

# MORNINGSTAR, INC.

## FORM 8-K/A (Unscheduled Material Events)

Filed 5/12/2006 For Period Ending 3/1/2006

Address	225 WEST WACKER DRIVE CHICAGO, Illinois 60606
Telephone	(312) 696-6000
CIK	0001289419
Industry	Computer Services
Sector	Technology
Fiscal Year	12/31

Powered By **EDGAR**Online

<http://www.edgar-online.com/>

© Copyright 2006. All Rights Reserved.

Distribution and use of this document restricted under EDGAR Online's Terms of Use.

---

---

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

---

**FORM 8-K/A**

---

**CURRENT REPORT**

**Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934**

Date of Report (Date of earliest event reported): March 1, 2006

**MORNINGSTAR, INC.**

(Exact name of registrant as specified in its charter)

**Illinois**  
(State or other jurisdiction  
of incorporation)

**000-51280**  
(Commission  
File Number)

**36-3297908**  
(I.R.S. Employer  
Identification No.)

**225 West Wacker Drive**  
**Chicago, Illinois**  
(Address of principal executive offices)

**60606**  
(Zip Code)

**(312) 696-6000**  
(Registrant's telephone number, including area code)

**N/A**  
(Former name or former address, if changed since last report)

---

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- ☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
  - ☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
  - ☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
  - ☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
- 
- 
-



## **Item 2.01. Completion of Acquisition or Disposition of Assets.**

On March 1, 2006, Morningstar, Inc. ( Morningstar), an Illinois corporation, filed with the Securities and Exchange Commission a Current Report on Form 8-K announcing the completion of its acquisition of all the outstanding capital stock of Ibbotson Associates, Inc. (Ibbotson), an Illinois corporation, from Roger G. Ibbotson, Jody L. Sindelar, The Timothy Ibbotson-Sindelar Spray Trust, and The Tyler Ibbotson-Sindelar Spray Trust.

As permitted under Items 9.01(a) and (b) of Form 8-K, Morningstar indicated that it would file financial statements and pro forma financial information required under Item 9.01 of Form 8-K no later than the date required. This Current Report on Form 8-K/A provides the required financial information and amends Item 9.01(a) and (b) of the initial Current Report on Form 8-K filed by Morningstar on March 1, 2006.

Audited Consolidated Financial Statements for the year ended June 30, 2005 of Ibbotson are attached hereto as Exhibit 99.2. Unaudited Consolidated Financial Statements as of December 31, 2005 and for the six months ended December 31, 2005 and 2004 are attached hereto as Exhibit 99.3. Unaudited Pro Forma Condensed Consolidated Financial Statements, derived from the historical consolidated financial statements of Morningstar and Ibbotson and adjusted to reflect the material effects directly attributable to Morningstar's acquisition of Ibbotson are attached hereto as Exhibit 99.4. Each of these exhibits is incorporated herein by reference.

## **Item 9.01. Financial Statements and Exhibits.**

- (a) Financial statements of business acquired.

Independent Auditor's Report on the Ibbotson Associates, Inc. Consolidated Balance Sheet as of June 30, 2005 and the related Statements of Operations, Stockholders' Equity, and Cash Flows for the year ended June 30, 2005.

Ibbotson Associates, Inc. Audited Consolidated Balance Sheet as of June 30, 2005 and the Consolidated Statements of Operations, Stockholders' Equity, and Cash Flows for the year ended June 30, 2005.

Ibbotson Associates, Inc. Unaudited Consolidated Balance Sheet as of December 31, 2005 and the Unaudited Consolidated Statements of Operations and Cash Flows for the six months ended December 31, 2005 and 2004.

- (b) Pro forma financial information.

Unaudited Pro Forma Condensed Consolidated Balance Sheet as of December 31, 2005 and Unaudited Pro Forma Condensed Consolidated Statement of Operations for the year ended December 31, 2005.

- (d) Exhibits:

<u>Exhibit No.</u>	<u>Description</u>
2.1	Stock Purchase Agreement dated as of December 9, 2005 by and among Morningstar, Inc., Roger G. Ibbotson, Jody L. Sindelar, The Timothy Ibbotson-Sindelar Spray Trust, and The Tyler Ibbotson-Sindelar Spray Trust (incorporated by reference to Exhibit 2.1 of Morningstar Inc.'s Current Report on Form 8-K filed on December 14, 2005).

- 23.1 Consent of McGladrey & Pullen, LLP.
- 99.1 Press Release dated March 1, 2006 (incorporated by reference to Exhibit 99.1 of Morningstar's Current Report on Form 8-K filed on March 1, 2006).
- 99.2 Ibbotson Associates, Inc. and Subsidiaries Audited Consolidated Financial Statements as of June 30, 2005 and for the year then ended.
- 99.3 Ibbotson Associates, Inc. and Subsidiaries Unaudited Consolidated Balance Sheet as of December 31, 2005 and the Unaudited Consolidated Statements of Operations and Cash Flows for the six months ended December 31, 2005 and 2004.
- 99.4 Unaudited Pro Forma Condensed Consolidated Balance Sheet as of December 31, 2005 and Unaudited Pro Forma Condensed Consolidated Statement of Operations for the year ended December 31, 2005.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

MORNINGSTAR, INC.

Date: May 12, 2006

By: /s/ Martha Dustin Boudos

Name: Martha Dustin Boudos

Title: Chief Financial Officer

## EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
2.1	Stock Purchase Agreement dated as of December 9, 2005 by and among Morningstar, Inc., Roger G. Ibbotson, Jody L. Sindelar, The Timothy Ibbotson-Sindelar Spray Trust, and The Tyler Ibbotson-Sindelar Spray Trust (incorporated by reference to Exhibit 2.1 of Morningstar Inc's Current Report on Form 8-K filed on December 14, 2005).
23.1	Consent of McGladrey & Pullen, LLP.
99.1	Press Release dated March 1, 2006 (incorporated by reference to Exhibit 99.1 of Morningstar Inc's Current Report on Form 8-K filed on March 1, 2006).
99.2	Ibbotson Associates, Inc. and Subsidiaries Audited Consolidated Financial Statements as of June 30, 2005 and for the year then ended.
99.3	Ibbotson Associates, Inc. and Subsidiaries Unaudited Consolidated Balance Sheet as of December 31, 2005 and the Unaudited Consolidated Statements of Operations and Cash Flows for the six months ended December 31, 2005 and 2004.
99.4	Unaudited Pro Forma Condensed Consolidated Balance Sheet as of December 31, 2005 and Unaudited Pro Forma Condensed Consolidated Statement of Operations for the year ended December 31, 2005.

---

**Consent of Independent Auditors**

We consent to our report dated October 8, 2005, with respect to the financial statements as of and for the year ended June 30, 2005 of Ibbotson Associates, Inc. and Subsidiaries, being included in the Amendment No. 1 to Form 8-K dated May 12, 2006 which is incorporated by reference in the previously filed Registration Statement on Form S-8 (No. 333-124783) of Morningstar, Inc.

