

Morningstar, Inc.
Form 10-Q
July 30, 2015

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED June 30, 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

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As of July 24, 2015, there were 44,247,059 shares of the Company's common stock, no par value, outstanding.

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

(in millions except per share amounts)	Three months ended June 30		Six months ended June 30	
	2015	2014	2015	2014
Revenue	\$202.1	\$189.4	\$391.9	\$370.6
Operating expense:				
Cost of revenue	83.2	81.5	161.8	157.1
Sales and marketing	25.1	27.9	50.5	56.4
General and administrative	27.8	30.4	53.9	56.5
Depreciation and amortization	16.3	13.4	31.4	25.8
Litigation settlement	—	61.0	—	61.0
Total operating expense	152.4	214.2	297.6	356.8
Operating income (loss)	49.7	(24.8)	94.3	13.8
Non-operating income (expense):				
Interest income, net	0.1	0.6	0.3	1.2
Gain on sale of investments, reclassified from other comprehensive income	0.5	0.4	0.4	0.3
Holding gain upon acquisition of additional ownership of equity and cost method investments	—	5.2	—	5.2
Other expense, net	—	(0.3)	(0.4)	—
Non-operating income, net	0.6	5.9	0.3	6.7
Income (loss) before income taxes and equity in net income of unconsolidated entities	50.3	(18.9)	94.6	20.5
Equity in net income of unconsolidated entities	0.6	0.5	1.0	1.1
Income tax expense (benefit)	18.7	(8.6)	33.6	5.0
Consolidated net income (loss)	32.2	(9.8)	62.0	16.6
Net income attributable to the noncontrolling interest	—	—	(0.2)	—
Net income (loss) attributable to Morningstar, Inc.	\$32.2	\$(9.8)	\$61.8	\$16.6
Net income (loss) per share attributable to Morningstar, Inc.:				
Basic	\$0.73	\$(0.22)	\$1.39	\$0.37
Diluted	\$0.72	\$(0.22)	\$1.39	\$0.37
Dividends per common share:				
Dividends declared per common share	\$0.19	\$0.17	\$0.38	\$0.34
Dividends paid per common share	\$0.19	\$0.17	\$0.38	\$0.34

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Weighted average shares outstanding:

Basic	44.3	44.8	44.3	44.8
Diluted	44.4	44.8	44.4	45.0

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)

(in millions)	Three months ended June 30		Six months ended June 30	
	2015	2014	2015	2014
Consolidated net income (loss)	\$32.2	\$(9.8	) \$62.0	\$16.6
Other comprehensive income (loss):				
Foreign currency translation adjustment	8.8	2.9	(11.0	) 5.3
Unrealized gains (losses) on securities, net of tax:				
Unrealized holding gains (losses) arising during period	(0.6	) 0.3	(0.5	) 0.4
Reclassification (gains) losses included in net income	0.3	(0.3	) 0.3	(0.2
Other comprehensive income (loss)	8.5	2.9	(11.2	) 5.5
Comprehensive income (loss)	40.7	(6.9	) 50.8	22.1
Comprehensive income attributable to noncontrolling interest	—	—	(0.2) —
Comprehensive income (loss) attributable to Morningstar, Inc.	\$40.7	\$(6.9) \$50.6	\$22.1

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(in millions except share amounts)	As of June 30 2015	As of December 31 2014
Assets		
Current assets:		
Cash and cash equivalents	\$225.6	\$ 185.2
Investments	33.0	39.4
Accounts receivable, less allowance of \$1.9 and \$1.5, respectively	143.9	136.7
Deferred tax asset, net	10.5	9.0
Income tax receivable	—	6.9
Other current assets	22.4	22.6
Total current assets	435.4	399.8
Property, equipment, and capitalized software, less accumulated depreciation and amortization of \$151.0 and \$132.9, respectively	122.6	117.6
Investments in unconsolidated entities	34.9	28.8
Goodwill	364.2	370.1
Intangible assets, net	83.5	95.9
Other assets	7.0	7.1
Total assets	\$1,047.6	\$ 1,019.3
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$36.0	\$ 34.3
Accrued compensation	58.9	80.5
Deferred revenue	163.1	146.0
Short-term debt	35.0	30.0
Income tax payable	8.4	—
Other current liabilities	3.6	3.0
Total current liabilities	305.0	293.8
Accrued compensation	8.2	7.9
Deferred tax liability, net	28.7	26.0
Deferred rent	26.3	26.4
Other long-term liabilities	9.5	10.8
Total liabilities	377.7	364.9
Equity:		
Morningstar, Inc. shareholders' equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 44,247,059 and 44,345,763 shares were outstanding as of June 30, 2015 and December 31, 2014, respectively	—	—
Treasury stock at cost, 8,605,118 shares as of June 30, 2015 and 8,257,214 shares as of December 31, 2014	(550.6	) (524.3
Additional paid-in capital	569.0	561.1
Retained earnings	686.4	641.5
Accumulated other comprehensive income (loss):		
Currency translation adjustment	(36.1) (25.1
Unrealized gain on available-for-sale investments	0.1	0.3

