

Morningstar, Inc.
Form 10-Q
November 06, 2013

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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 September 30, 2013

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

As of October 31, 2013, there were 45,953,013 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 Income

(in thousands except per share amounts)	Three months ended September		Nine months ended September		
	30 2013	2012	30 2013	2012	
Revenue	\$ 173,482	\$ 160,952	\$ 517,766	\$ 487,679	
Operating expense (1):					
Cost of revenue	72,422	60,568	198,499	186,143	
Sales and marketing	22,774	25,732	78,789	81,431	
General and administrative	22,416	23,966	77,863	77,090	
Depreciation and amortization	11,257	10,822	33,858	31,616	
Total operating expense	128,869	121,088	389,009	376,280	
Operating income	44,613	39,864	128,757	111,399	
Non-operating income (expense):					
Interest income, net	630	1,719	2,035	3,848	
Gain (loss) on sale of investments, reclassified from other comprehensive income	(42) (4) 1,106	(52)
Holding gain (loss) upon acquisition of additional ownership of equity method investments	(78	) —	3,635	—
Other income (expense), net	261	165	(1,949) (262)
Non-operating income, net	771	1,880	4,827	3,534	
Income before income taxes and equity in net income of unconsolidated entities	45,384	41,744	133,584	114,933	
Income tax expense	14,265	15,186	42,647	41,441	
Equity in net income of unconsolidated entities	315	478	1,172	1,541	
Consolidated net income	31,434	27,036	92,109	75,033	
Net loss attributable to the noncontrolling interest	29	34	93	62	
Net income attributable to Morningstar, Inc.	\$ 31,463	\$ 27,070	\$ 92,202	\$ 75,095	
Net income per share attributable to Morningstar, Inc.:					
Basic	\$0.68	\$0.56	\$1.99	\$1.53	
Diluted	\$0.68	\$0.56	\$1.98	\$1.51	
Dividends per common share:					
Dividends declared per common share	\$—	\$0.10	\$0.25	\$0.30	
Dividends paid per common share	\$0.13	\$0.10	\$0.25	\$0.30	

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Weighted average shares outstanding:

Basic	46,080	47,975	46,293	49,028
Diluted	46,519	48,481	46,635	49,664

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012

(1) Includes stock-based compensation expense of:

Cost of revenue	\$1,471	\$1,619	\$4,863	\$4,739
Sales and marketing	456	493	1,490	1,433
General and administrative	1,489	1,882	4,800	5,422
Total stock-based compensation expense	\$3,416	\$3,994	\$11,153	\$11,594

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Comprehensive Income

(in thousands)	Three months ended September		Nine months ended September	
	30 2013	2012	30 2013	2012
Consolidated net income	\$31,434	\$27,036	\$92,109	\$75,033
Other comprehensive income (loss):				
Foreign currency translation adjustment	11,247	7,375	(4,952	) 5,597
Unrealized gains on securities, net of tax:				
Unrealized holding gains arising during period	774	1,026	1,774	1,394
Reclassification of (gains) losses included in net income	28	—	(706	) 33
Other comprehensive income (loss)	12,049	8,401	(3,884	) 7,024
Comprehensive income	43,483	35,437	88,225	82,057
Comprehensive loss attributable to noncontrolling interest	40	16	246	77
Comprehensive income attributable to Morningstar, Inc.	\$43,523	\$35,453	\$88,471	\$82,134

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(in thousands except share amounts)	As of September 30 2013	As of December 31 2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 176,959	\$ 163,889
Investments	165,918	157,529
Accounts receivable, less allowance of \$1,005 and \$569, respectively	113,688	114,361
Deferred tax asset, net	3,155	3,741
Income tax receivable, net	3,451	14,267
Other current assets	26,229	20,823
Total current assets	489,400	474,610
Property, equipment, and capitalized software, less accumulated depreciation and amortization of \$101,046 and \$87,510, respectively	99,007	84,022
Investments in unconsolidated entities	38,376	35,305
Goodwill	326,741	320,845
Intangible assets, net	109,269	116,732
Other assets	11,357	10,438
Total assets	\$ 1,074,150	\$ 1,041,952
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 35,984	\$ 43,777
Accrued compensation	60,745	67,317
Deferred revenue	151,850	146,015
Other current liabilities	6,760	256
Total current liabilities	255,339	257,365
Accrued compensation	8,467	8,281
Deferred tax liability, net	22,188	21,583
Deferred rent	13,966	15,368
Other long-term liabilities	15,714	12,460
Total liabilities	315,674	315,057
Equity:		
Morningstar, Inc. shareholders' equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 46,068,303 and 46,541,571 shares were outstanding, respectively	5	5
Treasury stock at cost, 6,024,254 shares and 5,214,070 shares, respectively	(358,616	) (301,839
Additional paid-in capital	533,146	521,285
Retained earnings	576,828	496,354
Accumulated other comprehensive income:		
Currency translation adjustment	4,126	8,925
Unrealized gain on available-for-sale investments	1,855	787
Total accumulated other comprehensive income	5,981	9,712
Total Morningstar, Inc. shareholders' equity	757,344	725,517
Noncontrolling interest	1,132	1,378
Total equity	758,476	726,895