/s/ McGladrey & Pullen, LLP

Chicago, Illinois

May 12, 2006

---

**Ibbotson Associates, Inc.  
and Subsidiaries**

Consolidated Financial Report  
06.30.05

---

Contents

Independent Auditor’s Report	F-1
Financial Statements	
Consolidated Balance Sheet	F-2
Consolidated Statement of Operations	F-3
Consolidated Statement of Stockholders’ Equity	F-4
Consolidated Statement of Cash Flows	F-5
Notes to Consolidated Financial Statements	F6 - F12

## **Independent Auditor's Report**

To the Board of Directors  
Ibbotson Associates, Inc. and Subsidiaries  
Chicago, Illinois

We have audited the accompanying consolidated balance sheet of Ibbotson Associates, Inc. and Subsidiaries as of June 30, 2005, and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ibbotson Associates, Inc. and Subsidiaries as of June 30, 2005, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ McGladrey & Pullen, LLP

Chicago, Illinois  
October 8, 2005

**Ibbotson Associates, Inc. and Subsidiaries****Consolidated Balance Sheet****June 30, 2005****Assets**

Current Assets	
Cash and cash equivalents	\$ 10,077,757
Accounts receivable, less allowance for doubtful accounts	
2005 \$125,000; 2004 \$125,000	7,669,995
Deferred tax asset	35,766
Prepaid expenses and other current assets	1,089,392
Prepaid income taxes	87,149
<b>Total current assets</b>	<b>18,960,059</b>
Property and Equipment, net	947,964
Deferred Income Taxes	15,798
Deposits and Other Assets	144,167
	<u>\$ 20,067,988</u>

**Liabilities and Stockholders' Equity**

Current Liabilities	
Accounts payable	\$ 1,972,400
Accrued expenses and other current liabilities	4,257,082
Deferred revenue	9,963,248
Income taxes payable	71,729
<b>Total current liabilities</b>	<b>16,264,459</b>
Stockholders' Equity	
Common stock, no par value; authorized 199,000 shares; issued and outstanding 100,000 shares	663,190
Additional paid-in capital	12,035,462
Accumulated other comprehensive loss	(64,408)
Accumulated deficit	(8,830,715)
	<u>3,803,529</u>
	<u>\$ 20,067,988</u>

See Notes to Consolidated Financial Statements.

**Ibbotson Associates, Inc. and Subsidiaries****Consolidated Statement of Operations**  
**Year Ended June 30, 2005**

---

Revenues	<u>\$ 37,217,806</u>
Costs and expenses:	
Direct production	7,740,627
Selling and marketing	3,100,401
Salary and benefits	22,331,062
Other employee-related costs	658,965
MIS and telecommunications	1,500,992
Office	2,248,777
Corporate	982,947
	<u>38,563,771</u>
<b>Operating loss</b>	<b>(1,345,965)</b>
Other income	<u>112,289</u>
<b>Loss before income taxes</b>	<b>(1,233,676)</b>
Income tax expense	<u>54,250</u>
<b>Net loss</b>	<b><u>\$ (1,287,926)</u></b>

See Notes to Consolidated Financial Statements.

**Ibbotson Associates, Inc. and Subsidiaries**
**Consolidated Statement of Stockholders' Equity**  
**Year Ended June 30, 2005**

	<u>Comprehensive Loss</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total Stockholders' Equity</u>
Balance, June 30, 2004	\$	663,190	\$ 8,562,262	\$ (6,998,823)	\$ (67,403)	\$ 2,159,226
Stockholder distributions	\$ —	—	—	(543,966)	—	(543,966)
Stock options plan expense	—	—	4,173,536	—	—	4,173,536
Repurchase of stock options shares	—	—	(700,336)	—	—	(700,336)
Net loss	(1,287,926)	—	—	(1,287,926)	—	(1,287,926)
Other comprehensive loss, net of tax:						
Currency translation adjustment	2,995	—	—	—	2,995	2,995
Total comprehensive loss	<u>\$ (1,284,931)</u>					
Balance, June 30, 2005	<u>\$</u>	<u>663,190</u>	<u>\$ 12,035,462</u>	<u>\$ (8,830,715)</u>	<u>\$ (64,408)</u>	<u>\$ 3,803,529</u>

See Notes to Consolidated Financial Statements.

**Ibbotson Associates, Inc. and Subsidiaries**

**Consolidated Statement of Cash Flows**  
**Year Ended June 30, 2005**

<b>Cash Flows From Operating Activities</b>	
Net loss	\$ (1,287,926)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation and amortization	703,482
Deferred income taxes	(8,117)
Stock option expense	4,173,536
Loss on disposal of property and equipment	29,791
Changes in assets and liabilities:	
Accounts receivable	(492,368)
Prepaid expenses and other current assets	(246,700)
Accounts payable	161,061
Accrued expenses and other current liabilities	1,325,628
Deferred revenue	1,926,043
Income taxes payable	76,505
<b>Net cash provided by operating activities</b>	<b>6,360,935</b>
<b>Cash Flows From Investing Activities</b>	
Capital expenditures	(616,156)
Proceeds from sale of marketable securities	2,719
<b>Net cash used in investing activities</b>	<b>(613,437)</b>
<b>Cash Flows From Financing Activities</b>	
Distributions paid	(543,966)
Cash settlement of stock options	(700,336)
<b>Net cash used in financing activities</b>	<b>(1,244,302)</b>
Effect of exchange rate changes on cash	(8,769)
Net increase in cash and cash equivalents	4,494,427
<b>Cash and cash equivalents:</b>	
Beginning	5,583,330
Ending	<u>\$ 10,077,757</u>
<b>Supplemental Disclosures of Cash Flow Information</b>	
Cash paid for income taxes	\$ 15,125

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies

Ibbotson Associates, Inc. and Subsidiaries (the Company) is an Illinois corporation that performs market research and distributes information through subscription-based software and hard-copy books and presentation materials to corporations, partnership and individuals in North America, Europe and Japan. Credit terms are generally 30 days.

Significant accounting policies are as follows:

Principles of consolidation: The accompanying financial statements were prepared on a consolidated basis and include the accounts of Ibbotson Associates, Inc., its wholly owned subsidiary, Ibbotson Associates Advisors, LLC, and its 68-percent owned subsidiary, Ibbotson - Japan. All significant inter-company transactions and balances have been eliminated.

Foreign operations: The financial statements of Ibbotson-Japan are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities, the historical exchange rate for stockholders' equity and a weighted average exchange rate for each period for revenues and expenses. Translation adjustments are recorded in accumulated other comprehensive income as the local currency of the subsidiary is the functional currency. Assets located outside the United States totaled approximately \$610,000 at June 30, 2005.

Accounting estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash concentrations: The Company maintains substantially all of its cash in one bank deposit account which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Cash and cash equivalents: The Company's cash and cash equivalents include funds invested in overnight markets. The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

Accounts receivables: Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

Property and equipment: Property and equipment are carried at cost less accumulated depreciation and amortization. Leasehold improvements are amortized over the term of the related lease or the service lives of the improvements, whichever is shorter. Depreciation and amortization are provided for on a straight-line basis over the following estimated useful lives:

Computer equipment and software	3 years
Office equipment	5 years
Furniture and fixtures	7 years
Leasehold improvements	Lease term

Notes to Consolidated Financial Statements

---

**Note 1. Nature of Business and Significant Accounting Policies (continued)**

Software development costs: The Company accounts for software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*.

Long-lived assets: The Company periodically assesses the recoverability of its long-lived assets based upon its expectations of future profitability and undiscounted cash flow of the related operations. These factors, along with management's plans with respect to the operations, are considered in assessing the recoverability of long-lived assets. If the Company determines, based on such measures, that the carrying amount is impaired, the long-lived assets will be written down to their recoverable value with a corresponding charge to earnings. Recoverable value is calculated as the amount of estimated future cash flows (discounted at a rate commensurate with the risk involved) for the remaining amortization period. During the period presented, no such impairment was incurred.

Revenue recognition: The Company derives its revenue principally from consulting, advice, fund of funds and training services, sales of software and data, publication and presentation materials, and permissions licensing agreements. Consulting and training revenues are recognized upon completion of service delivery. Minimum annual fees for advice and fund of fund services are recognized as revenue on a straight-line basis while additional quarterly fees are calculated in arrears and recognized at the end of each quarter. License fees from software and data sales are recognized as revenue on a straight-line basis over the life of the license agreement as the Company services the customer and supplies data. Publications and presentation materials are purchased directly by customers and revenue is recognized upon shipment to the customer. Permissions licensing revenue is recognized at the beginning of the licensing period.

Deferred revenue: Deferred revenue primarily represents the unamortized portion of license fees for software and data sales or prepayments by customers in advance of services performed. Other items included are computer based training, access to the Company's valuation web site, subscriptions for presentation materials, and retainers for consulting work, all of which represent obligations for future services.

Delayed adoption of accounting standard: The FASB has issued Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. Statement No. 150 requires that certain freestanding financial instruments be reported as liabilities in the balance sheet. Depending on the type of financial instrument, it will be accounted for at either fair value or the present value of future cash flows determined at each balance sheet date with the change in that value reported as interest expense in the statement of income. Prior to the application of Statement No. 150, either those financial instruments were not required to be recognized, or if recognized, were reported in the balance sheet as equity and changes in the value of those instruments were normally not recognized in net income. The Company is required to apply Statement No. 150 for the year beginning on July 1, 2005.

As explained further in Note 2, any stock held by employees resulting from option exercise is redeemable upon termination of employment. At the date Statement No. 150 is applied, the common stock will remain in equity until the occurrence of such event that makes the shares mandatorily redeemable. At that time, stockholders' equity will be reduced and liabilities will be increased accordingly.

## Notes to Consolidated Financial Statements

**Note 1. Nature of Business and Significant Accounting Policies (continued)**

Pending adoption of accounting standard: In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised), *Share-Based Payment*. SFAS 123(R) is a replacement of SFAS 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related interpretive guidance.

SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. The effect of the standard will be to require entities to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award.

The Company will be required to apply SFAS 123(R) as of the beginning of its first interim or annual reporting period that begins after December 15, 2005.

The Company has not yet determined the impact that the adoption of FAS 123(R) may have on its financial statements.

Employee stock option plan: The Company has a stock-based compensation plan, which is described more fully in Note 2. As permitted under generally accepted accounting principles, the Company accounts for the plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. The following table illustrates the effect on net income had compensation cost for the stock-based compensation plan been determined based on the grant date fair values of awards (the method described in FASB Statement No. 123, *Accounting for Stock-Based Compensation*):

Net loss:	
As reported	\$(1,287,926)
Add total stock-based employee compensation expense included in reported net income	4,173,536
Deduct total stock-based employee compensation expense determined under fair value based method for all awards	(415,245)
Pro forma	<u>\$ 2,470,365</u>

Minority interest: Minority interest represents the limited partners' 32 percent share of Ibbotson-Japan. No minority interest in income or equity capital is recognized in the accompanying consolidated financial statements since the cumulative losses applicable to the minority interest exceed the minority interest in the equity capital of Ibbotson-Japan.

**Notes to Consolidated Financial Statements**

---

**Note 1. Nature of Business and Significant Accounting Policies (continued)**

Income taxes: Effective July 1, 2001, the Company switched to an accrual basis tax payer from the cash basis. This election resulted in the reversal of certain net deferred tax liabilities which are being recognized as taxes payable ratably over four years (IRC Section 481(a)).

Effective January 1, 2002, the Company elected to change its tax status from C corporation to S corporation for federal income tax purposes. Under S corporation status, the stockholder separately accounts for the Company's items of income, deduction, losses and credits in lieu of corporation income taxes. The Company continues to be a C corporation for state income tax purposes in certain states.

For state income taxes, deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

**Note 2. Stock Option Plan**

The Company has a stock option plan which provides for the granting of up to 99,000 nonqualified stock options to employees, directors and consultants of the Company. Generally, options under the plan are granted at a defined formula price and expire 10 years from the date of grant. Options vest over a three-year period from the date of grant or immediately upon death or disability of the employee or in the event of a sale of the Company. The Company is obligated to repurchase, at the current formula price, any stock options held by employees upon their termination.

The options granted under the plan are accounted for under variable plan accounting in accordance with APB Opinion No. 25 and related interpretations. Accordingly, the Company has recorded the difference between the exercise price and the current formula price of the common stock as compensation expense. Compensation expense was \$4,173,536 for the year ended June 30, 2005, and is included in salary and benefits expense in the accompanying consolidated statements of income.

In 2005, options were exercised for 4,250 shares of stock and were put back to the Company. The option share repurchases were effected by cashless exercise and the Company made a net payout of \$700,336.

## Notes to Consolidated Financial Statements

## Note 2. Stock Option Plan (continued)

A summary of the status of the stock option plan at June 30, 2005, and changes during the year ended on that date is as follows:

<b>Fixed Options</b>	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>
Outstanding at beginning of year	88,150	\$ 216.44
Granted	9,500	305.00
Exercised	(4,250)	168.34
Forfeited	(3,800)	257.12
Outstanding at end of year	<u>89,600</u>	<u>226.38</u>
Exercisable at end of year	66,969	
Weighted-average fair value per option of options granted during the year	\$ 46.68	

The fair value of each grant is estimated at grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants in 2005 and 2004, respectively: no volatility, risk-free interest rates of 3.35 percent and 3.19 percent, and expected lives of 5 years.

A further summary about fixed options outstanding at June 30, 2005, is as follows:

<b>Exercise Price</b>	<b>Options Outstanding</b>		<b>Weighted-Average Remaining Contractual Life</b>	<b>Options Exercisable</b>	
	<b>Number of Options</b>	<b>Weighted-Average Exercise Price</b>		<b>Number of Options</b>	<b>Weighted-Average Exercise Price</b>
\$136 - \$198	21,750	\$ 171.54	4.0	21,750	\$ 171.54
\$199 - \$242	29,950	\$ 210.39	5.1	29,950	\$ 210.39
\$243 - \$305	37,900	\$ 270.49	8.1	15,269	\$ 253.01
	<u>89,600</u>			<u>66,969</u>	

**Notes to Consolidated Financial Statements**

---

**Note 3. Property and Equipment**

Property and equipment consisted of the following at June 30, 2005:

Computer equipment and software	\$ 3,306,865
Office equipment	239,410
Furniture and fixtures	1,271,966
Leasehold improvements	607,416
	5,425,657
Less accumulated depreciation and amortization	4,477,693
	<u>\$ 947,964</u>

**Note 4. Lease Obligations**

The Company leases office facilities under various noncancelable operating lease agreements. The agreements expire at various dates through 2013 and require minimum annual rental payments summarized as follows:

Years ending June 30:	
2006	\$ 1,259,047
2007	1,306,937
2008	1,356,645
2009	1,408,386
2010	1,462,224
Thereafter	3,226,846
	<u>\$ 10,020,085</u>

Rent expense under operating leases was approximately \$1,447,000 for the year ended June 30, 2005.

