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

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**FORM 10-Q**

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2011

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

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**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)

**60602**  
(Zip Code)

**(312) 696-6000**  
(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

As of July 29, 2011, there were 50,573,958 shares of the Company's common stock, no par value, outstanding.

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

| (in thousands except per share amounts)                                        | Three months ended June 30 |            | Six months ended June 30 |            |
|--------------------------------------------------------------------------------|----------------------------|------------|--------------------------|------------|
|                                                                                | 2011                       | 2010       | 2011                     | 2010       |
| Revenue                                                                        | \$ 161,011                 | \$ 136,091 | \$ 312,778               | \$ 264,381 |
| Operating expense (1):                                                         |                            |            |                          |            |
| Cost of goods sold                                                             | 45,186                     | 39,738     | 85,855                   | 74,054     |
| Development                                                                    | 13,681                     | 11,899     | 25,669                   | 22,788     |
| Sales and marketing                                                            | 26,767                     | 24,435     | 53,249                   | 46,996     |
| General and administrative                                                     | 26,207                     | 23,106     | 56,824                   | 43,749     |
| Depreciation and amortization                                                  | 10,563                     | 9,246      | 20,765                   | 18,185     |
| Total operating expense                                                        | 122,404                    | 108,424    | 242,362                  | 205,772    |
| Operating income                                                               | 38,607                     | 27,667     | 70,416                   | 58,609     |
| Non-operating income (expense):                                                |                            |            |                          |            |
| Interest income (expense), net                                                 | (179)                      | 593        | 345                      | 1,180      |
| Other income (expense), net                                                    | 188                        | (572)      | 438                      | (1,338)    |
| Non-operating income (expense), net                                            | 9                          | 21         | 783                      | (158)      |
| Income before income taxes and equity in net income of unconsolidated entities | 38,616                     | 27,688     | 71,199                   | 58,451     |
| Income tax expense                                                             | 12,724                     | 10,225     | 23,242                   | 21,220     |
| Equity in net income of unconsolidated entities                                | 595                        | 454        | 969                      | 843        |
| Consolidated net income                                                        | 26,487                     | 17,917     | 48,926                   | 38,074     |
| Net (income) loss attributable to the noncontrolling interest                  | (2)                        | 85         | 96                       | 116        |
| Net income attributable to Morningstar, Inc.                                   | \$ 26,485                  | \$ 18,002  | \$ 49,022                | \$ 38,190  |
| Net income per share attributable to Morningstar, Inc.:                        |                            |            |                          |            |
| Basic                                                                          | \$ 0.53                    | \$ 0.37    | \$ 0.98                  | \$ 0.78    |
| Diluted                                                                        | \$ 0.52                    | \$ 0.36    | \$ 0.96                  | \$ 0.76    |
| Weighted average shares outstanding:                                           |                            |            |                          |            |
| Basic                                                                          | 50,165                     | 49,234     | 49,983                   | 49,032     |
| Diluted                                                                        | 51,142                     | 50,533     | 51,041                   | 50,426     |

|                                                   | Three months ended June 30 |        | Six months ended June 30 |          |
|---------------------------------------------------|----------------------------|--------|--------------------------|----------|
|                                                   | 2011                       | 2010   | 2011                     | 2010     |
| (1) Includes stock-based compensation expense of: |                            |        |                          |          |
| Cost of goods sold                                | \$ 1,072                   | \$ 907 | \$ 1,951                 | \$ 1,622 |

|                                        |                 |                 |                 |                 |
|----------------------------------------|-----------------|-----------------|-----------------|-----------------|
| Development                            | 572             | 449             | 1,043           | 842             |
| Sales and marketing                    | 481             | 486             | 903             | 889             |
| General and administrative             | 1,718           | 1,813           | 3,595           | 3,239           |
| Total stock-based compensation expense | <u>\$ 3,843</u> | <u>\$ 3,655</u> | <u>\$ 7,492</u> | <u>\$ 6,592</u> |

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 June 30<br>2011 | As of December 31<br>2010 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|---------------------------|
| <b>Assets</b>                                                                                                                                                                 |                       |                           |
| Current assets:                                                                                                                                                               |                       |                           |
| Cash and cash equivalents                                                                                                                                                     | \$ 195,023            | \$ 180,176                |
| Investments                                                                                                                                                                   | 235,216               | 185,240                   |
| Accounts receivable, less allowance of \$767 and \$1,056, respectively                                                                                                        | 111,518               | 110,891                   |
| Deferred tax asset, net                                                                                                                                                       | 2,787                 | 2,860                     |
| Income tax receivable, net                                                                                                                                                    | 14,381                | 10,459                    |
| Other                                                                                                                                                                         | 16,497                | 17,654                    |
| Total current assets                                                                                                                                                          | 575,422               | 507,280                   |
| Property, equipment, and capitalized software, net                                                                                                                            | 62,062                | 62,105                    |
| Investments in unconsolidated entities                                                                                                                                        | 24,424                | 24,262                    |
| Goodwill                                                                                                                                                                      | 326,543               | 317,661                   |
| Intangible assets, net                                                                                                                                                        | 156,940               | 169,023                   |
| Other assets                                                                                                                                                                  | 7,675                 | 5,971                     |
| Total assets                                                                                                                                                                  | \$ 1,153,066          | \$ 1,086,302              |
| <b>Liabilities and equity</b>                                                                                                                                                 |                       |                           |
| Current liabilities:                                                                                                                                                          |                       |                           |
| Accounts payable and accrued liabilities                                                                                                                                      | \$ 38,646             | \$ 42,680                 |
| Accrued compensation                                                                                                                                                          | 50,089                | 62,404                    |
| Deferred revenue                                                                                                                                                              | 156,760               | 146,267                   |
| Other                                                                                                                                                                         | 761                   | 1,373                     |
| Total current liabilities                                                                                                                                                     | 246,256               | 252,724                   |
| Accrued compensation                                                                                                                                                          | 4,855                 | 4,965                     |
| Deferred tax liability, net                                                                                                                                                   | 19,477                | 19,975                    |
| Other long-term liabilities                                                                                                                                                   | 26,256                | 27,213                    |
| Total liabilities                                                                                                                                                             | 296,844               | 304,877                   |
| Equity:                                                                                                                                                                       |                       |                           |
| Morningstar, Inc. shareholders' equity:                                                                                                                                       |                       |                           |
| Common stock, no par value, 200,000,000 shares authorized, of which 50,539,113 and 49,874,392 shares were outstanding as of June 30, 2011 and December 31, 2010, respectively | 5                     | 5                         |
| Treasury stock at cost, 266,334 shares as of June 30, 2011 and 279,456 shares as of December 31, 2010                                                                         | (6,391)               | (6,641)                   |
| Additional paid-in capital                                                                                                                                                    | 476,456               | 458,426                   |
| Retained earnings                                                                                                                                                             | 367,310               | 323,408                   |
| Accumulated other comprehensive income:                                                                                                                                       |                       |                           |
| Currency translation adjustment                                                                                                                                               | 17,070                | 4,503                     |
| Unrealized gain on available-for-sale securities                                                                                                                              | 762                   | 615                       |
| Total accumulated other comprehensive income                                                                                                                                  | 17,832                | 5,118                     |
| Total Morningstar, Inc. shareholders' equity                                                                                                                                  | 855,212               | 780,316                   |
| Noncontrolling interest                                                                                                                                                       | 1,010                 | 1,109                     |
| Total equity                                                                                                                                                                  | 856,222               | 781,425                   |
| Total liabilities and equity                                                                                                                                                  | \$ 1,153,066          | \$ 1,086,302              |