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Total liabilities and equity	\$1,074,150	\$ 1,041,952
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See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries
 Unaudited Condensed Consolidated Statement of Equity
 For the nine months ended September 30, 2013

(in thousands, 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	Treasury Stock	Additional Paid-in Capital	Retained Earnings			
Balance as of December 31, 2012	46,541,571	\$5	\$(301,839)	\$521,285	\$496,354	\$9,712	\$1,378	\$726,895
Net income (loss)		—	—	—	92,202	—	(93)	92,109
Other comprehensive income (loss):								
Unrealized gain on available-for-sale investments, net of income tax of \$605		—	—	—	—	1,774	—	1,774
Reclassification of adjustments for gains included in net income, net of income tax of \$399		—	—	—	—	(706)	—	(706)
Foreign currency translation adjustment, net		—	—	—	—	(4,799)	(153)	(4,952)
Other comprehensive loss, net		—	—	—	—	(3,731)	(153)	(3,884)
Issuance of common stock related to stock-option exercises and vesting of restricted stock units, net	356,023	—	1,350	(3,454)	—	—	—	(2,104)
Stock-based compensation — restricted stock units		—	—	10,493	—	—	—	10,493
Stock-based compensation — restricted stock		—	—	291	—	—	—	291
Stock-based compensation — stock-options		—	—	369	—	—	—	369
Excess tax benefit derived from stock-option exercises and vesting of restricted stock units		—	—	4,093	—	—	—	4,093
Common shares repurchased	(829,291)	—	(58,127)	—	—	—	—	(58,127)
Dividends declared — common shares outstanding		—	—	—	(11,578)	—	—	(11,578)
Dividends declared — restricted stock units		—	—	69	(150)	—	—	(81)
Balance as of September 30, 2013	46,068,303	\$5	\$(358,616)	\$533,146	\$576,828	\$5,981	\$1,132	\$758,476

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)	Nine months ended September	
	2013	2012
Operating activities		
Consolidated net income	\$92,109	\$75,033
Adjustments to reconcile consolidated net income to net cash flows from operating activities:		
Depreciation and amortization	33,858	31,616
Deferred income taxes	(2,315)	) 492
Stock-based compensation expense	11,153	11,594
Provision for bad debts	730	990
Equity in net income of unconsolidated entities	(1,172)	) (1,541)
Excess tax benefits from stock-option exercises and vesting of restricted stock units	(4,093)	) (5,007)
Holding gain upon acquisition of additional ownership of equity method investments	(3,635)) —
Other, net	12	342
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(1,249)	) (6,569)
Other assets	(2,887)	) (3,551)
Accounts payable and accrued liabilities	(3,151)	) (4,316)
Accrued compensation	(8,404)	) (20,851)
Income taxes—current	17,205	7,220
Deferred revenue	6,004	7,684
Deferred rent	(1,273)	) 291
Other liabilities	(679)	) (1,111)
Cash provided by operating activities	132,213	92,316
Investing activities		
Purchases of investments	(113,824)	) (134,929)
Proceeds from maturities and sales of investments	108,599	216,350
Capital expenditures	(27,950)	) (22,876)
Acquisitions, net of cash acquired	(11,079)) —
Proceeds from sale of a business	957	—
Purchases of equity- and cost-method investments	(2,751)	) (10,304)
Other, net	432	(4)
Cash provided by (used for) investing activities	(45,616)	) 48,237
Financing activities		
Proceeds from stock-option exercises	3,172	6,752
Employee taxes withheld for restricted stock units	(5,276)	) (3,992)
Excess tax benefits from stock-option exercises and vesting of restricted stock units	4,093	5,007
Common shares repurchased	(62,794)	) (183,698)
Dividends paid	(11,657)) (14,867)
Other, net	(54)) (18)
Cash used for financing activities	(72,516)) (190,816)

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Effect of exchange rate changes on cash and cash equivalents	(1,011) 2,007	
Net increase (decrease) in cash and cash equivalents	13,070	(48,256)
Cash and cash equivalents—beginning of period	163,889	200,437	
Cash and cash equivalents—end of period	\$176,959	\$152,181	

Supplemental disclosure of cash flow information:

Cash paid for income taxes