## Notes to Consolidated Financial Statements

**Note 5. Income Taxes**

Income tax expense (credits) consisted of the following for the year ended June 30, 2005:

Current	\$62,367
Deferred	(8,117)
	<u>\$54,250</u>

The primary components of the net deferred tax assets are state net operating loss carryforwards, IRC Section 481(a) liability, and stock option accruals.

As of June 30, 2005, the Company has approximately \$1,279,000 of federal net operating loss carryforwards and \$15,000 of charitable contribution carryovers for federal tax purposes. As the Company is now an S corporation for federal income tax purposes, the net carryforward of approximately \$339,000 at June 30, 2005, has been deemed not realizable by the Company and, as such, a 100 percent valuation reserve has been recorded against the related deferred tax asset.

**Note 6. Line of Credit**

The Company has a \$2,000,000 line of credit which bears interest at the prime rate (6.25% at June 30, 2005) and is secured by substantially all of the assets of the Company. The line of credit agreement contains a minimum debt service coverage ratio. During the year ended June 30, 2005, the Company made no periodic borrowings under the line of credit.

**Note 7. Employee Benefit Plans**

Retirement plan: The Company sponsors a defined contribution 401(k) plan with the same year-end as the Company for employees with six consecutive months of service who are at least 21 years of age. The plan allows eligible employees to defer their compensation up to the maximum amount allowed by law. The Company matches 50 percent of any pre-tax contributions of participants' eligible compensation with 20 percent vesting per year. Matching contributions and plan fees were approximately \$544,000 for the year ended June 30, 2005.

Health benefit plan: the Company acts as self-insurer for health care benefits provided to employees. The benefits are provided through an employee health benefit plan. All full-time employees are covered on the first of the month following their hire date. The Company maintains stop-loss insurance which limits its exposure to the first \$50,000 of benefits provided to covered employees and an approximate aggregate exposure to \$820,000.

**Note 8. Contingency**

The Company has entered into a bonus agreement with a key executive. Under the terms of the agreement, the executive is entitled to a cash bonus upon a sale of the Company under certain circumstances.

**Ibbotson Associates, Inc.  
and Subsidiaries**

Consolidated Financial Report  
12.31.05

---

## INDEX TO FINANCIAL STATEMENTS

	<u>Page</u>
<i>Ibbotson Associates, Inc. and Subsidiaries</i>	
Consolidated Balance Sheet (Unaudited) as of December 31, 2005	F-2
Consolidated Statements of Operations (Unaudited) for the Six Months Ended December 31, 2005 and 2004	F-3
Consolidated Statements of Cash Flows (Unaudited) for the Six Months Ended December 31, 2005 and 2004	F-4
Notes to Consolidated Financial Statements (Unaudited)	F-5

**Ibbotson Associates, Inc. and Subsidiaries****Consolidated Balance Sheet (Unaudited)  
December 31, 2005**

<b>Assets</b>	
Current Assets	
Cash and cash equivalents	\$ 7,588,030
Accounts receivable, less allowance for doubtful accounts of \$125,000	4,986,007
Deferred tax asset	49,474
Prepaid expenses and other current assets	1,449,403
Prepaid income taxes	86,749
<b>Total current assets</b>	<b>14,159,663</b>
Property and Equipment, net	1,052,566
Deferred Income Taxes	9,364
Deposits and Other Assets	143,656
	<u>\$ 15,365,249</u>
<b>Liabilities and Stockholders' Equity</b>	
Current Liabilities	
Accounts payable	\$ 3,045,580
Accrued expenses and other current liabilities	2,743,884
Deferred revenue	8,791,022
Income taxes payable	60,549
<b>Total current liabilities</b>	<b>14,641,035</b>
Stockholders' Equity	
Common stock, no par value; authorized 199,000 shares; issued and outstanding 100,000 shares	663,190
Additional paid-in capital	14,255,119
Accumulated other comprehensive loss	(57,493)
Accumulated deficit	(14,136,602)
	<u>724,214</u>
	<u>\$ 15,365,249</u>

See Notes to Consolidated Financial Statements.

**Ibbotson Associates, Inc. and Subsidiaries****Consolidated Statements of Operations (Unaudited)**  
**Six Months Ended December 31, 2005 and 2004**

	<u>2005</u>	<u>2004</u>
Revenues	<u>\$ 15,645,854</u>	<u>\$ 13,356,966</u>
Costs and expenses:		
Direct production	3,849,568	2,722,113
Selling and marketing	1,004,534	1,120,513
Salary and benefits	12,816,649	10,222,815
Other employee-related costs	496,612	326,994
MIS and telecommunications	636,819	771,983
Office	1,138,994	1,176,719
Corporate	1,003,065	371,648
	<u>20,946,241</u>	<u>16,712,785</u>
<b>Operating loss</b>	<b>(5,300,387)</b>	<b>(3,355,819)</b>
Other income	<u>138,574</u>	<u>34,272</u>
<b>Loss before income taxes</b>	<b>(5,161,813)</b>	<b>(3,321,547)</b>
Income tax expense (benefit)	<u>(7,709)</u>	<u>14,243</u>
<b>Net loss</b>	<b><u>\$ (5,154,104)</u></b>	<b><u>\$ (3,335,790)</u></b>

See Notes to Consolidated Financial Statements.

**Ibbotson Associates, Inc. and Subsidiaries**
**Consolidated Statements of Cash Flows (Unaudited)**  
**Six Months Ended December 31, 2005 and 2004**

	<u>2005</u>	<u>2004</u>
<b>Cash Flows From Operating Activities</b>		
Net loss	\$ (5,154,104)	\$ (3,335,790)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	300,358	358,319
Deferred income taxes	(7,274)	(352)
Stock option expense	3,181,095	2,084,757
Loss on disposal of property and equipment	639	32,510
Changes in assets and liabilities:		
Accounts receivable	2,682,692	3,830,981
Prepaid expenses and other current assets	(361,851)	(159,153)
Accounts payable	1,073,176	(525,370)
Accrued expenses and other current liabilities	(1,490,511)	(481,725)
Deferred revenue	(11,742)	(1,002,610)
Income taxes payable	(1,172,250)	19,743
<b>Net cash provided by (used in) operating activities</b>	<u>(959,772)</u>	<u>821,310</u>
<b>Cash Flows From Investing Activities</b>		
Capital expenditures	(392,179)	(315,961)
<b>Net cash used in investing activities</b>	<u>(392,179)</u>	<u>(315,961)</u>
<b>Cash Flows From Financing Activities</b>		
Distributions paid	(151,782)	(462,498)
Cash settlement of stock options	(961,439)	(695,620)
<b>Net cash used in financing activities</b>	<u>(1,113,221)</u>	<u>(1,158,118)</u>
Effect of exchange rate changes on cash	(24,555)	(16,223)
<b>Net decrease in cash and cash equivalents</b>	<u>(2,489,727)</u>	<u>(668,992)</u>
<b>Cash and cash equivalents:</b>		
Beginning	10,077,756	5,583,330
Ending	<u>\$ 7,588,029</u>	<u>\$ 4,914,338</u>
<b>Supplemental Disclosures of Cash Flow Information</b>		
Refunds received for income taxes	\$ (835)	\$ (38,476)

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements (Unaudited)

Note 1. Nature of Business and Significant Accounting Policies

Ibbotson Associates, Inc. and Subsidiaries (the Company) is an Illinois corporation that performs market research and distributes information through subscription-based software and hard-copy books and presentation materials to corporations, partnership and individuals in North America, Europe and Japan. Credit terms are generally 30 days.