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**Morningstar, Inc. and Subsidiaries**  
**Unaudited Condensed Consolidated Statement of Equity and Comprehensive Income (Loss)**  
**For the Six months ended June 30, 2011**

| <b>Morningstar, Inc. Shareholders' Equity</b>                                                         |                    |             |                   |                            |                   |                                               |                           |                   |  |
|-------------------------------------------------------------------------------------------------------|--------------------|-------------|-------------------|----------------------------|-------------------|-----------------------------------------------|---------------------------|-------------------|--|
| (in thousands, except share amounts)                                                                  | Common Stock       |             | Treasury Stock    | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Non Controlling Interests | Total Equity      |  |
|                                                                                                       | Shares Outstanding | Par Value   |                   |                            |                   |                                               |                           |                   |  |
| <b>Balance as of December 31, 2010</b>                                                                | 49,874,392         | \$ 5        | \$ (6,641)        | \$ 458,426                 | \$ 323,408        | \$ 5,118                                      | \$ 1,109                  | \$ 781,425        |  |
| Comprehensive income (loss):                                                                          |                    |             |                   |                            |                   |                                               |                           |                   |  |
| Net income (loss)                                                                                     |                    | —           | —                 | —                          | 49,022            | —                                             | (96)                      | 48,926            |  |
| Unrealized gain on available-for-sale investments, net of income tax of \$73                          |                    | —           | —                 | —                          | —                 | 147                                           | —                         | 147               |  |
| Foreign currency translation adjustment, net                                                          |                    | —           | —                 | —                          | —                 | 12,567                                        | (3)                       | 12,564            |  |
| Total comprehensive income (loss)                                                                     |                    | —           | —                 | —                          | 49,022            | 12,714                                        | (99)                      | 61,637            |  |
| Issuance of common stock related to stock-option exercises and vesting of restricted stock units, net | 666,614            | —           | 359               | 4,293                      | —                 | —                                             | —                         | 4,652             |  |
| Stock-based compensation — restricted stock units                                                     |                    | —           | —                 | 6,117                      | —                 | —                                             | —                         | 6,117             |  |
| Stock-based compensation — restricted stock                                                           |                    | —           | —                 | 1,308                      | —                 | —                                             | —                         | 1,308             |  |
| Stock-based compensation - stock-options                                                              |                    | —           | —                 | 67                         | —                 | —                                             | —                         | 67                |  |
| Excess tax benefit derived from stock-option exercises and vesting of restricted stock units          |                    | —           | —                 | 6,171                      | —                 | —                                             | —                         | 6,171             |  |
| Common shares repurchased                                                                             | (1,893)            | —           | (109)             | —                          | —                 | —                                             | —                         | (109)             |  |
| Dividends declared — common shares outstanding                                                        |                    | —           | —                 | —                          | (5,042)           | —                                             | —                         | (5,042)           |  |
| Dividends declared — restricted stock units                                                           |                    | —           | —                 | 74                         | (78)              | —                                             | —                         | (4)               |  |
| <b>Balance as of June 30, 2011</b>                                                                    | <b>50,539,113</b>  | <b>\$ 5</b> | <b>\$ (6,391)</b> | <b>\$ 476,456</b>          | <b>\$ 367,310</b> | <b>\$ 17,832</b>                              | <b>\$ 1,010</b>           | <b>\$ 856,222</b> |  |

See notes to unaudited condensed consolidated financial statements.

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**Unaudited Condensed Consolidated Statements of Cash Flows**

| (in thousands)                                                                                | Six months ended June 30 |            |
|-----------------------------------------------------------------------------------------------|--------------------------|------------|
|                                                                                               | 2011                     | 2010       |
| <b>Operating activities</b>                                                                   |                          |            |
| Consolidated net income                                                                       | \$ 48,926                | \$ 38,074  |
| Adjustments to reconcile consolidated net income to net cash flows from operating activities: |                          |            |
| Depreciation and amortization                                                                 | 20,765                   | 18,185     |
| Deferred income tax expense (benefit)                                                         | 454                      | (1,012)    |
| Stock-based compensation expense                                                              | 7,492                    | 6,592      |
| Provision for bad debt                                                                        | 530                      | 356        |
| Equity in net income of unconsolidated entities                                               | (969)                    | (843)      |
| Excess tax benefits from stock-option exercises and vesting of restricted stock units         | (6,171)                  | (4,205)    |
| Other, net                                                                                    | (547)                    | 1,386      |
| Changes in operating assets and liabilities, net of effects of acquisitions:                  |                          |            |
| Accounts receivable                                                                           | 617                      | (6,615)    |
| Other assets                                                                                  | 608                      | (511)      |
| Accounts payable and accrued liabilities                                                      | (5,260)                  | 2,859      |
| Accrued compensation                                                                          | (14,528)                 | (11,154)   |
| Income taxes payable                                                                          | 2,742                    | (4,255)    |
| Deferred revenue                                                                              | 8,197                    | 7,177      |
| Deferred rent                                                                                 | (657)                    | (80)       |
| Other liabilities                                                                             | (1,043)                  | (924)      |
| Cash provided by operating activities                                                         | 61,156                   | 45,030     |
| <b>Investing activities</b>                                                                   |                          |            |
| Purchases of investments                                                                      | (198,647)                | (85,528)   |
| Proceeds from maturities and sales of investments                                             | 150,360                  | 130,381    |
| Capital expenditures                                                                          | (8,418)                  | (3,839)    |
| Acquisitions, net of cash acquired                                                            | 569                      | (67,455)   |
| Other, net                                                                                    | 785                      | 889        |
| Cash used for investing activities                                                            | (55,351)                 | (25,552)   |
| <b>Financing activities</b>                                                                   |                          |            |
| Proceeds from stock-option exercises, net                                                     | 4,652                    | 3,650      |
| Excess tax benefits from stock-option exercises and vesting of restricted stock units         | 6,171                    | 4,205      |
| Common shares repurchased                                                                     | (109)                    | —          |
| Dividends paid                                                                                | (5,011)                  | —          |
| Other, net                                                                                    | (214)                    | 205        |
| Cash provided by financing activities                                                         | 5,489                    | 8,060      |
| Effect of exchange rate changes on cash and cash equivalents                                  | 3,553                    | (3,657)    |
| Net increase in cash and cash equivalents                                                     | 14,847                   | 23,881     |
| Cash and cash equivalents—beginning of period                                                 | 180,176                  | 130,496    |
| Cash and cash equivalents—end of period                                                       | \$ 195,023               | \$ 154,377 |
| <b>Supplemental disclosure of cash flow information:</b>                                      |                          |            |
| Cash paid for income taxes                                                                    | \$ 21,104                | \$ 26,396  |

**Supplemental information of non-cash investing and financing activities:**

|                                                          |    |     |    |       |
|----------------------------------------------------------|----|-----|----|-------|
| Unrealized gain (loss) on available-for-sale investments | \$ | 220 | \$ | (941) |
|----------------------------------------------------------|----|-----|----|-------|

See notes to unaudited condensed consolidated financial statements.

**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 requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue, and expenses. Actual results could differ from those estimates. In the opinion of management, the statements reflect all adjustments, which are of a normal recurring nature, necessary to present fairly our financial position, results of operations, equity, and cash flows. These financial statements and notes should be read in conjunction with our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on February 28, 2011.

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  
EITF: Emerging Issues Task Force  
FASB: Financial Accounting Standards Board  
SAB: Staff Accounting Bulletin  
SEC: Securities and Exchange Commission

**2. Summary of Significant Accounting Policies**

We discuss our significant accounting policies in Note 3 of our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on February 28, 2011.

In addition, effective January 1, 2011, we adopted FASB ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*. ASU 2009-13 supersedes EITF Issue 00-21, *Revenue Arrangements with Multiple Deliverables* and establishes the accounting and reporting guidance for arrangements when a vendor performs multiple revenue-generating activities, addresses how to separate deliverables, and specifies how to measure and allocate arrangement consideration. We are applying this guidance for revenue arrangements entered into or materially modified from January 1, 2011. The adoption of ASU 2009-13 does not significantly affect either the timing or amount of our revenue recognition.

In conjunction with the adoption of ASU 2009-13, we have updated our disclosures concerning revenue recognition, as follows:

Revenue recognition: We recognize revenue in accordance with SEC SAB Topic 13, *Revenue Recognition*, ASC 605-25, *Revenue Recognition: Multiple Element Arrangements*, and ASC 985-605, *Software: Revenue Recognition*.

We recognize revenue when all of the following conditions are met:

- There is persuasive evidence of an arrangement, as evidenced by a signed contract;
- Delivery of our products and services is a prerequisite for recognition of revenue. If arrangements include an acceptance provision, we generally begin recognizing revenue upon the receipt of customer acceptance;
- The amount of fees to be paid by the customer is fixed or determinable; and
- The collectibility of the fees is reasonably assured.

We generate revenue through sales of Licensed Data, Morningstar Advisor Workstation (including Morningstar Office), Morningstar Direct, Morningstar Equity Research, Premium membership fees for Morningstar.com, and a variety of other investment-related products and services. The revenue arrangements for these offerings are generally structured as licenses or subscriptions. We recognize revenue from licenses and subscription sales ratably as the product or service is delivered and over the service obligation period defined by the terms of the customer contract.

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We also generate revenue from Internet advertising, primarily from “impression-based” contracts. For advertisers who use our cost-per-impression pricing, we charge fees each time their ads are displayed on our site.

Investment Consulting includes a broad range of services. Pricing for the consulting services is based on the scope of work and the level of service required, and includes asset-based fees for work we perform that involves investment management or acting as a subadvisor to investment portfolios. In arrangements that involve asset-based fees, we generally invoice clients quarterly in arrears based on average assets for the quarter. We recognize asset-based fees once the fees are fixed and determinable assuming all other revenue recognition criteria are met.

Our Retirement Solutions offerings help retirement plan participants plan and invest for retirement. We offer these services both through retirement plan providers (typically third-party asset management companies that offer proprietary mutual funds) and directly to plan sponsors (employers that offer retirement plans to their employees). For our Retirement Solutions offerings, we provide both a hosted solution as well as proprietary installed software advice solution. The installed customized software can be integrated with a client’s existing systems to help investors accumulate wealth, transition into retirement, and manage income during retirement. The revenue arrangements for Retirement Solutions generally extend over multiple years. Our contracts may include one-time setup fees, implementation fees, technology licensing and maintenance fees, asset-based fees for managed retirement accounts, fixed and variable fees for advice and guidance, or a combination of these fee structures. Upon customer acceptance, we recognize revenue ratably over the term of the agreement. We recognize asset-based fees and variable fees in excess of any minimum once the value is fixed and determinable.

Some of our revenue arrangements with our customers combine multiple products and services. These products and services may be provided at different points in time or over different time periods within the same arrangement. We allocate fees to the separate deliverables based on the deliverables’ relative selling price. This relative selling price is generally based on the price we charge when the same deliverable is sold separately.

We record taxes imposed on revenue-producing transactions (such as sales, use, value-added, and some excise taxes) on a net basis; therefore, such taxes are excluded from revenue in our Consolidated Statements of Income.

Deferred revenue represents the portion of subscriptions billed or collected in advance of the service being provided, which we expect to recognize as revenue in future periods. Certain arrangements may have cancellation or refund provisions. If we make a refund, it typically reflects the amount collected from a customer for which services have not yet been provided. The refund therefore results in a reduction of deferred revenue.

### 3. Acquisitions, Goodwill, and Other Intangible Assets

#### 2011 Acquisitions

We did not complete any acquisitions in the first six months of 2011 .

#### 2010 Acquisitions

The table below summarizes the acquisitions completed during 2010 . Some of the purchase price allocations related to these acquisitions are preliminary as they relate to tax-related balances and values of certain intangible assets. Additional information concerning these acquisitions can be found in the Notes to our Consolidated Financial Statements included in our Annual Report on Form 10-K filed with the SEC on February 28, 2011 .

| Acquisition                                                               | Description                                                                                                                                                                                                                                                                | Date of Acquisition | Purchase Price*                                                                                                                                                 |
|---------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Footnoted business of Financial Fineprint Inc.                            | Footnoted is a highly regarded blog for professional money managers, analysts, and sophisticated individual investors. Footnoted Pro, a service for institutional investors, provides insight on actionable items and trends in SEC filings.                               | February 1, 2010    | Not separately disclosed                                                                                                                                        |
| Aegis Equities Research                                                   | A leading provider of independent equity research in Sydney, Australia.                                                                                                                                                                                                    | April 1, 2010       | \$10.3 million                                                                                                                                                  |
| Old Broad Street Research Ltd.                                            | A premier provider of fund research, ratings, and investment consulting services in the United Kingdom.                                                                                                                                                                    | April 12, 2010      | \$16.8 million                                                                                                                                                  |
| Realpoint, LLC                                                            | A Nationally Recognized Statistical Rating Organization (NRSRO) that specializes in structured finance.                                                                                                                                                                    | May 3, 2010         | \$38.4 million in cash and 199,174 shares of restricted stock (valued at approximately \$10 million as of the date the acquisition was announced in March 2010) |
| Morningstar Danmark A/S (Morningstar Denmark)                             | Acquisition of the 75% ownership interest not previously owned by Morningstar, bringing our ownership to 100%.                                                                                                                                                             | July 1, 2010        | \$14.6 million                                                                                                                                                  |
| Seeds Group                                                               | A leading provider of investment consulting services and fund research in France.                                                                                                                                                                                          | July 1, 2010        | Not separately disclosed                                                                                                                                        |
| Annuity Intelligence business of Advanced Sales and Marketing Corporation | The Annuity Intelligence business provides a web-based service that leverages a proprietary database of more than 1,000 variable annuities that includes "plain-English" translations of complex but important information found in prospectuses and other public filings. | November 1, 2010    | \$14.1 million                                                                                                                                                  |

\* Total purchase price, less cash acquired, subject to post closing adjustments.

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*Goodwill*

The following table shows the changes in our goodwill balances from December 31, 2010 to June 30, 2011 :

|                                       | (\$000)           |
|---------------------------------------|-------------------|
| Balance as of December 31, 2010       | \$ 317,661        |
| Adjustments to 2010 acquisitions      | 1,387             |
| Other, primarily currency translation | 7,495             |
| Balance as of June 30, 2011           | <u>\$ 326,543</u> |

We did not record any impairment losses in the second quarter of 2011 and 2010 , respectively. We perform our annual impairment reviews in the fourth quarter.

The following table summarizes our intangible assets:

| (\$000)                                                                               | As of June 30, 2011 |                          |                   | Weighted Average Useful Life (years) | As of December 31, 2010 |                          |                   | Weighted Average Useful Life (years) |
|---------------------------------------------------------------------------------------|---------------------|--------------------------|-------------------|--------------------------------------|-------------------------|--------------------------|-------------------|--------------------------------------|
|                                                                                       | Gross               | Accumulated Amortization | Net               |                                      | Gross                   | Accumulated Amortization | Net               |                                      |
| Intellectual property                                                                 | \$ 32,759           | \$ (17,744)              | \$ 15,015         | 10                                   | \$ 33,990               | \$ (15,970)              | \$ 18,020         | 10                                   |
| Customer-related assets                                                               | 137,412             | (46,880)                 | 90,532            | 12                                   | 130,675                 | (39,951)                 | 90,724            | 11                                   |
| Supplier relationships                                                                | 240                 | (78)                     | 162               | 20                                   | 240                     | (72)                     | 168               | 20                                   |
| Technology-based assets                                                               | 81,556              | (30,992)                 | 50,564            | 9                                    | 78,651                  | (25,682)                 | 52,969            | 9                                    |
| Non-competition agreement                                                             | 1,781               | (1,114)                  | 667               | 4                                    | 1,751                   | (909)                    | 842               | 4                                    |
| Intangible assets related to acquisitions with preliminary purchase price allocations | —                   | —                        | —                 | —                                    | 6,407                   | (107)                    | 6,300             | 10                                   |
| Total intangible assets                                                               | <u>\$ 253,748</u>   | <u>\$ (96,808)</u>       | <u>\$ 156,940</u> | 10                                   | <u>\$ 251,714</u>       | <u>\$ (82,691)</u>       | <u>\$ 169,023</u> | 10                                   |

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

| (\$000)              | Three months ended June 30 |          | Six months ended June 30 |           |
|----------------------|----------------------------|----------|--------------------------|-----------|
|                      | 2011                       | 2010     | 2011                     | 2010      |
| Amortization expense | \$ 6,632                   | \$ 5,848 | \$ 13,145                | \$ 11,316 |

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

We expect intangible amortization expense for 2011 and subsequent years as follows:

|      | (\$000)   |
|------|-----------|
| 2011 | \$ 25,947 |
| 2012 | 24,416    |
| 2013 | 21,677    |
| 2014 | 20,407    |
| 2015 | 19,525    |
| 2016 | 14,896    |

Our estimates of future amortization expense for intangible assets may be affected by changes to the preliminary purchase price allocations, additional acquisitions, and currency translations.

#### 4. Income Per Share

We compute income per share based on the two-class method, in accordance with FASB ASC 260-10-45-59A, *Participating Securities and the Two Class Method*. We issued restricted shares in conjunction with the Realpoint acquisition. Because the restricted shares contain nonforfeitable rights to dividends, they meet the criteria of a participating security. Under the two-class method, earnings are allocated between common stock and participating securities. The two-class method includes an earnings allocation formula that determines earnings per share for each class of common stock according to dividends declared and undistributed earnings for the period. We reduce our reported net earnings by the amount allocated to participating securities to arrive at the earnings allocated to common stock shareholders for purposes of calculating earnings per share.

ASC 260-10-45-59A requires the dilutive effect of participating securities to be calculated using the more dilutive of the treasury stock or the two-class method. We have determined the two-class method to be the more dilutive of the two methods. As such, we adjusted the earnings allocated to common stock shareholders in the basic earnings per share calculation for the reallocation of undistributed earnings to participating securities to calculate diluted earnings 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:

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| (in thousands, except per share amounts)                                                                             | Three months ended June 30 |                  | Six months ended June 30 |                  |
|----------------------------------------------------------------------------------------------------------------------|----------------------------|------------------|--------------------------|------------------|
|                                                                                                                      | 2011                       | 2010             | 2011                     | 2010             |
| <b>Basic net income per share attributable to Morningstar, Inc.:</b>                                                 |                            |                  |                          |                  |
| Net income attributable to Morningstar, Inc.:                                                                        | \$ 26,485                  | \$ 18,002        | \$ 49,022                | \$ 38,190        |
| Less: Distributed earnings available to participating securities                                                     | (8)                        | —                | (17)                     | —                |
| Less: Undistributed earnings available to participating securities                                                   | (72)                       | —                | (131)                    | —                |
| Numerator for basic net income per share — undistributed and distributed earnings available to common shareholders   | <u>\$ 26,405</u>           | <u>\$ 18,002</u> | <u>\$ 48,874</u>         | <u>\$ 38,190</u> |
| Weighted average common shares outstanding                                                                           | 50,165                     | 49,234           | 49,983                   | 49,032           |
| Basic net income per share attributable to Morningstar, Inc.                                                         | \$ 0.53                    | \$ 0.37          | \$ 0.98                  | \$ 0.78          |
| <b>Diluted net income per share attributable to Morningstar, Inc.:</b>                                               |                            |                  |                          |                  |
| Numerator for basic net income per share — undistributed and distributed earnings available to common shareholders   | \$ 26,405                  | \$ 18,002        | \$ 48,874                | \$ 38,190        |
| Add: Undistributed earnings allocated to participating securities                                                    | 72                         | —                | 131                      | —                |
| Less: Undistributed earnings reallocated to participating securities                                                 | (70)                       | —                | (129)                    | —                |
| Numerator for diluted net income per share — undistributed and distributed earnings available to common shareholders | <u>\$ 26,407</u>           | <u>\$ 18,002</u> | <u>\$ 48,876</u>         | <u>\$ 38,190</u> |
| Weighted average common shares outstanding                                                                           | 50,165                     | 49,234           | 49,983                   | 49,032           |
| Net effect of dilutive stock options and restricted stock units                                                      | 977                        | 1,299            | 1,058                    | 1,394            |
| Weighted average common shares outstanding for computing diluted income per share                                    | <u>51,142</u>              | <u>50,533</u>    | <u>51,041</u>            | <u>50,426</u>    |
| Diluted net income per share attributable to Morningstar, Inc.                                                       | \$ 0.52                    | \$ 0.36          | \$ 0.96                  | \$ 0.76          |

## 5. Segment and Geographical Area Information

Morningstar has two operating segments:

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

The largest products in this segment based on revenue are Licensed Data, Morningstar Advisor Workstation (including Morningstar Office), Morningstar.com, Morningstar Direct, Morningstar Integrated Web Tools (formerly Morningstar Site Builder), and Morningstar Principia. Licensed Data is a set of investment data spanning all of our investment databases, including real-time pricing data, and is available through electronic data feeds. Advisor Workstation is a web-based investment planning system for advisors. Advisor Workstation is available in two editions: Morningstar Office for independent financial advisors and an enterprise edition for financial advisors affiliated with larger firms. Morningstar.com includes both Premium Memberships and Internet advertising sales. Morningstar Direct is a web-based institutional research platform. Morningstar Integrated Web Tools is a set of services that helps institutional clients build customized websites or enhance their existing sites with Morningstar's online tools and components. Principia is our CD-ROM-based investment research and planning software for advisors.

The Investment Information segment also includes Morningstar Equity Research, which we sell to other companies that purchase our research for their own use or provide our research to their affiliated advisors or individual investor clients.

- *Investment Management.* The Investment Management segment includes all of our asset management operations, which earn the majority of their revenue from asset-based fees.

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

Our segment accounting policies are the same as those described in Note 2, except for the capitalization and amortization of internal product development costs, amortization of intangible assets, and costs related to corporate functions. We exclude these items from our operating segment results to provide our chief operating decision maker with a better indication of each segment's ability to generate cash flow. This information is one of the criteria used by our chief operating decision maker in determining how to allocate resources to each segment. We include capitalization and amortization of internal product development costs, amortization of intangible assets, and costs related to corporate functions in the Corporate Items category. Our segment disclosures are consistent with the business segment information provided to our chief operating decision maker on a recurring basis; for that reason, we don't present balance sheet information by segment. We disclose goodwill by segment in accordance with the requirements of FASB ASC 350-20-50, *Intangibles - Goodwill - Disclosure*.

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The following tables show selected segment data for the three and six months ended June 30, 2011 and 2010 :

| (\$000)                                                                                       | Three months ended June 30, 2011 |                       |                 |            |
|-----------------------------------------------------------------------------------------------|----------------------------------|-----------------------|-----------------|------------|
|                                                                                               | Investment Information           | Investment Management | Corporate Items | Total      |
| External revenue                                                                              | \$ 128,116                       | \$ 32,895             | \$ —            | \$ 161,011 |
| Operating expense, excluding stock-based compensation expense, depreciation, and amortization | 86,484                           | 13,833                | 7,681           | 107,998    |
| Stock-based compensation expense                                                              | 2,488                            | 531                   | 824             | 3,843      |
| Depreciation and amortization                                                                 | 2,047                            | 40                    | 8,476           | 10,563     |
| Operating income (loss)                                                                       | \$ 37,097                        | \$ 18,491             | \$ (16,981)     | \$ 38,607  |

|                               |            |
|-------------------------------|------------|
| U.S. capital expenditures     | \$ 1,593   |
| Non-U.S. capital expenditures | \$ 1,788   |
| U.S. revenue                  | \$ 113,424 |
| Non-U.S. revenue              | \$ 47,587  |

| (\$000)                                                                                       | Three months ended June 30, 2010 |                       |                 |            |
|-----------------------------------------------------------------------------------------------|----------------------------------|-----------------------|-----------------|------------|
|                                                                                               | Investment Information           | Investment Management | Corporate Items | Total      |
| External revenue                                                                              | \$ 109,021                       | \$ 27,070             | \$ —            | \$ 136,091 |
| Operating expense, excluding stock-based compensation expense, depreciation, and amortization | 74,785                           | 12,166                | 8,572           | 95,523     |
| Stock-based compensation expense                                                              | 2,112                            | 539                   | 1,004           | 3,655      |
| Depreciation and amortization                                                                 | 1,582                            | 44                    | 7,620           | 9,246      |
| Operating income (loss)                                                                       | \$ 30,542                        | \$ 14,321             | \$ (17,196)     | \$ 27,667  |

|                               |           |
|-------------------------------|-----------|
| U.S. capital expenditures     | \$ 731    |
| Non-U.S. capital expenditures | \$ 1,458  |
| U.S. revenue                  | \$ 98,986 |
| Non-U.S. revenue              | \$ 37,105 |

| (\$000)                                                                                       | Six months ended June 30, 2011 |                       |                 |            |
|-----------------------------------------------------------------------------------------------|--------------------------------|-----------------------|-----------------|------------|
|                                                                                               | Investment Information         | Investment Management | Corporate Items | Total      |
| External revenue                                                                              | \$ 248,515                     | \$ 64,263             | \$ —            | \$ 312,778 |
| Operating expense, excluding stock-based compensation expense, depreciation, and amortization | 170,247                        | 27,671                | 16,187          | 214,105    |
| Stock-based compensation expense                                                              | 4,958                          | 973                   | 1,561           | 7,492      |
| Depreciation and amortization                                                                 | 3,906                          | 82                    | 16,777          | 20,765     |
| Operating income (loss)                                                                       | \$ 69,404                      | \$ 35,537             | \$ (34,525)     | \$ 70,416  |

|                               |            |
|-------------------------------|------------|
| U.S. capital expenditures     | \$ 3,523   |
| Non-U.S. capital expenditures | \$ 4,895   |
| U.S. revenue                  | \$ 221,605 |
| Non-U.S. revenue              | \$ 91,173  |



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| (\$000)                                                                                       | Six months ended June 30, 2010 |                       |                 |            |
|-----------------------------------------------------------------------------------------------|--------------------------------|-----------------------|-----------------|------------|
|                                                                                               | Investment Information         | Investment Management | Corporate Items | Total      |
| External revenue                                                                              | \$ 212,545                     | \$ 51,836             | \$ —            | \$ 264,381 |
| Operating expense, excluding stock-based compensation expense, depreciation, and amortization | 142,430                        | 23,098                | 15,467          | 180,995    |
| Stock-based compensation expense                                                              | 3,600                          | 1,032                 | 1,960           | 6,592      |
| Depreciation and amortization                                                                 | 3,227                          | 92                    | 14,866          | 18,185     |
| Operating income (loss)                                                                       | \$ 63,288                      | \$ 27,614             | \$ (32,293)     | \$ 58,609  |
| U.S. capital expenditures                                                                     |                                |                       |                 | \$ 1,632   |
| Non-U.S. capital expenditures                                                                 |                                |                       |                 | \$ 2,207   |
| U.S. revenue                                                                                  |                                |                       |                 | \$ 191,596 |
| Non-U.S. revenue                                                                              |                                |                       |                 | \$ 72,785  |

| (000's)                    | As of June 30, 2011    |                       |                 |            |
|----------------------------|------------------------|-----------------------|-----------------|------------|
|                            | Investment Information | Investment Management | Corporate Items | Total      |
| Goodwill                   | \$ 284,097             | \$ 42,446             | \$ —            | \$ 326,543 |
| U.S. long-lived assets     |                        |                       |                 | \$ 38,772  |
| Non-U.S. long-lived assets |                        |                       |                 | \$ 23,290  |

| (000's)                    | As of December 31, 2010 |                       |                 |            |
|----------------------------|-------------------------|-----------------------|-----------------|------------|
|                            | Investment Information  | Investment Management | Corporate Items | Total      |
| Goodwill                   | \$ 275,611              | \$ 42,050             | \$ —            | \$ 317,661 |
| U.S. long-lived assets     |                         |                       |                 | \$ 39,496  |
| Non-U.S. long-lived assets |                         |                       |                 | \$ 22,609  |

## 6. Investments and Fair Value Measurements

We account for our investments in accordance with FASB ASC 320, *Investments—Debt and Equity Securities*. We classify our investments in three categories: available-for-sale, held-to-maturity, and trading. We monitor the concentration, diversification, maturity, and liquidity of our investment portfolio, which is primarily invested in fixed-income securities, and classify our investment portfolio as shown below:

| (\$000)            | As of June 30 | As of December 31 |
|--------------------|---------------|-------------------|
|                    | 2011          | 2010              |
| Available-for-sale | \$ 214,211    | \$ 173,072        |
| Held-to-maturity   | 15,496        | 7,476             |
| Trading securities | 5,509         | 4,692             |
| Total              | \$ 235,216    | \$ 185,240        |

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

| (\$000)                                     | As of June 30, 2011 |                 |                 |                   | As of December 31, 2010 |                 |                 |                   |
|---------------------------------------------|---------------------|-----------------|-----------------|-------------------|-------------------------|-----------------|-----------------|-------------------|
|                                             | Cost                | Unrealized Gain | Unrealized Loss | Fair Value        | Cost                    | Unrealized Gain | Unrealized Loss | Fair Value        |
| Available-for-sale:                         |                     |                 |                 |                   |                         |                 |                 |                   |
| Government obligations                      | \$ 116,101          | \$ 58           | \$ (46)         | \$ 116,113        | \$ 113,597              | \$ 36           | \$ (56)         | \$ 113,577        |
| Corporate bonds                             | 55,758              | 86              | (56)            | 55,788            | 42,839                  | 63              | (24)            | 42,878            |
| Commercial paper                            | 25,959              | 6               | (3)             | 25,962            | 2,994                   | —               | (3)             | 2,991             |
| Equity securities and exchange-traded funds | 6,182               | 312             | (46)            | 6,448             | 4,510                   | 418             | (6)             | 4,922             |
| Mutual funds                                | 9,006               | 894             | —               | 9,900             | 8,146                   | 558             | —               | 8,704             |
| <b>Total</b>                                | <b>\$ 213,006</b>   | <b>\$ 1,356</b> | <b>\$ (151)</b> | <b>\$ 214,211</b> | <b>\$ 172,086</b>       | <b>\$ 1,075</b> | <b>\$ (89)</b>  | <b>\$ 173,072</b> |

|                         |           |      |      |           |          |      |      |          |
|-------------------------|-----------|------|------|-----------|----------|------|------|----------|
| Held-to-maturity:       |           |      |      |           |          |      |      |          |
| Certificates of deposit | \$ 15,496 | \$ — | \$ — | \$ 15,496 | \$ 7,476 | \$ — | \$ — | \$ 7,476 |

As of June 30, 2011 and December 31, 2010, investments with unrealized losses for greater than a 12-month period were not material to the Condensed Consolidated Balance Sheets and were not deemed to have other than temporary declines in value.

The table below shows the cost and fair value of investments classified as available-for-sale and held-to-maturity based on their contractual maturities as of June 30, 2011 and December 31, 2010. The expected maturities of certain fixed-income securities may differ from their contractual maturities because some of these holdings have call features that allow the issuers the right to prepay obligations without penalties.

| (\$000)                                                    | As of June 30, 2011 |                   | As of December 31, 2010 |                   |
|------------------------------------------------------------|---------------------|-------------------|-------------------------|-------------------|
|                                                            | Cost                | Fair Value        | Cost                    | Fair Value        |
| Available-for-sale:                                        |                     |                   |                         |                   |
| Due in one year or less                                    | \$ 143,986          | \$ 144,052        | \$ 85,990               | \$ 85,964         |
| Due in one to two years                                    | 53,832              | 53,811            | 73,440                  | 73,482            |
| Equity securities, exchange-traded funds, and mutual funds | 15,188              | 16,348            | 12,656                  | 13,626            |
| <b>Total</b>                                               | <b>\$ 213,006</b>   | <b>\$ 214,211</b> | <b>\$ 172,086</b>       | <b>\$ 173,072</b> |
| Held-to-maturity:                                          |                     |                   |                         |                   |
| Due in one year or less                                    | \$ 15,490           | \$ 15,490         | \$ 7,223                | \$ 7,223          |
| Due in more than one year                                  | 6                   | 6                 | 253                     | 253               |
| <b>Total</b>                                               | <b>\$ 15,496</b>    | <b>\$ 15,496</b>  | <b>\$ 7,476</b>         | <b>\$ 7,476</b>   |

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

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The following table shows the realized gains and losses arising from sales of our investments classified as available-for-sale recorded in our Condensed Consolidated Statements of Income:

| (\$000)             | Six months ended June 30 |       |
|---------------------|--------------------------|-------|
|                     | 2011                     | 2010  |
| Realized gains      | \$ 397                   | \$ 17 |
| Realized losses     | —                        | (8)   |
| Realized gains, net | \$ 397                   | \$ 9  |

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

| (\$000)              | Six months ended June 30 |        |
|----------------------|--------------------------|--------|
|                      | 2011                     | 2010   |
| Unrealized loss, net | \$ 9                     | \$ 398 |

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

| (\$000)                                     | Fair Value<br>as of<br>June 30, 2011 | Fair Value Measurements as of June 30, 2011<br>Using Fair Value Hierarchy |            |         |
|---------------------------------------------|--------------------------------------|---------------------------------------------------------------------------|------------|---------|
|                                             |                                      | Level 1                                                                   | Level 2    | Level 3 |
| Available-for-sale investments              |                                      |                                                                           |            |         |
| Government obligations                      | \$ 116,113                           | \$ —                                                                      | \$ 116,113 | \$ —    |
| Corporate bonds                             | 55,788                               | —                                                                         | 55,788     | —       |
| Commercial paper                            | 25,962                               | —                                                                         | 25,962     | —       |
| Equity securities and exchange-traded funds | 6,448                                | 6,448                                                                     | —          | —       |
| Mutual funds                                | 9,900                                | 9,900                                                                     | —          | —       |
| Trading securities                          | 5,509                                | 5,509                                                                     | —          | —       |
| Total                                       | \$ 219,720                           | \$ 21,857                                                                 | \$ 197,863 | \$ —    |

| (\$000)                                     | Fair Value<br>as of<br>December 31, 2010 | Fair Value Measurements as of December 31, 2010<br>Using Fair Value Hierarchy |            |         |
|---------------------------------------------|------------------------------------------|-------------------------------------------------------------------------------|------------|---------|
|                                             |                                          | Level 1                                                                       | Level 2    | Level 3 |
| Available-for-sale investments              |                                          |                                                                               |            |         |
| Government obligations                      | \$ 113,577                               | \$ —                                                                          | \$ 113,577 | \$ —    |
| Corporate bonds                             | 42,878                                   | —                                                                             | 42,878     | —       |
| Commercial paper                            | 2,991                                    | —                                                                             | 2,991      | —       |
| Equity securities and exchange-traded funds | 4,922                                    | 4,922                                                                         | —          | —       |
| Mutual funds                                | 8,704                                    | 8,704                                                                         | —          | —       |
| Trading securities                          | 4,692                                    | 4,692                                                                         | —          | —       |
| Total                                       | \$ 177,764                               | \$ 18,318                                                                     | \$ 159,446 | \$ —    |

- Level 1: Valuations based on quoted prices in active markets for identical assets or liabilities that we have the ability to access.
- Level 2: Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3: Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Based on our analysis of the nature and risks of our investments in equity securities and mutual funds, we have determined that presenting these investment categories each in the aggregate is appropriate.

## 7. Investments in Unconsolidated Entities

Our investments in unconsolidated entities consist primarily of the following:

| (\$000)                                         | As of June 30 | As of December 31 |
|-------------------------------------------------|---------------|-------------------|
|                                                 | 2011          | 2010              |
| Investment in MJKK                              | \$ 18,971     | \$ 19,036         |
| Other equity method investments                 | 232           | 109               |
| Investments accounted for using the cost method | 5,221         | 5,117             |
| Total investments in unconsolidated entities    | \$ 24,424     | \$ 24,262         |

*Morningstar Japan K.K.* Morningstar Japan K.K. (MJKK) develops and markets products and services customized for the Japanese market. MJKK's shares are traded on the Osaka Stock Exchange, "Hercules Market," using the ticker 4765. We account for our investment in MJKK using the equity method. The following table summarizes our ownership percentage in MJKK and the market value of this investment based on MJKK's publicly quoted share price:

|                                                              | As of June 30 | As of December 31 |
|--------------------------------------------------------------|---------------|-------------------|
|                                                              | 2011          | 2010              |
| Morningstar's approximate ownership of MJKK                  | 33%           | 34%               |
| Approximate market value of Morningstar's ownership in MJKK: |               |                   |
| Japanese yen (¥000)                                          | ¥ 2,674,000   | ¥ 3,197,000       |
| Equivalent U.S. dollars (\$000)                              | \$ 33,022     | \$ 38,361         |

*Other Equity Method Investments* . As of June 30, 2011 and December 31, 2010 , other equity method investments include our investment in Morningstar Sweden AB (Morningstar Sweden). Morningstar Sweden develops and markets products and services customized for its respective market. Our ownership interest in Morningstar Sweden was approximately 24% as of June 30, 2011 and December 31, 2010 .

*Cost Method Investments* . As of June 30, 2011 and December 31, 2010 , our cost method investments consist mainly of minority investments in Pitchbook Data, Inc. (Pitchbook) and Bundle Corporation (Bundle). Pitchbook offers detailed data and information about private equity transactions, investors, companies, limited partners, and service providers. Bundle is a social media company dedicated to helping people make smarter spending and saving choices. Its website, Bundle.com, features a money comparison tool that shows spending trends across the United States, along with a range of information on saving, investing, and budgeting. We did not record any impairment losses on our cost method investments in the first six months of 2011 and 2010 , respectively.

## 8. Liability for Vacant Office Space

The following table shows the change in our liability for vacant office space from December 31, 2010 to June 30, 2011 :

| Liability for vacant office space         | (\$000)  |
|-------------------------------------------|----------|
| Balance as of December 31, 2010           | \$ 2,429 |
| Reduction of liability for lease payments | (855)    |
| Balance as of June 30, 2011               | \$ 1,574 |

## 9. Stock-Based Compensation

### *Stock-Based Compensation Plans*

In November 2004, we adopted the 2004 Stock Incentive Plan. The 2004 Stock Incentive Plan provides for grants of options, stock appreciation rights, restricted stock units, and performance shares. All of our employees and our non-employee directors are eligible for awards under the 2004 Stock Incentive Plan. Since the adoption of the 2004 Stock Incentive Plan, we have granted stock options, restricted stock units, and restricted stock.

Prior to November 2004, we granted stock options under various plans, including the 1993 Stock Option Plan, the 2000 Morningstar Stock Option Plan, and the 2001 Morningstar Stock Option Plan (collectively, the Prior Plans). The 2004 Stock Incentive Plan amends and restates the Prior Plans. Under the 2004 Stock Incentive Plan, we will not grant any additional options under any of the Prior Plans, and any shares subject to an award under any of the Prior Plans that are forfeited, canceled, settled, or otherwise terminated without a distribution of shares, or withheld by us in connection with the exercise of options or in payment of any required income tax withholding, were not available for awards under the 2004 Stock Incentive Plan.

In May 2011, we adopted the 2011 Stock Incentive Plan (the 2011 Plan). With the adoption of the 2011 Plan, we will not grant any additional awards under the 2004 Stock Incentive Plan. The 2011 Plan provides for grants of options, stock appreciation rights, restricted stock units, and performance shares. All of our employees and our non-employee directors are eligible for awards under the 2011 Plan. Grants awarded under the 2011 Plan or the 2004 Stock Incentive Plan that are forfeited, canceled, settled, or otherwise terminated without a distribution of shares, or shares withheld by us in connection with the exercise of options or in payment of any required income tax withholding, will be available for awards under the 2011 Plan.

The following table summarizes the number of shares available for future grants under our 2011 Plan:

| (000)                              | As of June 30<br>2011 |
|------------------------------------|-----------------------|
| Shares available for future grants | 5,000                 |

### *Accounting for Stock-Based Compensation Awards*

The following table summarizes our stock-based compensation expense and the related income tax benefit we recorded in the three and six months ended June 30, 2011 and June 30, 2010 :

| (\$000)                                                            | Three months ended June 30 |                 | Six months ended June 30 |                 |
|--------------------------------------------------------------------|----------------------------|-----------------|--------------------------|-----------------|
|                                                                    | 2011                       | 2010            | 2011                     | 2010            |
| Restricted stock units                                             | \$ 3,332                   | \$ 3,343        | \$ 6,117                 | \$ 6,280        |
| Restricted stock                                                   | 444                        | 312             | 1,308                    | 312             |
| Stock options                                                      | 67                         | —               | 67                       | —               |
| Total stock-based compensation expense                             | <u>\$ 3,843</u>            | <u>\$ 3,655</u> | <u>\$ 7,492</u>          | <u>\$ 6,592</u> |
| Income tax benefit related to the stock-based compensation expense | \$ 944                     | \$ 1,008        | \$ 1,669                 | \$ 1,901        |

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The following table summarizes the amount of unrecognized stock-based compensation expense as of June 30, 2011 and the expected number of months over which the expense will be recognized:

|                                                     | Unrecognized<br>stock-based<br>compensation<br>expense (\$000) | Expected<br>amortization<br>period (months) |
|-----------------------------------------------------|----------------------------------------------------------------|---------------------------------------------|
| Restricted stock units                              | \$ 33,520                                                      | 36                                          |
| Restricted stock                                    | 6,807                                                          | 46                                          |
| Stock options                                       | 1,978                                                          | 45                                          |
| Total unrecognized stock-based compensation expense | <u>\$ 42,305</u>                                               | <u>38</u>                                   |

In accordance with FASB ASC 718, *Compensation—Stock Compensation*, we estimate forfeitures of employee stock-based awards and recognize compensation cost only for those awards expected to vest. Because our largest annual equity grants typically have vesting dates in the second quarter, we adjust the stock-based compensation expense at that time to reflect those awards that ultimately vested and update our estimate of the forfeiture rate that will be applied to awards not yet vested.

### *Restricted Stock Units*

Restricted stock units represent the right to receive a share of Morningstar common stock when that unit vests. Restricted stock units granted under the 2004 Stock Incentive Plan generally vest ratably over a four-year period. For restricted stock units granted through December 31, 2008, employees could elect to defer receipt of the Morningstar common stock issued upon vesting of the restricted stock unit.

We measure the fair value of our restricted stock units on the date of grant based on the closing market price of the underlying common stock on the day prior to grant. We amortize that value to stock-based compensation expense, net of estimated forfeitures, ratably over the vesting period.

The following table summarizes restricted stock unit activity during the first six months of 2011 :

| Restricted Stock Units (RSUs)      | Unvested       | Vested but<br>Deferred | Total          | Weighted<br>Average<br>Grant Date Value<br>per RSU |
|------------------------------------|----------------|------------------------|----------------|----------------------------------------------------|
| RSUs outstanding—December 31, 2010 | 777,666        | 45,189                 | 822,855        | \$ 47.14                                           |
| Granted                            | 264,402        | —                      | 264,402        | 57.25                                              |
| Vested                             | (221,806)      | —                      | (221,806)      | 48.37                                              |
| Vested but deferred                | (1,726)        | 1,726                  | —              | —                                                  |
| Issued                             | —              | (26,962)               | (26,962)       | 46.71                                              |
| Forfeited                          | (58,025)       | —                      | (58,025)       | 47.45                                              |
| RSUs outstanding—June 30, 2011     | <u>760,511</u> | <u>19,953</u>          | <u>780,464</u> | 50.20                                              |

### *Restricted Stock*

In conjunction with the Realpoint acquisition in May 2010, we issued 199,174 shares of restricted stock to the selling employee-shareholders under the 2004 Stock Incentive Plan. The restricted stock vests ratably over a five-year period from the acquisition date and may be subject to forfeiture if the holder terminates his or her employment during the vesting period.

Because of the terms of the restricted share agreements prepared in conjunction with the Realpoint acquisition, we account for the grant of restricted shares as stock-based compensation expense and not as part of the acquisition consideration. See Note 3, in the Notes to our Condensed Consolidated Financial Statements, for additional information concerning the Realpoint acquisition.

We measured the fair value of the restricted stock on the date of grant based on the closing market price of our common stock on the day prior to the grant. We amortize the fair value of \$9,363,000 to stock-based compensation

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expense over the vesting period. The stock-based compensation expense recorded in the first six months of 2011 includes approximately \$396,000 of expense recognized upon the accelerated vesting of a restricted stock grant. We have assumed that all of the remaining restricted stock will ultimately vest, and therefore we have not incorporated a forfeiture rate for purposes of determining the stock-based compensation expense.

*Stock Options*

Stock options granted under the 2004 Stock Incentive Plan generally vest ratably over a four-year period and expire 10 years after the date of grant. Almost all of the options granted under this plan have a premium feature in which the exercise price increases over the term of the option at a rate equal to the 10-year Treasury bond yield as of the date of grant.

In May 2011, we granted 86,106 stock options under the 2004 Stock Incentive Plan. We estimated the fair value on the date of grant using a Black-Scholes option-pricing model. The fair value of these options using this model was \$23.75 per share, based on the following assumptions:

**Assumptions for Black-Scholes Option Pricing Model**

|                          |         |   |
|--------------------------|---------|---|
| Expected life (years):   | 7.4     |   |
| Volatility factor:       | 35.1    | % |
| Dividend yield:          | 0.35    | % |
| Interest rate:           | 2.87    | % |
| Expected exercise price: | \$57.28 |   |

The following tables summarize stock option activity in the first six months of 2011 for our various stock option grants. The first table includes activity for options granted at an exercise price below the fair value per share of our common stock on the grant date; the second table includes activity for all other option grants.

| <b>Options Granted At an Exercise Price Below the Fair Value Per Share on the Grant Date</b> | <b>Underlying Shares</b> | <b>Weighted Average Exercise Price</b> |
|----------------------------------------------------------------------------------------------|--------------------------|----------------------------------------|
| Options outstanding—December 31, 2010                                                        | 648,885                  | \$ 18.91                               |
| Granted                                                                                      | —                        | —                                      |
| Canceled                                                                                     | —                        | —                                      |
| Exercised                                                                                    | (114,956)                | 18.95                                  |
| Options outstanding—June 30, 2011                                                            | <u>533,929</u>           | 19.32                                  |
| Options exercisable— June 30, 2011                                                           | 533,929                  | \$ 19.32                               |

| <b>All Other Option Grants, Excluding Activity Shown Above</b> | <b>Underlying Shares</b> | <b>Weighted Average Exercise Price</b> |
|----------------------------------------------------------------|--------------------------|----------------------------------------|
| Options outstanding—December 31, 2010                          | 1,207,540                | \$ 17.09                               |
| Granted                                                        | 86,106                   | 57.28                                  |
| Canceled                                                       | (450)                    | 21.12                                  |
| Exercised                                                      | (374,630)                | 15.66                                  |
| Options outstanding— June 30, 2011                             | <u>918,566</u>           | 21.71                                  |
| Options exercisable— June 30, 2011                             | 832,460                  | \$ 18.03                               |

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The following table summarizes the total intrinsic value (difference between the market value of our stock on the date of exercise and the exercise price of the option) of options exercised:

| (\$000)                              | Six months ended June 30 |           |
|--------------------------------------|--------------------------|-----------|
|                                      | 2011                     | 2010      |
| Intrinsic value of options exercised | \$ 20,137                | \$ 14,502 |

The table below shows additional information for options outstanding and exercisable as of June 30, 2011 :

| Range of Exercise Prices | Options Outstanding |                                                     |                                 |                                   | Options Exercisable |                                                     |                                 |                                   |
|--------------------------|---------------------|-----------------------------------------------------|---------------------------------|-----------------------------------|---------------------|-----------------------------------------------------|---------------------------------|-----------------------------------|
|                          | Number of Options   | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Aggregate Intrinsic Value (\$000) | Exercisable Shares  | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Aggregate Intrinsic Value (\$000) |
| \$8.57 - \$14.70         | 410,323             | 1.34                                                | \$ 9.78                         | \$ 20,926                         | 410,323             | 1.34                                                | \$ 9.78                         | \$ 20,926                         |
| \$19.33 - \$43.87        | 956,066             | 3.44                                                | 22.29                           | 36,799                            | 956,066             | 3.44                                                | 22.29                           | 36,799                            |
| \$57.28                  | 86,106              | 9.88                                                | 57.28                           | 301                               | —                   | —                                                   | —                               | —                                 |
| <b>\$8.57 - \$57.28</b>  | <b>1,452,495</b>    | <b>3.23</b>                                         | <b>20.83</b>                    | <b>\$ 58,026</b>                  | <b>1,366,389</b>    | <b>2.81</b>                                         | <b>18.54</b>                    | <b>\$ 57,725</b>                  |

**Vested or Expected to Vest**

|                  |           |      |          |           |
|------------------|-----------|------|----------|-----------|
| \$8.57 - \$57.28 | 1,452,495 | 3.23 | \$ 20.83 | \$ 58,026 |
|------------------|-----------|------|----------|-----------|

The aggregate intrinsic value in the table above represents the total pretax intrinsic value all option holders would have received if they had exercised all outstanding options on June 30, 2011 . The intrinsic value is based on our closing stock price of \$60.78 on that date.

*Excess Tax Benefits Related to Stock-Based Compensation*

FASB ASC 718, *Compensation—Stock Compensation*, requires that we classify the cash flows that result from excess tax benefits as financing cash flows. Excess tax benefits correspond to the portion of the tax deduction taken on our income tax return that exceeds the amount of tax benefit related to the compensation cost recognized in our Statement of Income. The following table summarizes our excess tax benefits for the three and six months ended June 30, 2011 and June 30, 2010 :

| (\$000)                                                 | Three months ended June 30 |          | Six months ended June 30 |          |
|---------------------------------------------------------|----------------------------|----------|--------------------------|----------|
|                                                         | 2011                       | 2010     | 2011                     | 2010     |
| Excess tax benefits related to stock-based compensation | \$ 2,049                   | \$ 1,157 | \$ 6,171                 | \$ 4,205 |

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**10. Income Taxes**

*Effective Tax Rate*

The following table shows our effective income tax rate for the three and six months ended June 30, 2011 and June 30, 2010 :

| (\$000)                                                                        | Three months ended June 30 |           | Six months ended June 30 |           |
|--------------------------------------------------------------------------------|----------------------------|-----------|--------------------------|-----------|
|                                                                                | 2011                       | 2010      | 2011                     | 2010      |
| Income before income taxes and equity in net income of unconsolidated entities | \$ 38,616                  | \$ 27,688 | \$ 71,199                | \$ 58,451 |
| Equity in net income of unconsolidated entities                                | 595                        | 454       | 969                      | 843       |
| Net (income) loss attributable to the noncontrolling interest                  | (2)                        | 85        | 96                       | 116       |
| