	\$	20,544	\$	27,999	\$	45,506	\$	51,075
Net income per share attributable to Morningstar, Inc.:								
Basic	\$	0.43	\$	0.61	\$	0.95	\$	1.12
Diluted	\$	0.41	\$	0.57	\$	0.92	\$	1.04
Weighted average shares outstanding:								

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Basic	47,941	45,921	47,661	45,572
Diluted	49,631	49,290	49,385	49,150

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
(1) Includes stock-based compensation expense of:				
Cost of goods sold	\$ 715	\$ 528	\$ 1,264	\$ 964
Development	413	367	767	688
Sales and marketing	422	379	778	724
General and administrative	1,518	1,695	2,984	3,337
Total stock-based compensation expense	\$ 3,068	\$ 2,969	\$ 5,793	\$ 5,713

See notes to unaudited condensed consolidated financial statements.

Table of Contents**Morningstar, Inc. and Subsidiaries****Unaudited Condensed Consolidated Balance Sheets**

(in thousands except share amounts)	June 30 2009	December 31 2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 187,099	\$ 173,891
Investments	136,096	123,686
Accounts receivable, less allowance of \$695 and \$466, respectively	84,146	89,537
Deferred tax asset, net	3,766	3,538
Income tax receivable	3,261	9,193
Other	13,469	13,891
Total current assets	427,837	413,736
Property, equipment, and capitalized software, net	60,367	58,822
Investments in unconsolidated entities	20,150	20,404
Goodwill	207,113	187,242
Intangible assets, net	123,675	119,812
Other assets	3,683	3,924
Total assets	\$ 842,825	\$ 803,940
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 27,949	\$ 30,071
Accrued compensation	27,100	73,012
Deferred revenue	133,997	130,270
Other	31	88
Total current liabilities	189,077	233,441
Accrued compensation	4,449	3,611
Deferred tax liability, net	7,606	7,531
Other long-term liabilities	23,279	23,428
Total liabilities	224,411	268,011
Equity:		
Morningstar, Inc. shareholders' equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 48,367,477 and 47,282,958 shares were outstanding as of June 30, 2009 and December 31, 2008, respectively	4	4
Treasury stock at cost, 225,881 shares as of June 30, 2009 and 233,332 shares as of December 31, 2008	(3,175)	(3,280)
Additional paid-in capital	412,289	390,404
Retained earnings	209,795	164,289
Accumulated other comprehensive income (loss):		
Currency translation adjustment	(1,312)	(16,366)
Unrealized gain on available-for-sale securities	434	481
Total accumulated other comprehensive loss	(878)	(15,885)
Total Morningstar, Inc. shareholders' equity	618,035	535,532
Noncontrolling interest	379	397
Total equity	618,414	535,929
Total liabilities and equity	\$ 842,825	\$ 803,940

See notes to unaudited condensed consolidated financial statements.

Table of Contents**Morningstar, Inc. and Subsidiaries****Unaudited Condensed Consolidated Statement of Equity and Comprehensive Income (Loss)****For the Six Months Ended June 30, 2009**

		Morningstar, Inc. Shareholders' Equity				Accumulated Other Comprehensive Income		Non-	Total
(in thousands, except share amounts)		Common Stock Shares Outstanding	Par Value	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Income (Loss)	controlling Interest	Equity
Balance as of December 31, 2008		47,282,958	\$ 4	\$ (3,280)	\$ 390,404	\$ 164,289	\$ (15,885)	\$	\$ 535,532
Adoption of SFAS No. 160								397	397
Balance as of January 1, 2009		47,282,958	4	(3,280)	390,404	164,289	(15,885)	397	535,929
Comprehensive income:									
Consolidated net income (loss)						45,506		(18)	45,488
Unrealized loss on investments, net of income tax of \$(28)							(47)		(47)
Foreign currency translation adjustment							15,054		15,054
Total comprehensive income (loss)						45,506	15,007	(18)	60,495
Issuance of common stock related to stock option exercises and vesting of restricted stock units, net		1,084,519		105	11,548				11,653
Stock-based compensation					5,793				5,793
Tax benefit derived from stock option exercises and vesting of restricted stock units					4,544				4,544
Balance as of June 30, 2009		48,367,477	\$ 4	\$ (3,175)	\$ 412,289	\$ 209,795	\$ (878)	\$ 379	\$ 618,414

See notes to unaudited condensed consolidated financial statements.

Table of Contents**Morningstar, Inc. and Subsidiaries****Unaudited Condensed Consolidated Statements of Cash Flows**

(in thousands)	Six Months Ended June 30	
	2009	2008
Operating activities		
Consolidated net income	\$ 45,488	\$ 51,410
Adjustments to reconcile consolidated net income to net cash flows from operating activities:		
Depreciation and amortization	16,716	12,433
Deferred income tax expense (benefit)	(956)	2,919
Stock-based compensation expense	5,793	5,713
Provision for (recovery of) bad debt	187	(11)
Equity in net income of unconsolidated entities	(361)	(797)
Excess tax benefits from stock option exercises and vesting of restricted stock units	(4,544)	(17,343)
Other, net	(752)	(1,099)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	9,312	(3,222)
Other assets	341	(1,846)
Accounts payable and accrued liabilities	(6,012)	997
Accrued compensation	(45,431)	(28,890)
Income taxes current	10,396	13,104
Deferred revenue	806	6,772
Deferred rent	(286)	9,306
Other liabilities	570	(327)
Cash provided by operating activities	31,267	49,119
Investing activities		
Purchases of investments	(50,273)	(46,946)
Proceeds from sale of investments	38,128	82,213
Capital expenditures	(6,768)	(17,354)
Acquisitions, net of cash acquired	(18,571)	(51,017)
Other, net	629	
Cash used for investing activities	(36,855)	(33,104)
Financing activities		
Proceeds from stock options exercises	11,653	12,595
Excess tax benefits from stock option exercises and vesting of restricted stock units	4,544	17,343
Other	(178)	(4)
Cash provided by financing activities	16,019	29,934
Effect of exchange rate changes on cash and cash equivalents	2,777	1,352
Net increase in cash and cash equivalents	13,208	47,301
Cash and cash equivalents beginning of period	173,891	159,576
Cash and cash equivalents end of period	\$ 187,099	\$ 206,877
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$ 14,152	\$ 15,252
Supplemental information of non-cash investing and financing activities:		
Unrealized gain (loss) on available-for-sale investments	\$ (75)	\$ 154

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See notes to unaudited condensed consolidated financial statements.

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MORNINGSTAR, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation of Interim Financial Information

The accompanying unaudited condensed consolidated financial statements of Morningstar, Inc. and subsidiaries (Morningstar, we, our, the Company) included herein have been prepared to conform to the rules and regulations of the Securities and Exchange Commission. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue, and expenses. Actual results could differ from those estimates. In the opinion of management, the statements reflect all adjustments, which are of a normal recurring nature, necessary to present fairly our financial position, results of operations, equity, and cash flows. These financial statements and notes should be read in conjunction with our Consolidated Financial Statements and Notes thereto as of December 31, 2008 included in our Annual Report on Form 10-K.

2. Summary of Significant Accounting Policies

We discuss our significant accounting policies in Note 2 of our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2008.

We adopted the following financial accounting standards effective January 1, 2009:

SFAS No. 160, Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51

Statement of Financial Accounting Standards (SFAS) No. 160, *Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*, amends the financial accounting and reporting of noncontrolling interests in consolidated financial statements. A noncontrolling interest is the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to the parent company. We conduct our business operations outside of the United States through wholly owned or majority-owned operating subsidiaries. As a result of adopting SFAS No. 160, the noncontrolling interest is now reported in our Consolidated Balance Sheet within equity, separately from the shareholders' equity attributable to Morningstar, Inc. In addition, the net income or loss and comprehensive income or loss attributed to the Morningstar, Inc. shareholders and the noncontrolling interest are presented in our Statements of Income and Statement of Equity and Comprehensive Income (Loss).

SFAS No. 141(R), Business Combinations

Effective January 1, 2009, SFAS No. 141(R), *Business Combinations*, modifies the financial accounting and reporting of business combinations. For business combinations which occur after January 1, 2009, SFAS No. 141(R) requires the acquirer to recognize and measure the fair value of the acquired operation as a whole, and the assets acquired and liabilities assumed at their full fair values as of the date control is obtained, regardless of the percentage ownership in the acquired operation or how the acquisition was achieved. With the adoption of SFAS No. 141(R), direct costs incurred in connection with a business combination, such as finder's fees, advisory, accounting, legal, valuation, and other professional fees are expensed as incurred. Restructuring costs, including severance and relocation of employees of the acquired entity, are recognized separately from the business combination as post-combination expenses unless the criteria of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, are met on the acquisition date by the target entity. Prior to the adoption of SFAS No. 141(R), acquisition-related costs and restructuring costs were generally included as part of the cost of the acquired business.

In April 2009, the Financial Accounting Standards Board (FASB) issued a Final Staff Position (FSP) to amend and clarify SFAS No. 141(R), to address application issues on recognition, measurement, and disclosure of assets and liabilities, arising from contingencies in a business combination. This FSP is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after January 1, 2009.

EITF Issue 08-6, Equity Method Investment Accounting Considerations

We adopted Emerging Issues Task Force (EITF) 08-6, *Equity Method Investment Accounting Considerations*, concurrently with the adoption of SFAS No. 141(R) and SFAS No. 160. The intent of EITF 08-6 is to clarify the accounting for certain transactions and impairment considerations related to equity method investments as modified by the provisions of SFAS No. 141(R) and SFAS No. 160.

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We adopted the following financial accounting standards in the second quarter of 2009:

In April 2009, the FASB issued three FSPs intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities.

1. FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides guidelines for making fair value measurements more consistent with the principles presented in SFAS No. 157, *Fair Value Measurements*.
2. FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, enhances consistency in financial reporting by increasing the frequency of fair value disclosures.
3. FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities.

The disclosures related to these FSPs appear in Note 6 in the Notes to our Condensed Consolidated Financial Statements.

SFAS No. 165, Subsequent Events

SFAS No. 165, *Subsequent Events*, establishes the accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. See Note 12 in the Notes to our Condensed Consolidated Financial Statements for the related disclosure.

The adoption of these financial accounting standards did not have a material impact on our Condensed Consolidated Financial Statements.

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In the second quarter of 2009, we completed four acquisitions. Cash used for these acquisitions, net of acquired cash, was \$18,671,000, and is subject to post-closing adjustments. The table below shows additional information concerning these acquisitions:

Acquisition	Description	Date Completed	Purchase Price*
Global financial filings database business of Global Reports LLC	A leading provider of online financial and Corporate and Social Responsibility reports for publicly traded companies around the world	April 20, 2009	Not separately disclosed
Equity research and data business of C.P.M.S. Computerized Portfolio Management Services Inc.	C.P.M.S. tracks fundamental equity data for approximately 4,000 securities in the United States and Canada as well as tracks and provides brokerage earnings estimates for Canadian equities	May 1, 2009	\$13.9 million
Andex Associates, Inc.	The company is known for its Andex Charts, individual graphic charts detailing historical market returns, stock index growth, inflation rates, currency rates, and general economic conditions for the United States dating back to 1926, and for Canada dating back to 1950	May 1, 2009	Not separately disclosed
Intech Pty Ltd	A leading provider of multi-manager and investment portfolio solutions in Sydney, Australia, Intech also manages a range of single sector, alternative strategy, and diversified investment portfolios, has one of the leading separately managed account databases in Australia and offers the Intech Desktop Consultant, a research software product for institutions	June 30, 2009	Not separately disclosed

* Total purchase price less cash acquired

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

	(\$000)
Cash	\$ 1,333
Accounts receivable	2,706
Other current assets	135
Fixed assets	56
Other non-current assets	334
Intangible assets	9,876

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Goodwill	10,380
Deferred revenue	(634)
Accounts payable and accrued liabilities	(3,404)
Deferred tax liability non-current	(778)
Total purchase price	\$ 20,004

The preliminary allocation includes \$9,876,000 of acquired intangible assets. These assets primarily include customer-related assets and technology-based assets, including software and databases. The deferred tax liability of \$778,000 results primarily because the amortization expense related to certain intangible assets is not deductible for income tax purposes. Approximately \$7,590,000 of the intangible assets is deductible for income tax purposes over a period of approximately 15 years from the acquisition date.

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Goodwill of \$10,380,000 represents the premium we paid over the fair value of the net tangible and intangible assets we acquired with these four acquisitions. We paid this premium for a number of reasons, including the strategic benefits of expanding our Canadian equity research and data offerings, expanding our international presence in the area of funds-of-funds investment management to Australia, expanding our library of market analysis communications materials to include financial charts and communications materials for financial advisors in Canada, and broadening our database to include a global financial filings database. Approximately \$8,182,000 of the goodwill is deductible for income tax purposes over a period of approximately 15 years from the acquisition date.

2008 Acquisitions

In January 2008, we acquired the Hemscott data, media, and investor relations Web site businesses. We completed five additional acquisitions throughout the remainder of 2008. The table below summarizes the acquisitions completed during 2008. We did not make any significant changes during the first half of 2009 to the purchase price allocations compared with the preliminary estimates existing as of December 31, 2008. Additional information concerning these acquisitions can be found in the Notes to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2008.

Acquisition	Description	Date Completed	Purchase Price*
Hemscott data, media, and investor relations Web site businesses	U.K.-based operation providing more than 20 years of comprehensive fundamental data on publicly listed companies in the United States, Canada, the United Kingdom, and Ireland; free and paid investment research sites and data services; online investor relations services in the United Kingdom	January 9, 2008	\$51.3 million
Financial Computer Support, Inc. (FCSI)	A leading provider of practice management software for independent advisors	September 2, 2008	\$4.9 million
Fundamental Data Limited (Fundamental Data)	A leading provider of data on closed-end funds in the United Kingdom	October 2, 2008	\$18.6 million
10-K Wizard Technology, LLC (10-K Wizard)	A leading provider of SEC filing research and alert services	December 4, 2008	\$11.5 million
Tenfore Systems Limited (Tenfore)	Global provider of real-time market data and financial data workstations based in the United Kingdom	December 17, 2008	\$19.2 million
InvestData (Proprietary) Limited (InvestData)	A leading provider of fund information in South Africa	December 29, 2008	Not separately disclosed

* Total purchase price less cash acquired

Pro Forma Information for 2009 and 2008 Acquisitions

The following unaudited pro forma information presents a summary of our Consolidated Statements of Income for the six months ended June 30, 2009 and 2008 as if we had completed these 10 acquisitions as of January 1 of each of these years. In calculating the pro forma information below, we made an adjustment to include amortization expense related to the intangible assets acquired.

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	Six months ended	
	June 30, 2009	June 30, 2008
Revenue	\$ 242,138	\$ 279,953
Operating income	\$ 66,956	\$ 74,664
Net income	\$ 45,272	\$ 49,736
Basic net income per share	\$ 0.95	\$ 1.09
Diluted net income per share	\$ 0.92	\$ 1.01

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Goodwill

The following table shows the changes in our goodwill balances from January 1, 2008 to June 30, 2009:

	(\$000)
Balance as of January 1, 2008	\$ 128,141
Acquisition of the Hemscott data, media, and investor relations Web site businesses	35,683
Acquisition of Fundamental Data	13,669
Acquisition of 10-K Wizard	7,219
Acquisition of Tenfore	13,916
Acquisition of FCSI and InvestData	3,858
Other, primarily currency translation	(15,244)
Balance as of December 31, 2008	187,242
Goodwill for acquisitions completed in the first six months of 2009	10,380
Other, primarily currency translation	9,491
Balance as of June 30, 2009	\$ 207,113

We did not record any impairment losses in the second quarter or year-to-date periods ended June 30, 2009 and June 30, 2008, respectively.

The following table summarizes our intangible assets:

(\$000)	As of June 30, 2009			Weighted Average Useful Life (years)	As of December 31, 2008			Weighted Average Useful Life (years)
	Gross	Accumulated Amortization	Net		Gross	Accumulated Amortization	Net	
Intellectual property	\$ 27,327	\$ (10,322)	\$ 17,005	10	\$ 26,198	\$ (8,338)	\$ 17,860	10
Customer-related assets	68,908	(21,746)	47,162	10	67,325	(17,620)	49,705	10
Supplier relationships	240	(54)	186	20	240	(48)	192	20
Technology-based assets	35,719	(12,064)	23,655	9	34,845	(9,525)	25,320	9
Non-competition agreement	810	(459)	351	5	810	(375)	435	5
Intangible assets related to acquisitions of FCSI, Fund Data, Tenfore, 10-K Wizard, InvestData, Global Reports, C.P.M.S., Anex, and Intech	39,176	(3,860)	35,316	5	26,962	(662)	26,300	5
	\$ 172,180	\$ (48,505)	\$ 123,675	8	\$ 156,380	\$ (36,568)	\$ 119,812	9

Total intangible
assets

We amortize intangible assets using the straight-line method over their expected economic useful lives. Amortization expense was \$10,663,000 and \$8,113,000 for the six months ended June 30, 2009 and 2008, respectively.

As of June 30, 2009, we estimate that aggregate amortization expense for intangible assets will be \$22,509,000 in 2009; \$21,563,000 in 2010; \$20,078,000 in 2011; \$19,420,000 in 2012; \$17,094,000 in 2013; and \$10,751,000 in 2014. Our estimates of future amortization expense for intangible assets may be affected by changes to the preliminary purchase price allocations.

Table of Contents**4. Income Per Share**

The numerator for both basic and diluted income per share is net income attributable to Morningstar, Inc. The denominator for basic income per share is the weighted average number of common shares outstanding during the period. For diluted income per share, we reflect the dilutive effect of outstanding employee stock options and restricted stock units in the denominator using the treasury stock method. The following table shows how we reconcile our net income and the number of shares used in computing basic and diluted income per share:

(in thousands, except per share amounts)	Three Months Ended June 30 2009		2008		Six Months Ended June 30 2009		2008	
Basic income per share attributable to Morningstar, Inc.:								
Net income attributable to Morningstar, Inc.	\$	20,544	\$	27,999	\$	45,506	\$	51,075
Weighted average common shares outstanding		47,941		45,921		47,661		45,572
Basic net income per share attributable to Morningstar, Inc.	\$	0.43	\$	0.61	\$	0.95	\$	1.12
Diluted income per share attributable to Morningstar, Inc.:								
Net income attributable to Morningstar, Inc.	\$	20,544	\$	27,999	\$	45,506	\$	51,075
Weighted average common shares outstanding		47,941		45,921		47,661		45,572
Net effect of dilutive stock options and restricted stock units		1,690		3,369		1,724		3,578
Weighted average common shares outstanding for computing diluted income per share		49,631		49,290		49,385		49,150
Diluted net income per share attributable to Morningstar, Inc.	\$	0.41	\$	0.57	\$	0.92	\$	1.04

5. Segment and Geographical Area Information

Beginning in 2009, we changed our organizational structure and now have two operating segments: Investment Information and Investment Management. Previously, we organized our operations based on three audience segments: Individual, Advisor, and Institutional. The new structure organizes our operations according to product lines and growth strategies rather than audience segments. Under the previous segment reporting, we allocated costs for our corporate functions to each of the segments. Beginning in 2009, we no longer allocate corporate costs to our business segments. We have changed the presentation of the 2008 segment information to conform to the current year's presentation.

- *Investment Information.* The Investment Information segment includes all of our data, software, and research products and services. These products are typically sold through subscriptions or license agreements.

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The largest products in this segment based on revenue are Licensed Data; Morningstar Advisor Workstation; Morningstar.com, including Premium memberships and Internet advertising sales; Morningstar Direct; and Morningstar Principia. Licensed Data is a set of investment data spanning all of our investment databases and available through electronic data feeds. Advisor Workstation is a Web-based investment planning system for advisors. Advisor Workstation is available in two editions: one for independent financial advisors and an enterprise edition for financial advisors affiliated with larger firms. Morningstar.com includes both Premium Memberships and Internet advertising sales. Morningstar Direct is a Web-based institutional research platform. Principia is our CD-ROM-based investment research and planning software for advisors.

The Investment Information segment also includes Morningstar Equity Research, which we distribute through several channels. Our equity research has been distributed through six major investment banks to meet the requirements for independent research under the Global Analyst Research Settlement, as well as to several other companies that purchase our research for their own use or provide our research to their affiliated financial advisors or to individual investors.

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- *Investment Management.* The Investment Management segment includes all of our asset management operations, which operate as registered investment advisors and earn more than half of their revenue from asset-based fees.

The key products and services in this segment based on revenue are Investment Consulting, which focuses on investment monitoring and asset allocation for funds of funds, including mutual funds and variable annuities; Retirement Advice, including the Morningstar Retirement Manager and Advice by Ibbotson platforms; and Morningstar Managed Portfolios, a fee-based discretionary asset management service that includes a series of mutual fund, exchange-traded fund, and stock portfolios tailored to meet a range of investment time horizons and risk levels that financial advisors can use for their clients' taxable and tax-deferred accounts.

Our segment accounting policies are the same as those described in Note 2 to our Consolidated Financial Statements included in our Annual Report on Form 10-K as of December 31, 2008, except for the capitalization and amortization of internal product development costs, amortization of intangible assets, and costs related to corporate functions. We exclude these items from our operating segment results to provide our chief operating decision maker with a better indication of each segment's ability to generate cash flow. This information is one of the criteria used by our chief operating decision maker in determining how to allocate resources to each segment. We include capitalization and amortization of internal product development costs, amortization of intangible assets, and costs related to corporate functions in the Corporate Items category to arrive at the consolidated financial information. Our segment disclosures include the business segment information provided to our chief operating decision maker on a recurring basis, and therefore, we do not present balance sheet information by segment. We disclose goodwill by segment in accordance with the requirements of SFAS No. 142, *Goodwill and Other Intangible Assets*.

The following tables show selected segment data for the three and six months ended June 30, 2009 and 2008:

Three months ended June 30, 2009

(\$000)	Investment Information	Investment Management	Corporate Items	Total
Revenue	\$ 97,739	\$ 21,794	\$	\$ 119,533
Operating expense, excluding stock-based compensation expense, depreciation, and amortization	57,770	8,126	9,031	74,927
Stock-based compensation expense	1,526	517	1,025	3,068
Depreciation and amortization	1,201	89	7,560	8,850
Operating income (loss)	\$ 37,242	\$ 13,062	\$ (17,616)	\$ 32,688
Capital expenditures	\$ 1,713	\$ 148	\$ 317	\$ 2,178
U.S. revenue				\$ 89,286
Non-U.S. revenue				\$ 30,247

Three months ended June 30, 2008

(\$000)	Investment Information	Investment Management	Corporate Items	Total
Revenue	\$ 101,580	\$ 30,657	\$	\$ 132,237
	60,460	12,592	8,370	81,422

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Operating expense, excluding
stock-based compensation expense,
depreciation, and amortization

Stock-based compensation expense	1,389	525	1,055	2,969
Depreciation and amortization	1,034	44	5,198	6,276
Operating income (loss)	\$ 38,697	\$ 17,496	\$ (14,623)	\$ 41,570
Capital expenditures	\$ 7,574	\$ 1,272	\$ 1,797	\$ 10,643
U.S. revenue			\$	99,534
Non-U.S. revenue			\$	32,703

Table of Contents**Six months ended June 30, 2009**

(\$000)	Investment Information	Investment Management	Corporate Items	Total
Revenue	\$ 193,979	\$ 42,286	\$	\$ 236,265
Operating expense, excluding stock-based compensation expense, depreciation, and amortization	114,835	16,303	15,305	146,443
Stock-based compensation expense	2,793	985	2,015	5,793
Depreciation and amortization	2,272	109	14,335	16,716
Operating income (loss)	\$ 74,079	\$ 24,889	\$ (31,655)	\$ 67,313
Capital expenditures	\$ 5,473	\$ 332	\$ 963	\$ 6,768
U.S. revenue				\$ 177,434
Non-U.S. revenue				\$ 58,831

Six months ended June 30, 2008

(\$000)	Investment Information	Investment Management	Corporate Items	Total
Revenue	\$ 198,086	\$ 59,595	\$	\$ 257,681
Operating expense, excluding stock-based compensation expense, depreciation, and amortization	121,355	25,714	16,211	163,280
Stock-based compensation expense	2,678	1,029	2,006	5,713
Depreciation and amortization	2,068	97	10,268	12,433
Operating income (loss)	\$ 71,985	\$ 32,755	\$ (28,485)	\$ 76,255
Capital expenditures	\$ 12,954	\$ 2,304	\$ 2,096	\$ 17,354
U.S. revenue				\$ 194,697
Non-U.S. revenue				\$ 62,984

As of June 30, 2009

(\$000)	Investment Information	Investment Management	Corporate Items	Total
Goodwill	\$ 175,618	\$ 31,495	\$	\$ 207,113
U.S. long-lived assets				\$ 44,285
Non-U.S. long-lived assets				\$ 16,082

As of June 30, 2008

(\$000)	Investment Information	Investment Management	Corporate Items	Total
Goodwill	\$ 126,868	\$ 31,470	\$	\$ 158,338
U.S. long-lived assets				\$ 24,220
Non-U.S. long-lived assets				\$ 11,731

Table of Contents**6. Investments and Fair Value Measurements**

We account for our investments in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. We classify our investments into three categories: held-to-maturity, trading, and available-for-sale. We monitor the concentration, diversification, maturity, and liquidity of our investment portfolio, which is primarily invested in fixed-income securities, and classify our investment portfolio as follows:

		June 30, 2009		December 31, 2008
Available-for-sale	\$	128,033	\$	116,867
Held-to-maturity		4,456		3,497
Trading securities		3,607		3,322
Total	\$	136,096	\$	123,686

Available-for-Sale: Investments not considered held-to-maturity or trading securities are classified as available-for-sale securities and consist primarily of fixed-income securities. We record these securities at their fair value in our Consolidated Balance Sheets. We report unrealized gains and losses for available-for-sale securities as other comprehensive income (loss), net of related income taxes.

Held-to-maturity: Investments consist primarily of certificates of deposit based on our intent and ability to hold these securities to maturity. We record held-to-maturity investments at amortized cost in our Consolidated Balance Sheets. The amortized cost of these securities approximates the fair value of these investments.

Trading: Investments consist primarily of mutual fund and equity securities based on our intent to hold the securities for a short period of time and generate profits on short-term differences in price, as well as to satisfy the requirements of one of our wholly owned subsidiaries which is a registered broker-dealer. We record these securities at their fair value in our Consolidated Balance Sheets and include realized and unrealized gains and losses associated with these investments as a component of our operating income in the Consolidated Statements of Income.

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

(\$000)	June 30, 2009			Fair Value	December 31, 2008			Fair Value
	Cost	Unrealized Gain	Unrealized Loss		Cost	Unrealized Gain	Unrealized Loss	
Available-for-sale:								
Government obligations	\$ 127,338	\$ 721	\$ (26)	\$ 128,033	\$ 111,513	\$ 806	\$ (27)	\$ 112,292
Corporate bonds					3,595	1	(21)	3,575
Commercial paper					1,000			1,000
Total	\$ 127,338	\$ 721	\$ (26)	\$ 128,033	\$ 116,108	\$ 807	\$ (48)	\$ 116,867

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Held-to-maturity:

Certificates of deposit	\$	4,456	\$		\$	4,456	\$	3,497	\$		\$	3,497
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As of June 30, 2009, we did not hold any investments with unrealized losses for greater than a 12-month period. Investments with unrealized losses for less than a 12-month period were not material to our Condensed Consolidated Balance Sheet and were not deemed to have other than temporary declines in value.

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

(\$000)	June 30, 2009		December 31, 2008	
	Cost	Fair Value	Cost	Fair Value
Available-for-sale:				
Due in one year or less	\$ 60,464	\$ 60,679	\$ 72,910	\$ 73,376
Due in one to two years	66,874	67,354	43,198	43,491
Total	\$ 127,338	\$ 128,033	\$ 116,108	\$ 116,867
Held-to-maturity:				
Due in one year or less	\$ 3,998	\$ 3,998	\$ 3,350	\$ 3,350
Due in one to two years	458	458	147	147
Total	\$ 4,456	\$ 4,456	\$ 3,497	\$ 3,497

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Held-to-maturity investments include a \$1,600,000 certificate of deposit held as collateral against two bank guarantees for our office space lease in Australia.

Net unrealized gains on trading securities included in our Condensed Consolidated Statement of Income were \$604,000 for the six months ended June 30, 2009. Our Condensed Consolidated Statement of Income for the six months ended June 30, 2008 includes \$302,000 of net unrealized losses on trading securities.

The following table shows the net realized gains (losses) arising from sales of our investments recorded in our Condensed Consolidated Statements of Income:

(\$000)	Six months ended	
	June 30, 2009	June 30, 2008
Realized gains	\$ 9	\$ 32
Realized losses	(531)	(43)
Realized loss, net	\$ (522)	\$ (11)

The fair value of our assets subject to fair value measurements and the necessary disclosures are as follows:

(\$000)	Fair Value as of June 30, 2009	Fair Value Measurements as of June 30, 2009 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Available-for-sale investments	\$ 128,033	\$ 128,033	\$	\$
Trading securities	3,607	3,607		
Total	\$ 131,640	\$ 131,640	\$	\$

(\$000)	Fair Value as of December 31, 2008	Fair Value Measurements as of December 31, 2008 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Available-for-sale investments	\$ 116,867	\$ 116,867	\$	\$
Trading securities	3,322	3,322		
Total	\$ 120,189	\$ 120,189	\$	\$

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- Level 1: Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has 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.

Table of Contents**7. Investments In Unconsolidated Entities**

Our investments in unconsolidated entities consist primarily of the following:

Morningstar Japan K.K. Morningstar Japan K.K. (MJKK) develops and markets products and services customized for the Japanese market. MJKK's shares are traded on the Osaka Stock Exchange, Hercules Market, using the ticker 4765. As of June 30, 2009 and December 31, 2008, we owned approximately 34% of MJKK. We account for our investment in MJKK using the equity method. The book value of our investment in MJKK totaled \$17,848,000 and \$18,083,000 as of June 30, 2009 and December 31, 2008, respectively. The market value of our investment in MJKK was approximately ¥3.6 billion (approximately U.S. \$37,448,000) as of June 30, 2009 and ¥2.9 billion (approximately U.S. \$32,536,000) as of December 31, 2008.

Morningstar Korea, Ltd. Morningstar Korea provides financial information and services for investors in South Korea. Our ownership interest and profit- and loss-sharing interest in Morningstar Korea was 40% as of June 30, 2009 and December 31, 2008. We account for this investment using the equity method. Our investment totaled \$1,553,000 and \$1,560,000 as of June 30, 2009 and December 31, 2008, respectively.

Other Investments in Unconsolidated Entities. As of June 30, 2009 and December 31, 2008, the book value of our other investments in unconsolidated entities totaled \$749,000 and \$761,000, respectively, and consist primarily of our investments in Morningstar Danmark A/S (Morningstar Denmark) and Morningstar Sweden AB (Morningstar Sweden). Morningstar Denmark and Morningstar Sweden develop and market products and services customized for their respective markets. Our ownership interest in both Morningstar Denmark and Morningstar Sweden was approximately 25% as of June 30, 2009 and December 31, 2008. We account for our investments in Morningstar Denmark and Morningstar Sweden using the equity method.

The following table shows unaudited condensed combined financial information for our investments in unconsolidated entities.

(\$000)	Three months ended June 30		Six months ended June 30		2008
	2009	2008	2009	2008	
Revenue	\$ 7,429	\$ 10,042	\$ 15,304	\$ 30,784	
Operating income	\$ 1,044	\$ 1,780	\$ 1,835	\$ 3,406	
Net income	\$ 804	\$ 1,424	\$ 1,445	\$ 2,553	

In April 2008, MJKK sold one of its subsidiaries. The information for the six months ended June 30, 2008 includes the financial results of this subsidiary.

8. Stock-Based Compensation

Stock-Based Compensation Plans

Our 2004 Stock Incentive Plan (the 2004 Plan) provides for grants of options, stock appreciation rights, restricted stock units, and performance shares. Prior to adopting the 2004 Plan, we granted stock options under various plans, including the 1993 Stock Option Plan, the 2000 Morningstar Stock Option Plan, and the 2001 Morningstar Stock Option Plan (collectively, the Prior Plans). The 2004 Plan amends and restates the Prior Plans. Under the 2004 Plan, we will not grant any additional options under any of the Prior Plans, and any shares subject to an award under any of the Prior Plans that are forfeited, canceled, settled, or otherwise terminated without a distribution of shares, or withheld by us in connection with the exercise of options or in payment of any required income tax withholding, will not be available for awards under the 2004 Plan. As of June 30, 2009, we had approximately 2,200,000 shares available for future grants under our 2004 Plan. All of our employees and our non-employee directors are eligible for awards under the 2004 Stock Incentive Plan. Joe Mansueto, our chairman and chief executive officer, does not participate in the 2004 Stock Incentive Plan or Prior Plans.

Under the 2004 Plan, we have granted stock options and, beginning in 2006, restricted stock units. Stock options granted under the 2004 Plan generally vest ratably over a four-year period and expire 10 years after the date of grant. Almost all of the options granted under the 2004 Plan have a premium feature in which the exercise price increases over the term of the option at a rate equal to the 10-year Treasury bond yield as of the date of grant. Restricted stock units represent the right to receive a share of Morningstar common stock when that unit vests. Restricted stock units granted under the 2004 Plan generally vest ratably over a four-year period. For restricted stock units granted through December 31, 2008, employees could elect to defer receipt of the Morningstar common stock issued upon vesting of the restricted stock unit.

Options granted under the Prior Plans generally vest over a four-year period and were substantially all vested as of June 30, 2009; however, because the options under the Prior Plans expire 10 years after the date of grant, some options granted under these plans remain outstanding as of June 30, 2009.

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In February 1999, we entered into an Incentive Stock Option Agreement and a Nonqualified Stock Option Agreement under the 1999 Incentive Stock Option Plan (the 1999 Plan) with Don Phillips, an officer of Morningstar. Under these agreements, we granted Don options to purchase 1,500,000 shares of common stock at an exercise price of \$2.77 per share, equal to the fair value at the grant date. These options were fully vested and expired in February 2009. The 30,576 options outstanding as of December 31, 2008 were exercised in 2009, prior to the expiration date.

Accounting for Stock-Based Compensation Awards

In accordance with SFAS No. 123(R), *Stock Based Compensation*, we estimate forfeitures of all employee stock-based awards and recognize compensation cost only for those awards expected to vest. We determine forfeiture rates based on historical experience. Estimated forfeitures are adjusted to actual forfeiture experience as needed.

The following table summarizes stock-based compensation expense:

(\$000)	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
Stock-based compensation expense	\$ 3,068	\$ 2,969	\$ 5,793	\$ 5,713

The income tax benefit related to the stock-based compensation expense above was \$967,000 and \$1,113,000 for the three months ended June 30, 2009 and 2008, respectively, and \$1,834,000 and \$2,004,000 for the six months ended June 30, 2009 and 2008, respectively.

Restricted Stock Units

We measure the fair value of our restricted stock units on the date of grant based on the closing market price of the underlying common stock on the day prior to grant. We amortize that value to stock-based compensation expense, net of estimated forfeitures, ratably over the vesting period. The total grant date fair value of restricted stock units granted in the first six months of 2009 was approximately \$13,291,000. As of June 30, 2009, the total amount of unrecognized stock-based compensation expense related to restricted stock units was approximately \$28,204,000. We expect to recognize this expense over an average period of approximately 36 months.

The following table summarizes restricted stock unit activity in the first six months of 2009:

Restricted Stock Units (RSUs)	Unvested	Vested but Deferred	Total	Weighted Average Grant Date Value
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					per RSU
RSUs outstanding December 31, 2008	494,500	22,024	516,524	\$	55.17
Granted	348,236		348,236		38.17
Vested	(121,942)		(121,942)		54.74
Vested but deferred	(17,561)	17,561			
Forfeited	(9,292)		(9,292)		52.84
RSUs outstanding June 30, 2009	693,941	39,585	733,526		46.94

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Stock Options

The following tables summarize stock option activity in the first six months of 2009 for our various stock option grants. The first table includes activity for options granted at an exercise price below the fair value per share of our common stock on the grant date; the second table includes activity for all other option grants.

		Underlying Shares		Weighted Average Exercise Price
Options Granted At an Exercise Price Below the Fair Value Per Share on the Grant Date				
Options outstanding	December 31, 2008	1,110,652	\$	15.33
Canceled		(175)		15.14
Exercised		(237,233)		10.19
Options outstanding	June 30, 2009	873,244		17.06
Options exercisable	June 30, 2009	873,119	\$	17.06

		Underlying Shares		Weighted Average Exercise Price
All Other Option Grants, Excluding Activity Shown Above				
Options outstanding	December 31, 2008	2,942,706	\$	15.14
Canceled		(2,754)		21.99
Exercised		(757,206)		13.89
Options outstanding	June 30, 2009	2,182,746		15.71
Options exercisable	June 30, 2009	2,159,818	\$	15.47

The total intrinsic value (difference between the market value of our stock on the date of exercise and the exercise price of the option) of options exercised during the six months ended June 30, 2009 and 2008 was \$25,041,000 and \$82,224,000, respectively.

The table below shows additional information for options outstanding and options exercisable as of June 30, 2009:

Range of Exercise Prices	Options Outstanding				Options Exercisable			
	Outstanding Shares	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Aggregate Intrinsic Value (\$000)	Exercisable Shares	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Aggregate Intrinsic Value (\$000)
\$8.57 - \$14.70	1,646,376	2.04	\$ 12.18	\$ 47,827	1,646,233	2.04	\$ 12.18	\$ 47,822
\$17.79 - \$40.26	1,409,614	5.71	20.67	28,954	1,386,704	5.70	20.37	28,903
\$8.57 - \$40.26	3,055,990	3.73	16.09	\$ 76,781	3,032,937	3.71	15.93	\$ 76,725
Vested or Expected to Vest:								
\$8.57 - \$40.26	3,053,862	3.73	\$ 16.08	\$ 76,776				

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The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing stock price of \$41.23 on June 30, 2009, which would have been received by the option holders had all option holders exercised their options as of that date.

As of June 30, 2009, the total amount of unrecognized stock-based compensation expense related to non-vested stock options was approximately \$114,000. We expect to recognize this expense over a weighted average period of approximately five months.

Table of Contents**9. Related Party Transactions**

In February 1999, in conjunction with the expiration of options granted under the 1989 Nonqualified Stock Option Plan, we entered into a Deferred Compensation Agreement (the Agreement) with Don Phillips, an officer of Morningstar. Under the terms of the Agreement, on any date that Don exercises the right to purchase shares under the 1999 Plan, we shall pay to him \$2.69 per share in the form of cash or, at our election, shares of common stock. Our obligation to pay deferred compensation will not be increased by any imputed interest or earnings amount.

As of December 31, 2008, our Condensed Consolidated Balance Sheet included a liability of \$82,000 for the Agreement. This amount was paid to Don in the first six months of 2009 in accordance with the Agreement.

10. Income Taxes

The following table shows our effective income tax rate for the three and six months ended June 30, 2009 and 2008:

(\$000)	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
Income before income taxes and equity in net income (loss) of unconsolidated entities	\$ 34,660	\$ 42,717	\$ 69,819	\$ 79,193
Equity in net income (loss) of unconsolidated entities	(21)	445	361	797
Net (income) loss attributable to the noncontrolling interest	(71)	(87)	18	(335)
Total	\$ 34,568	\$ 43,075	\$ 70,198	\$ 79,655
Income tax expense	\$ 14,024	\$ 15,076	\$ 24,692	\$ 28,580
Effective tax rate	40.6%	35.0%	35.2%	35.9%

Our effective tax rate increased by 5.6 percentage points in the second quarter of 2009. A deposit penalty of \$3,500,000, which decreased pre-tax income and which is not deductible for tax purposes, accounted for 3.7 percentage points of the increase. Year-to-date, our effective tax rate decreased to 35.2% from 35.9% in 2008. The year-to-date effective tax rate reflects the impact from the first quarter of 2009 of reversing a \$1,420,000 reserve for uncertain tax positions as a result of a lapse in the statute of limitations and the reversal in the second quarter of 2009 of \$635,000 of reserves due to settlements and other audit activity. These non-cash benefits contributed approximately 3 percentage points of the decrease in the effective tax rate in the year-to-date period. This reduction in our effective tax rate was partially offset by the impact of the non-deductible deposit penalty expense, which increased our effective tax rate by approximately 2 percentage points in the year-to-date period.

We conduct business globally and as a result, we file income tax returns in U.S. Federal, state, local, and foreign jurisdictions. In the normal course of business we are subject to examination by tax authorities throughout the world. The open tax years for our U.S. Federal tax return include the years 2005 to the present. Most of our state tax returns have open tax years from 2005 to the present. In non-U.S. jurisdictions, the statute of limitations generally extends to years prior to 2003.

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As of June 30, 2009, our Consolidated Balance Sheet includes a current liability of \$1,356,000 and a non-current liability of \$3,796,000 for unrecognized tax benefits. As of December 31, 2008, our Consolidated Balance Sheet includes a current liability of \$3,983,000 and a non-current liability of \$3,756,000 for unrecognized tax benefits. These amounts include interest and penalties, less any associated tax benefits. The decrease in the liability from December 31, 2008 primarily reflects the reversal of \$2,055,000 of reserves for uncertain tax positions, which reduced our effective tax rate.

We are currently being audited by the U.S. federal and various state and local tax authorities in the United States as well as the tax authorities in certain non-U.S. jurisdictions. It is likely that the examination phase of some of these audits will conclude in 2009. It is not possible to estimate the impact of current audits on previously recorded unrecognized tax benefits.

Our effective income tax rate reflects the fact that we are not recording an income tax benefit related to losses recorded by certain of our non-U.S. operations. The net operating losses (NOLs) may become deductible in certain non-U.S. tax jurisdictions to the extent these non-U.S. operations become profitable. In the year certain non-U.S. entities record a loss, we do not record a corresponding tax benefit, thus increasing our effective tax rate. 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. 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.

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11. Contingencies

Estimated Penalties Related to the Timing of Deposits for Taxes Withheld on Non-Qualified Stock Option Exercises

In the second quarter of 2009, we recorded an operating expense of \$3,500,000 for estimated penalties related to the timing of deposits for taxes withheld on stock option exercises from 2006 through June 30, 2009. We recorded this operating expense and the related liability in accordance with SFAS No. 5, *Accounting for Contingencies*. For some companies, including Morningstar, it is common practice for taxes withheld on stock-based compensation to be paid with the company's regularly scheduled payroll deposit. This approach, however, does not technically comply with Internal Revenue Service guidelines concerning deposits of taxes withheld in connection with stock-based compensation, which generally require that if a company's cumulative deposit liability for all compensation exceeds \$100,000, the tax withholding must be deposited by the following business day. Transactions related to stock-based compensation frequently cause companies to exceed this threshold outside of their regularly scheduled payroll cycles, thus triggering the accelerated deposit rules. The subject of tax deposit penalties is part of an ongoing IRS audit that began in 2009. We have since increased the frequency of deposits for taxes withheld on stock option exercises.

NewRiver, Inc.

In January 2009, NewRiver, Inc. filed a lawsuit in the Superior Court of the Commonwealth of Massachusetts against Morningstar, Inc. alleging that Morningstar inappropriately accessed a database containing SEC-filed mutual fund disclosure documents. In February 2009, the case was removed to the United States District Court for the District of Massachusetts. NewRiver seeks, among other things, a permanent injunction preventing Morningstar from accessing NewRiver's Prospectus Express Web-based data warehouse, and unspecified damages. While Morningstar is vigorously contesting the claims against it, we cannot predict the outcome of the proceeding.

Morningstar Associates, LLC Subpoenas from the Securities and Exchange Commission, the New York Attorney General's Office, and the Department of Labor

Securities and Exchange Commission

In February 2005, Morningstar Associates, LLC, a wholly owned subsidiary of Morningstar, Inc., received a request from the SEC for the voluntary production of documents relating to the investment consulting services the company offers to retirement plan providers, including fund lineup recommendations for retirement plan sponsors. In July 2005, the SEC issued a subpoena to Morningstar Associates that was virtually identical to its February 2005 request.

Subsequently, the SEC focused on disclosure relating to an optional service offered to retirement plan sponsors (employers) that select 401(k) plan services from ING, one of Morningstar Associates' clients. In response to the SEC investigation, ING and Morningstar Associates revised certain documents for plan sponsors to further clarify the roles of ING and Morningstar Associates

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in providing that service. The revisions also help reinforce that Morningstar Associates makes its selections only from funds available within ING's various retirement products.

In January 2007, the SEC notified Morningstar Associates that it ended its investigation, with no enforcement action, fines, or penalties.

New York Attorney General's Office

In December 2004, Morningstar Associates received a subpoena from the New York Attorney General's office seeking information and documents related to an investigation the New York Attorney General's office is conducting. The request is similar in scope to the SEC subpoena described above. Morningstar Associates has provided the requested information and documents.

In January 2007, Morningstar Associates received a Notice of Proposed Litigation from the New York Attorney General's office. The Notice centers on the same issues that became the focus of the SEC investigation described above. The Notice gave Morningstar Associates the opportunity to explain why the New York Attorney General's office should not institute proceedings. Morningstar Associates promptly submitted its explanation and has cooperated fully with the New York Attorney General's office.

We cannot predict the scope, timing, or outcome of this matter, which may include the institution of administrative, civil, injunctive, or criminal proceedings, the imposition of fines and penalties, and other remedies and sanctions, any of which could lead to an adverse impact on our stock price, the inability to attract or retain key employees, and the loss of customers. We also cannot predict what impact, if any, this matter may have on our business, operating results, or financial condition.

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United States Department of Labor

In May 2005, Morningstar Associates received a subpoena from the United States Department of Labor, seeking information and documents related to an investigation the Department of Labor is conducting. The Department of Labor subpoena is substantially similar in scope to the SEC and New York Attorney General subpoenas.

In January 2007, the Department of Labor issued a request for additional documents pursuant to the May 2005 subpoena, including documents and information regarding Morningstar Associates' retirement advice products for plan participants. Morningstar Associates continues to cooperate fully with the Department of Labor.

We cannot predict the scope, timing, or outcome of this matter, which may include the institution of administrative, civil, injunctive, or criminal proceedings, the imposition of fines and penalties, and other remedies and sanctions, any of which could lead to an adverse impact on our stock price, the inability to attract or retain key employees, and the loss of customers. We also cannot predict what impact, if any, these matters may have on our business, operating results, or financial condition.

12. Subsequent Events

We evaluated events for potential recognition and disclosure in the Condensed Consolidated Financial Statements and Notes thereto presented in this Quarterly Report on Form 10Q through August 4, 2009, the date the financial statements were issued.

13. Recently Issued Accounting Pronouncements

In June 2009, the FASB issued the following accounting pronouncements:

- SFAS No. 166, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement 140*, and SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*

These accounting pronouncements change the way entities account for transfers of financial assets and determine what entities must be consolidated. The most significant amendment resulting from SFAS No. 166 consists of the removal of the concept of a Qualifying Special-Purpose Entity (QSPE) from SFAS No. 140.

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SFAS No. 167 addresses the effects of eliminating the QSPE concept from SFAS No. 140 and responds to concerns about the application of certain key provisions of FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities (FIN 46(R))*, including concerns over the transparency of enterprises' involvement with Variable Interest Entities (VIEs).

For Morningstar, both SFAS No. 166 and SFAS No. 167 will be effective beginning January 1, 2010. We are in the process of determining the impact, if any, these accounting pronouncements will have on our Consolidated Financial Statements.

- SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* a replacement of FASB Statement No. 162

The FASB's *Accounting Standards Codification (ASC)* will become the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the SEC. The Codification reorganizes the thousands of U.S. GAAP pronouncements into roughly 90 accounting topics and displays all topics using a consistent structure. It also includes relevant SEC guidance that follows the same topical structure in separate sections in the Codification. SFAS No. 168 is the final standard that will be issued by FASB in the current form. For Morningstar, this Statement will be applied beginning with our financial statements for the quarter and year-to-date period ended September 30, 2009. We are in the process of determining the impact this accounting pronouncement will have on our Consolidated Financial Statement disclosures.

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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. These statements 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, general industry conditions and competition, including the current global financial crisis that began in 2007; the impact of market volatility on revenue from asset-based fees; damage to our reputation resulting from claims made about possible conflicts of interest; liability for any losses that result from an actual or claimed breach of our fiduciary duties; financial services industry consolidation; a prolonged outage of our database and network facilities; challenges faced by our non-U.S. operations; and the availability of free or low-cost investment information.

A more complete description of these risks and uncertainties can be found in our other filings with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2008. 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 prior 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 Internet, software, and print-based products for individual investors, financial advisors, and institutional clients. We also offer asset management services for advisors, institutions, and retirement plan participants. Many of our products are sold through subscriptions or license agreements. As a result, we typically generate recurring revenue.

We emphasize a decentralized approach to running our business to create a culture of responsibility and accountability. Beginning in 2009, we changed our segment reporting to focus on two operating segments: Investment Information, which includes all of our data, software, and research products and services, and Investment Management, which includes our asset management operations.

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Historically, we have focused primarily on organic growth by introducing new products and services and expanding our existing products. However, we have made and expect to continue to make selective acquisitions that support our five key growth strategies, which are:

- Enhance our position in each of our key market segments by focusing on our three major Internet-based platforms;
- Become a global leader in funds-of-funds investment management;
- Continue building thought leadership in independent investment research;
- Create a premier global investment database; and
- Expand our international brand presence, products, and services.

Industry Overview

We monitor developments in the economic and financial information industry on an ongoing basis and use these insights to help inform our company strategy, product development plans, and marketing initiatives.

The U.S. equity market generally showed strong performance in the second quarter of 2009, reversing direction from continued negative returns in the first quarter. Morningstar's U.S. Market Index, a broad market benchmark, was up 16.6% during the quarter and 4.3% for the first half of 2009. Total U.S. mutual fund assets increased to \$10.0 trillion as of June 30, 2009 based on data from the Investment Company Institute (ICI), compared with \$9.2 trillion as of March 31, 2009. Many stock and bond funds experienced net inflows as the market turned up during the quarter.

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Despite the more positive market environment, alternative asset classes, such as hedge funds, continued to show mixed results. In aggregate, hedge funds included in Morningstar's database, excluding funds of hedge funds, experienced net outflows of about \$53 billion for the year-to-date period through May 31, 2009.

Assets in exchange-traded funds (ETFs) increased to \$590 billion as of June 2009, compared with \$578 billion as of June 2008, based on data from the ICI.

Based on data from Nielsen/Net Ratings, aggregate page views and pages viewed per visit for financial and investment sites were both up slightly compared with the second quarter of 2008, while the number of unique users was similar to levels shown in the second quarter of 2008. Although page views to Morningstar.com declined year over year because of reduced traffic to several areas of the site, the site continued to perform well based on metrics such as pages viewed per visit and time spent per visit.

Market weakness and economic uncertainty continued to weigh on the global advertising market. Some industry researchers, including ZenithOptimedia and GroupM, have revised their forecasts for global advertising sales to project continued downturns in 2009. Although online advertising has held up better than other areas as advertisers have continued to shift spending from traditional media to the Internet, we believe that spending trends in the financial services area remain under pressure. Some industry surveys indicate that many investment management firms plan to continue reducing their marketing budgets in 2009.

Overall, we remain cautious because of the difficult market environment, which has persisted in the wake of the financial crisis that began in 2008. Despite the recent upturn in the U.S. equity market, we believe asset management firms and other financial services companies continue to carefully scrutinize their spending levels, creating additional pricing pressure and increasing the time required to close new business and renewals. On the positive side, however, we believe some of the uncertainty in the financial services sector began easing during the first half of the year.

Three and Six Months Ended June 30, 2009 vs. Three and Six Months Ended June 30, 2008**Consolidated Results**

Key Metrics (\$000)	Three Months Ended June 30			Six Months Ended June 30		
	2009	2008	Change	2009	2008	Change
Revenue	\$ 119,533	\$ 132,237	(9.6)%	\$ 236,265	\$ 257,681	(8.3)%
Operating income	32,688	41,570	(21.4)%	67,313	76,255	(11.7)%
Operating margin	27.3%	31.4%	(4.1)pp	28.5%	29.6%	(1.1)pp
Cash provided by (used for) investing activities	(26,652)	4,859	NMF	(36,855)	(33,104)	11.3%
Cash provided by financing activities	12,913	18,217	(29.1)%	16,019	29,934	(46.5)%

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Cash provided by operating activities	\$	39,589	\$	47,742	(17.1)%	\$	31,267	\$	49,119	(36.3)%
Capital expenditures		(2,178)		(10,643)	(79.5)					