Significant accounting policies are as follows:

Principles of consolidation : The accompanying financial statements were prepared on a consolidated basis and include the accounts of Ibbotson Associates, Inc., its wholly owned subsidiary, Ibbotson Associates Advisors, LLC, and its 68-percent owned subsidiary, Ibbotson - Japan. All significant inter-company transactions and balances have been eliminated.

Foreign operations : The financial statements of Ibbotson-Japan are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities, the historical exchange rate for stockholders' equity and a weighted average exchange rate for each period for revenues and expenses. Translation adjustments are recorded in accumulated other comprehensive income as the local currency of the subsidiary is the functional currency. Assets located outside the United States totaled approximately \$655,000 at December 31, 2005.

Accounting estimates : The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash concentrations : The Company maintains substantially all of its cash in one bank deposit account which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Cash and cash equivalents : The Company's cash and cash equivalents include funds invested in overnight markets. The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

Accounts receivables : Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

Property and equipment : Property and equipment are carried at cost less accumulated depreciation and amortization. Leasehold improvements are amortized over the term of the related lease or the service lives of the improvements, whichever is shorter. Depreciation and amortization are provided for on a straight-line basis over the following estimated useful lives:

Computer equipment and software	3 years
Office equipment	5 years
Furniture and fixtures	7 years
Leasehold improvements	Lease term

Notes to Consolidated Financial Statements (Unaudited)

---

**Note 1. Nature of Business and Significant Accounting Policies (continued)**

Software development costs : The Company accounts for software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed* .

Long-lived assets : The Company periodically assesses the recoverability of its long-lived assets based upon its expectations of future profitability and undiscounted cash flow of the related operations. These factors, along with management's plans with respect to the operations, are considered in assessing the recoverability of long-lived assets. If the Company determines, based on such measures, that the carrying amount is impaired, the long-lived assets will be written down to their recoverable value with a corresponding charge to earnings. Recoverable value is calculated as the amount of estimated future cash flows (discounted at a rate commensurate with the risk involved) for the remaining amortization period. During the period presented, no such impairment was incurred.

Revenue recognition : The Company derives its revenue principally from consulting, advice, fund of funds and training services, sales of software and data, publication and presentation materials, and permissions licensing agreements. Consulting and training revenues are recognized upon completion of service delivery. Minimum annual fees for advice and fund of fund services are recognized as revenue on a straight-line basis while additional quarterly fees are calculated in arrears and recognized at the end of each quarter. License fees from software and data sales are recognized as revenue on a straight-line basis over the life of the license agreement as the Company services the customer and supplies data. Publications and presentation materials are purchased directly by customers and revenue is recognized upon shipment to the customer. Permissions licensing revenue is recognized at the beginning of the licensing period.

Deferred revenue : Deferred revenue primarily represents the unamortized portion of license fees for software and data sales or prepayments by customers in advance of services performed. Other items included are computer based training, access to the Company's valuation web site, subscriptions for presentation materials, and retainers for consulting work, all of which represent obligations for future services.

Adoption of accounting standard : The FASB has issued Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* . Statement No. 150 requires that certain freestanding financial instruments be reported as liabilities in the balance sheet. Depending on the type of financial instrument, it will be accounted for at either fair value or the present value of future cash flows determined at each balance sheet date with the change in that value reported as interest expense in the statement of income. Prior to the application of Statement No. 150, either those financial instruments were not required to be recognized, or if recognized, were reported in the balance sheet as equity and changes in the value of those instruments were normally not recognized in net income. The Company adopted Statement No. 150 for the period beginning on July 1, 2005.

As explained further in Note 2, any stock held by employees resulting from option exercise is redeemable upon termination of employment. The common stock will remain in equity until the occurrence of such event that makes the shares mandatorily redeemable. At that time, stockholders' equity will be reduced and liabilities will be increased accordingly.

## Notes to Consolidated Financial Statements (Unaudited)

**Note 1. Nature of Business and Significant Accounting Policies (continued)**

Pending adoption of accounting standard : In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised), *Share-Based Payment* . SFAS 123(R) is a replacement of SFAS 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* , and its related interpretive guidance.

SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. The effect of the standard will be to require entities to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award.

The Company will be required to apply SFAS 123(R) as of the beginning of its first interim or annual reporting period that begins after December 15, 2005.

The Company has not yet determined the impact that the adoption of FAS 123(R) may have on its financial statements.

Employee stock option plan : The Company has a stock-based compensation plan, which is described more fully in Note 2. As permitted under generally accepted accounting principles, the Company accounts for the plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees* , and related interpretations. The following table illustrates the effect on net income had compensation cost for the stock-based compensation plan been determined based on the grant date fair values of awards (the method described in FASB Statement No. 123, *Accounting for Stock-Based Compensation* ).

	Six Months Ended December 31	
	2005	2004
Net loss:		
As reported	\$ (5,154,104)	\$ (3,335,790)
Add total stock-based employee compensation expense included in reported net income	3,181,095	2,084,757
(Deduct) add total stock-based employee compensation (expense) income determined under fair value based method for all awards	23,229	(203,862)
Pro forma	<u>\$ (1,949,780)</u>	<u>\$ (1,454,895)</u>

Minority interest : Minority interest represents the limited partners' 32 percent share of Ibbotson-Japan. No minority interest in income or equity capital is recognized in the accompanying consolidated financial statements since the cumulative losses applicable to the minority interest exceed the minority interest in the equity capital of Ibbotson-Japan.

**Notes to Consolidated Financial Statements (Unaudited)**

---

**Note 1. Nature of Business and Significant Accounting Policies (continued)**

Income taxes : Effective July 1, 2001, the Company switched to an accrual basis tax payer from the cash basis. This election resulted in the reversal of certain net deferred tax liabilities which are being recognized as taxes payable ratably over four years (IRC Section 481(a)).

Effective January 1, 2002, the Company elected to change its tax status from C corporation to S corporation for federal income tax purposes. Under S corporation status, the stockholder separately accounts for the Company's items of income, deduction, losses and credits in lieu of corporation income taxes. The Company continues to be a C corporation for state income tax purposes in certain states.

For state income taxes, deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

**Note 2. Stock Option Plan**

The Company has a stock option plan which provides for the granting of up to 99,000 nonqualified stock options to employees, directors and consultants of the Company. Generally, options under the plan are granted at a defined formula price and expire 10 years from the date of grant. Options vest over a three-year period from the date of grant or immediately upon death or disability of the employee or in the event of a sale of the Company. The Company is obligated to repurchase, at the current formula price, any stock options held by employees upon their termination.

The options granted under the plan are accounted for under variable plan accounting in accordance with APB Opinion No. 25 and related interpretations. Accordingly, the Company has recorded the difference between the exercise price and the current formula price of the common stock as compensation expense. Compensation expense was \$3,181,095 and \$2,084,757 for the six months ended December 31, 2005 and 2004, respectively, and is included in salary and benefits expense in the accompanying consolidated statements of income.

During the six months ended December 31, 2005 and 2004, options were exercised for 3,067 and 4,217 shares, respectively, of stock and were put back to the Company. The option share repurchases were effected by cashless exercise and the Company made net payouts of \$961,439 and \$695,620, respectively.

## Notes to Consolidated Financial Statements

**Note 2. Stock Option Plan (continued)**

A summary of the status of the stock option plan at December 31, 2005 and 2004, and changes during the six months ended on those dates is as follows:

	Six Months Ended December 31, 2005		Weighted- Average Exercise Price	Six Months Ended December 31, 2004		Weighted- Average Exercise Price
	Shares			Shares		
<b>Fixed Options</b>						
Outstanding at beginning of period	89,600	\$	226.53	88,150	\$	216.44
Granted	—		—	9,500		305.00
Exercised	(3,067)		164.00	(4,217)		167.43
Forfeited	(733)		286.17	(3,633)		255.31
Outstanding at end of period	85,800		228.10	89,800		226.53
Exercisable at end of period	76,150			67,002		
Weighted-average fair value per option of options granted during the period	\$	—		\$	46.68	

The fair value of each grant is estimated at grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants in 2004: no volatility, risk-free interest rate of 3.35 percent, and expected lives of 5 years.

A further summary about fixed options outstanding at December 31, 2005, is as follows:

Options Outstanding	Number of Options	Weighted- Average Exercise Price	Weighted Average Remaining Contractual Life	Options Exercisable	
				Number of Options	Weighted- Average Exercise Price
Exercise Price					
\$136 - \$198	19,500	\$ 175.22	3.9	19,500	\$ 175.22
\$199 - \$242	29,550	\$ 210.39	4.6	29,550	\$ 210.39
\$243 - \$305	36,750	\$ 270.40	7.6	27,100	\$ 260.91
	<u>85,800</u>			<u>76,150</u>	

**Notes to Consolidated Financial Statements**

---

**Note 3. Property and Equipment**

Property and equipment consisted of the following at December 31, 2005:

Computer equipment and software	\$ 3,574,744
Office equipment	259,994
Furniture and fixtures	1,204,748
Leasehold improvements	613,954
	5,653,440
Less accumulated depreciation and amortization	(4,600,874)
	<u>\$ 1,052,566</u>

**Note 4. Lease Obligations**

The Company leases office facilities under various noncancelable operating lease agreements. The agreements expire at various dates through 2013 and require minimum annual rental payments summarized as follows:

Years ending December 31:	
2006	\$ 1,313,568
2007	1,363,816
2008	1,416,143
2009	1,470,616
2010	1,527,303
Thereafter	<u>2,532,516</u>
	<u>\$ 9,623,962</u>

Rent expense under operating leases was approximately \$727,000 and \$724,000 for the six months ended December 31, 2005 and 2004, respectively.

## Notes to Consolidated Financial Statements

**Note 5. Income Taxes**

Income tax expense (credits) consisted of the following for the six months ended December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Current	\$ (435)	\$14,595
Deferred	<u>(7,274)</u>	<u>(352)</u>
	<u>\$ (7,709)</u>	<u>\$14,243</u>

The primary components of the net deferred tax assets are state net operating loss carryforwards, IRC Section 481(a) liability, and stock option accruals.

As of December 31, 2005, the Company has approximately \$1,279,000 of federal net operating loss carryforwards and \$15,000 of charitable contribution carryovers for federal tax purposes. These carryforwards are partially offset by future taxable income as a result of IRS Section 481(a) federal liabilities of approximately \$119,500 as of December 31, 2005. As the Company is now an S corporation for federal income tax purposes, the net carryforward of approximately \$339,000 at December 31, 2005, has been deemed not realizable by the Company and, as such, a 100 percent valuation reserve has been recorded against the related deferred tax asset.

**Note 6. Line of Credit**

The Company has a \$2,000,000 line of credit which bears interest at the prime rate (7.25% at December 31, 2005) and is secured by substantially all of the assets of the Company. The line of credit agreement contains a minimum debt service coverage ratio. During the six months ended December 31, 2005, the Company made no periodic borrowings under the line of credit.

**Note 7. Employee Benefit Plans**

Retirement plan: The Company sponsors a defined contribution 401(k) plan with the same year-end as the Company for employees with six consecutive months of service who are at least 21 years of age. The plan allows eligible employees to defer their compensation up to the maximum amount allowed by law. The Company matches 50 percent of any pre-tax contributions of participants' eligible compensation with 20 percent vesting per year. Matching contributions and plan fees were approximately \$316,000 and \$201,000 for the six months ended December 31, 2005 and 2004, respectively.

Health benefit plan: the Company acts as self-insurer for health care benefits provided to employees. The benefits are provided through an employee health benefit plan. All full-time employees are covered on the first of the month following their hire date. The Company maintains stop-loss insurance which limits its exposure to the first \$50,000 of benefits provided to covered employees and an approximate aggregate exposure to \$820,000.

**Note 8. Contingency**

The Company has entered into a bonus agreement with a key executive. Under the terms of the agreement, the executive is entitled to a cash bonus upon a sale of the Company under certain circumstances.

**Note 9. Subsequent Event**

On March 1, 2006, the Company was acquired by Morningstar, Inc. for approximately \$83 million in cash subject to adjustments for working capital and other items. Upon the sale closing, the Company paid approximately \$29 million to employees in exchange for the cancellation of their stock options. The Company also paid a transaction bonus to the key executive mentioned in Note 8 of approximately \$1.7 million.

**Morningstar Inc. and Subsidiaries**  
**Unaudited Pro Forma Condensed Consolidated Financial Statements**

On March 1, 2006, Morningstar, Inc. (Morningstar) acquired Ibbotson Associates, Inc. (Ibbotson), a privately held firm specializing in asset allocation research and services. This acquisition fits several of Morningstar's growth strategies and broadens our reach in the areas of investment consulting, managed retirement accounts, and institutional and advisor software.

For purposes of the Unaudited Pro Forma Condensed Consolidated Statement of Operations, we assume the Ibbotson acquisition occurred on January 1, 2005.

The Unaudited Pro Forma Condensed Consolidated Balance Sheet gives effect to the Ibbotson acquisition as if it had occurred on December 31, 2005.

These Unaudited Pro Forma Condensed Consolidated Financial Statements ("the unaudited pro forma financial statements") have been prepared based on preliminary estimates of fair values of the assets acquired and liabilities assumed as of December 31, 2005. The actual amounts recorded for the acquisition may differ materially from the information presented here. The purchase price has been allocated on a preliminary basis based on management's best estimates of fair value, with the excess cost over net tangible and identifiable intangible assets acquired being allocated to goodwill. These allocations are subject to change pending a final analysis of the fair value of the assets acquired and liabilities assumed as of March 1, 2006 (the acquisition date). In addition, post-closing adjustments to the purchase price will affect the purchase price allocation.

The unaudited pro forma financial statements presented are for illustration purposes only and do not necessarily indicate the operating results or financial position that would have been achieved if the Ibbotson acquisition had occurred at the beginning of the period presented, nor is it indicative of future operating results or financial position.

These unaudited pro forma financial statements do not reflect any operating efficiencies and cost savings that we may achieve with respect to the combined companies, nor do they include the effects of restructuring activities.

The unaudited pro forma financial statements should be read in conjunction with the accompanying Notes to Unaudited Pro Forma Condensed Consolidated Financial Statements; our "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the historical consolidated financial statements and accompanying notes as of December 31, 2005 included in Morningstar's Annual Report on Form 10-K filed with the SEC on March 16, 2006; and the Ibbotson historical consolidated financial statements and notes included as Exhibits 99.2 and 99.3 in this filing on Form 8-K/A.

**Morningstar, Inc.**  
**Unaudited Pro Forma Condensed Consolidated Balance Sheet**  
**As of December 31, 2005**

	Audited	Unaudited	Pro Forma Adjustments (Note 4)	Pro Forma Consolidated
(in thousands except share amounts)	Morningstar	Ibbotson		
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 92,367	\$ 7,588	\$ (94,600)b	\$ 5,355
Investments	60,823	—	—	60,823
Accounts receivable, net	47,530	4,986	—	52,516
Deferred tax asset, net	—	50	(50)f	—
Income tax receivable, net	—	87	10,332 c	10,419
Other	5,495	1,449	—	6,944
Total current assets	206,215	14,160	(84,318)	136,057
Property, equipment, and capitalized software, net	17,355	1,052	—	18,407
Investments in unconsolidated entities	16,355	—	—	16,355
Goodwill	17,500	—	49,244 a	66,744
Intangible assets, net	7,251	—	55,990 a	63,241
Deferred tax asset, net	29,729	9	(22,253)a	7,485
Other assets	1,906	144	—	2,050
Total assets	<u>\$ 296,311</u>	<u>\$ 15,365</u>	<u>\$ (1,337)</u>	<u>\$ 310,339</u>
<b>Liabilities and shareholders' equity</b>				
Current liabilities:				
Accounts payable and accrued liabilities	\$ 13,664	\$ 3,463	\$ 1,200 a	\$ 18,327
Accrued compensation	26,463	2,326	(1,204)d	27,585
Income tax payable	1,259	61	(1,320)c	—
Deferred revenue	71,155	8,791	—	79,946
Deferred tax liability, net	833	—	(50)f	783
Other	2,467	—	—	2,467
Total current liabilities	115,841	14,641	(1,374)	129,108
Accrued compensation	4,458	—	—	4,458
Other long-term liabilities	2,298	—	761 e	3,059
Total liabilities	122,597	14,641	(613)	136,625
Shareholders' equity	173,714	724	(724)a	173,714
Total liabilities and shareholders' equity	<u>\$ 296,311</u>	<u>\$ 15,365</u>	<u>\$ (1,337)</u>	<u>\$ 310,339</u>

See Notes to Unaudited Pro Forma Condensed Consolidated Financial Statements.

**Morningstar, Inc.**  
**Unaudited Pro Forma Condensed Consolidated Statement of Operations**  
**Year ended December 31, 2005**

	Audited	Unaudited	Pro Forma Adjustments (Note 4)	Pro Forma Consolidated
(in thousands except per share amounts)	Morningstar	Ibbotson		
Revenue	\$ 227,114	\$ 39,507	\$ —	\$ 266,621
Operating expense: (1)				
Cost of goods sold	64,408	16,092	(440)g,h	80,060
Development	19,654	5,409	(317)g,h	24,746
Sales and marketing	39,071	10,311	(813)g,h	48,569
General and administrative	49,235	10,345	(3,502)	56,078
Depreciation and amortization	8,266	640	5,868 i	14,774
Total operating expense	180,634	42,797	796	224,227
Operating income (loss)	46,480	(3,290)	(796)	42,394
Non-operating income:				
Interest income, net	3,078	—	(2,591)j	487
Other income, net	121	216	—	337
Non-operating income, net	3,199	216	(2,591)	824
Income (loss) before income taxes and equity in net income of unconsolidated entities	49,679	(3,074)	(3,387)	43,218
Income tax expense	20,224	32	(2,600)k	17,656
Equity in net income of unconsolidated entities	1,662	—	—	1,662
Net income (loss)	\$ 31,117	\$ (3,106)	\$ (787)	\$ 27,224
Basic income per share	\$ 0.79			\$ 0.69
Diluted income per share	\$ 0.70			\$ 0.61
Weighted average shares outstanding:				
Basic	39,392		—	39,392
Diluted	44,459		14 l	44,473

	Audited	Unaudited	Pro Forma Adjustments (Note 4)	Pro Forma Combined
	Morningstar	Ibbotson		
(1) Includes stock-based compensation expense of:				
Cost of goods sold	\$ 1,473	\$ 457	\$ (440)g,h	\$ 1,490
Development	603	329	(317)g,h	615
Sales and marketing	710	845	(813)g,h	742
General and administrative	8,109	3,639	(3,502)g,h	8,246
Total stock-based compensation expense	\$ 10,895	\$ 5,270	\$ (5,072)	\$ 11,093

See Notes to Unaudited Pro Forma Condensed Consolidated Financial Statements.

**Morningstar Inc.**  
**Notes to Unaudited Pro forma Condensed Consolidated Financial Statements**

**1. Description of Transaction and Basis of Presentation**

On March 1, 2006, Morningstar, Inc. (Morningstar) acquired Ibbotson Associates, Inc. (Ibbotson), a privately held firm specializing in asset allocation research and services. This acquisition fits several of Morningstar's growth strategies and broadens our reach in the areas of investment consulting, managed retirement accounts, and institutional and advisor software. We paid \$86.4 million in cash for Ibbotson, subject to working capital and post-closing adjustments.

*Unaudited Pro Forma Condensed Consolidated Statement of Operations*

For purposes of the Unaudited Pro Forma Condensed Consolidated Statement of Operations, we assume the Ibbotson acquisition occurred on January 1, 2005.

Morningstar and Ibbotson have different fiscal year-ends. Morningstar's fiscal year is based on the calendar year. Ibbotson's fiscal year-end is June 30<sup>th</sup>. As a result, the Unaudited Pro Forma Condensed Consolidated Statement of Operations for the year ended December 31, 2005 has been derived from:

- The audited historical consolidated statement of operations of Morningstar for the year ended December 31, 2005
- The audited historical consolidated statement of operations of Ibbotson for the year ended June 30, 2005 plus the unaudited statement of operations for the six months ended December 31, 2005; less the unaudited statement of operations for the six months ended December 31, 2004.

In addition, we have reclassified the operating expenses included in Ibbotson's statement of operations and certain liabilities included in Ibbotson's balance sheet to conform to the presentation used in Morningstar's financial statements. These reclassifications had no effect on Ibbotson's previously reported operating income, net income, or total liabilities.

*Unaudited Pro Forma Condensed Consolidated Balance Sheet*

The Unaudited Pro Forma Condensed Consolidated Balance Sheet gives effect to the Ibbotson acquisition as if it had occurred on December 31, 2005 and has been derived from:

- Morningstar's audited historical consolidated balance sheet as of December 31, 2005
- Ibbotson's unaudited historical consolidated balance sheet as of December 31, 2005

## 2. Purchase Price

The preliminary purchase price that Morningstar paid for Ibbotson consists of the following:

	(\$000)
Ibbotson acquisition price	\$83,000
Working capital adjustment as of March 1, 2006 and other items contemplated in the Stock Purchase Agreement	3,153
Acquisition-related transaction costs	224
Total purchase price	<u>\$86,377</u>

The acquisition was an all-cash transaction. The portion of the purchase price related to working capital is subject to post-closing adjustments.

## 3. Pro Forma Purchase Price Allocation

The purchase price allocation presented in these unaudited pro forma condensed consolidated financial statements will differ from the purchase price allocation to be performed as of March 1, 2006 (date of the Ibbotson acquisition). In addition, adjustments to the purchase price allocation will be made upon settlement of the working capital or other post-closing adjustments.

For purposes of the unaudited pro forma condensed consolidated balance sheet, the \$86.4 million purchase price has been allocated to the assets recorded by Ibbotson as of December 31, 2005, based on estimated fair values. In addition, the estimated fair values at December 31, 2005 have been adjusted to reflect distributions to Ibbotson shareholders and expenses directly related to the acquisition incurred by Ibbotson, which were recorded subsequent to December 31, 2005.

The following table presents the adjustments to the Ibbotson assets acquired and liabilities assumed as of December 31, 2005. The excess of the purchase price over the values assigned to identifiable intangible and net tangible assets is allocated to goodwill.

	(\$000)
Purchase price	<u>\$86,377</u>
Ibbotson net assets as of December 31, 2005	\$ 724
Income tax receivable arising from stock options cancellation payment	11,652
Intangible assets	55,990
Distributions to Ibbotson shareholders made subsequent to December 31, 2005	(2,058)
Acquisition-related costs recorded by Ibbotson subsequent to December 31, 2005	(4,889)
Other current liabilities	(1,272)
Other non-current liabilities	(761)
Deferred tax liability related to intangible assets acquired	(22,253)
Total net assets acquired and liabilities assumed as of December 31, 2005	<u>\$37,133</u>
Goodwill	<u>\$49,244</u>

### *Income tax receivable*

As part of the preliminary purchase price allocation, we recorded an asset of \$11.7 million for the income tax benefit related to the portion of the purchase price which paid for the cancellation of Ibbotson's employee stock options. This amount will reduce the amount we anticipate paying for income taxes in 2006.

### *Intangible assets other than goodwill*

The preliminary purchase price allocation includes acquired intangible assets that consist primarily of customer-related assets, trade names, and technology-based assets. The estimated useful lives for these assets range from three to 25 years. The following table shows the components of these intangible assets and their weighted average estimated useful lives at March 1, 2006.

	(\$000)	Weighted Average Useful Life (in years)
Customer-related assets	\$ 32,300	10
Trade names	19,770	10
Technology-based assets	2,880	5
Other intangibles	1,040	9
Total intangible assets	<u>\$ 55,990</u>	10

Had the acquisition occurred on January 1, 2005, the annual amount of amortization expense related to the above intangible assets would have been \$5.9 million.

Because the amortization expense for these intangible assets is not deductible for U.S. income tax purposes, we recorded a deferred tax liability of \$22.3 million based on these preliminary values.

### *Goodwill*

The goodwill resulting from the Ibbotson acquisition is not deductible for income tax purposes. Statement of Financial Accounting Standards (SFAS) No. 109, *Income Taxes*, prohibits recognition of a deferred tax asset or liability for goodwill temporary differences if goodwill is not amortizable and deductible for tax purposes. The goodwill will be tested at least annually for impairment in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*.

#### 4. Pro Forma Adjustments

Adjustments included in the column under the heading “Pro Forma Adjustments” relate to the following:

##### *Unaudited Pro Forma Condensed Consolidated Balance Sheet*

- a. To eliminate Ibbotson’s historical equity and to record the pro forma purchase price allocation, including liabilities for distributions to Ibbotson’s shareholders and acquisition-related costs recorded by Ibbotson subsequent to December 31, 2005, as described in Note 4b. below. (See Note 3)
- b. To reflect the following cash-related payments attributable to the Ibbotson acquisition:
  - Cash paid by Morningstar of \$86.4 million. The cash paid includes the acquisition price including adjustments for working capital and other items contemplated in the Stock Purchase Agreement dated as of December 9, 2005 and costs incurred related to the acquisition.
  - Distributions of \$2.1 million paid by Ibbotson to its shareholders.
  - Acquisition-related costs of \$4.9 million paid by Ibbotson subsequent to December 31, 2005.
  - Cash paid by Ibbotson of \$1.2 million for bonuses accrued as of December 31, 2005. Upon closing of the acquisition, Ibbotson made a cash disbursement to its employees for bonuses accrued through the date of acquisition.
- c. As part of the pro forma purchase price allocation, we recorded an asset of \$11.7 million for the income tax benefit related to the portion of the purchase price considered payment for the cancellation of Ibbotson’s stock options. This amount will reduce the amount Morningstar anticipates paying for income taxes in 2006. (See Note 3 above.) In addition, we reclassified the combined income tax payable of \$1.3 million recorded by Morningstar and Ibbotson at December against the tax receivable.
- d. To reflect the payment of \$1.2 million of Ibbotson’s employee bonuses, (see Note 4b. above), and adjust other employee-related accruals related to severance and paid time off.
- e. To record a non-current liability for lease termination expenses expected to be incurred upon vacating Ibbotson office space which is deemed to be in excess of our needs.
- f. To reclassify the current deferred tax asset recorded by Ibbotson against the current deferred tax liability.

*Unaudited Pro Forma Condensed Consolidated Statement of Operations*

- g. To eliminate stock-based compensation expense of \$5.3 million recorded by Ibbotson based on the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. In conjunction with the acquisition, a portion of the purchase price paid was for the cancellation of Ibbotson's employee stock options.
- h. To record stock based compensation expense related to an estimated value of stock options assumed to be granted to Ibbotson employees. The stock based compensation expense of \$0.2 million assumes that the award was made in May 2005, consistent with the timing of Morningstar's annual equity grant and vests over a four year period. In 2005, Morningstar recorded stock-based compensation expense based on the recognition and measurement principles of SFAS No. 123, *Accounting for Stock Based Compensation*.
- i. To reflect amortization expense of intangible assets acquired for the year ended December 31, 2005. (See Note 3 above.)
- j. To reflect a reduction of Morningstar's interest income, assuming that the acquisition price had been paid on January 1, 2005, which would have reduced cash available for investment during the year.
- k. Adjustment to apply Morningstar's U.S. income tax rate to the pro forma adjustments and to Ibbotson's income before income taxes. Prior to the acquisition, Ibbotson was an S-Corporation for U.S. Federal income tax purposes.
- l. To adjust Morningstar's weighted average common shares outstanding for computing diluted income per share to reflect the assumed impact, using the treasury stock method, of the stock options assumed to have been granted to Ibbotson employees. The calculation assumes that the stock options were awarded in May 2005, consistent with the timing of Morningstar's annual equity grant. (See Note 4h. above)