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Total accumulated other comprehensive loss	(36.0) (24.8)
Total Morningstar, Inc. shareholders' equity	668.8	653.5	
Noncontrolling interests	1.1	0.9	
Total equity	669.9	654.4	
Total liabilities and equity	\$1,047.6	\$1,019.3	

See notes to unaudited condensed consolidated financial statements.

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

(in millions, except share amounts)	Morningstar, Inc. Shareholders' Equity					Accumulated Other Comprehensive Income (Loss)	Non- Controlling Interests	Total Equity
	Common Stock Shares Outstanding	Par Value	Treasury Stock	Additional Paid-in Capital	Retained Earnings			
Balance as of December 31, 2014	44,345,763	\$—	\$(524.3)	\$561.1	\$641.5	\$(24.8)	\$0.9	\$654.4
Net income		—	—	—	61.8	—	0.2	62.0
Other comprehensive loss:								
Unrealized loss on available-for-sale investments, net of income tax of \$0.3		—	—	—	—	(0.5)	—	(0.5)
Reclassification of adjustments for losses included in net income, net of income tax of \$0.2		—	—	—	—	0.3	—	0.3
Foreign currency translation adjustment, net		—	—	—	—	(11.0)	—	(11.0)
Other comprehensive loss, net		—	—	—	—	(11.2)	—	(11.2)
Issuance of common stock related to stock-option exercises and vesting of restricted stock units, net	267,066	—	1.4	(3.1)	—	—	—	(1.7)
Stock-based compensation		—	—	8.9	—	—	—	8.9
Excess tax benefit derived from stock-option exercises and vesting of restricted stock units		—	—	2.1	—	—	—	2.1
Common shares repurchased	(365,770)	—	(27.7)	—	—	—	—	(27.7)
Dividends declared — common shares outstanding		—	—	—	(16.9)	—	—	(16.9)
Balance as of June 30, 2015	44,247,059	\$—	\$(550.6)	\$569.0	\$686.4	\$(36.0)	\$1.1	\$669.9

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

(in millions)	Six months ended June 30	
	2015	2014
Operating activities		
Consolidated net income	\$62.0	\$16.6
Adjustments to reconcile consolidated net income to net cash flows from operating activities:		
Depreciation and amortization	31.4	25.8
Deferred income taxes	1.3	(2.6)
Stock-based compensation expense	8.9	8.3
Provision for (recoveries of) bad debts	0.4	(0.3)
Equity in net income of unconsolidated entities	(1.0)	(1.1)
Excess tax benefits from stock-option exercises and vesting of restricted stock units	(2.1)	(1.9)
Holding gain upon acquisition of additional ownership of equity and cost method investments	—	(5.2)
Other, net	—	(0.8)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(8.8)	(19.3)
Other assets	—	0.2
Accounts payable and accrued liabilities	2.0	61.2
Accrued compensation	(18.1)	(8.7)
Income taxes—current	15.7	(12.2)
Deferred revenue	19.1	8.8
Deferred rent	0.1	(1.0)
Other liabilities	—	(1.1)
Cash provided by operating activities	110.9	66.7
Investing activities		
Purchases of investments	(14.0)	(7.7)
Proceeds from maturities and sales of investments	20.5	95.5
Capital expenditures	(27.6)	(30.8)
Acquisitions, net of cash acquired	—	(64.4)
Other, net	(5.1)	0.2
Cash used for investing activities	(26.2)	(7.2)
Financing activities		
Common shares repurchased	(27.7)	(36.7)
Dividends paid	(16.9)	(15.3)
Proceeds from short-term debt	15.0	—
Repayment of short-term debt	(10.0)	—
Proceeds from stock-option exercises	3.2	2.1
Employee taxes withheld for restricted stock units	(4.9)	(5.0)
Excess tax benefits from stock-option exercises and vesting of restricted stock units	2.1	1.9
Other, net	0.1	—
Cash used for financing activities	(39.1)	(53.0)

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Effect of exchange rate changes on cash and cash equivalents	(5.2) 1.6
Net increase in cash and cash equivalents	40.4	8.1
Cash and cash equivalents—beginning of period	185.2	168.2
Cash and cash equivalents—end of period	\$225.6	\$176.3
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$14.5	\$19.9
Supplemental information of non-cash investing and financing activities:		
Unrealized gain on available-for-sale investments	\$0.3	\$0.3
Equipment obtained under long-term financing arrangement	\$1.3	\$—

See notes to unaudited condensed consolidated financial statements.

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MORNINGSTAR, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation of Interim Financial Information

The accompanying condensed consolidated financial statements of Morningstar, Inc. and subsidiaries (Morningstar, we, our, the company) have been prepared to conform to the rules and regulations of the Securities and Exchange Commission (SEC). The preparation of financial statements in conformity with accounting principles generally accepted in the United States (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.

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3. Credit Arrangements

In July 2015, we renewed our \$75.0 million, single-bank revolving credit facility. We had an outstanding principal balance of \$35.0 million at an interest rate of LIBOR plus 100 basis points as of June 30, 2015. On July 20, 2015, we repaid the outstanding principal balance of \$35.0 million, leaving full availability of the facility.

4. Goodwill and Other Intangible Assets

Goodwill

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

	(in millions)
Balance as of December 31, 2014	\$370.1
Foreign currency translation	(5.9)
Balance as of June 30, 2015	\$364.2

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

Intangible Assets

The following table summarizes our intangible assets:

(in millions)	As of June 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	\$28.6	\$ (25.9)	\$2.7	9	\$29.0	\$ (25.0)	\$4.0	9
Customer-related assets	139.4	(88.2)	51.2	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	88.5	(61.2)	27.3	8	88.8	(57.4)	31.4	8
Non-competition agreement	4.3	(2.1)	2.2	5	4.4	(1.9)	2.5	5
Total intangible assets	\$261.0	\$ (177.5)	\$83.5	10	\$263.9	\$ (168.0)	\$95.9	10

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

(in millions)	Three months ended June 30		Six months ended June 30	
	2015	2014	2015	2014
Amortization expense	\$5.4	\$5.5	\$10.9	\$10.6

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

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

	(in millions)
Remainder of 2015 (from July 1 through December 31)	\$10.8
2016	17.2
2017	12.8
2018	10.6
2019	7.9
Thereafter	24.2

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.

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5. Income Per Share

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

(in millions, except per share amounts)	Three months ended June 30		Six months ended June 30	
	2015	2014	2015	2014
Basic net income (loss) per share attributable to Morningstar, Inc.:				
Net income (loss) attributable to Morningstar, Inc.:	\$32.2	\$(9.8	) \$61.8	\$16.6
Less: Distributed earnings available to participating securities	—	—	—	—
Less: Undistributed earnings available to participating securities	—	—	—	—
Numerator for basic net income (loss) per share — undistributed and distributed earnings available to common shareholders	\$32.2	\$(9.8	) \$61.8	\$16.6
Weighted average common shares outstanding	44.3	44.8	44.3	44.8
Basic net income (loss) per share attributable to Morningstar, Inc.	\$0.73	\$(0.22	) \$1.39	\$0.37
Diluted net income (loss) per share attributable to Morningstar, Inc.:				
Numerator for basic net income (loss) per share — undistributed and distributed earnings available to common shareholders	\$32.2	\$(9.8	) \$61.8	\$16.6
Add: Undistributed earnings allocated to participating securities	—	—	—	—
Less: Undistributed earnings reallocated to participating securities	—	—	—	—
Numerator for diluted net income (loss) per share — undistributed and distributed earnings available to common shareholders	\$32.2	\$(9.8	) \$61.8	\$16.6
Weighted average common shares outstanding	44.3	44.8	44.3	44.8
Net effect of dilutive stock options, restricted stock units, and performance share awards	0.1	—	0.1	0.2
Weighted average common shares outstanding for computing diluted income per share	44.4	44.8	44.4	45.0
Diluted net income (loss) per share attributable to Morningstar, Inc.	\$0.72	\$(0.22) \$1.39	\$0.37

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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 June 30		Six months ended June 30	
	2015	2014	2015	2014
Weighted average stock options	—	160	—	—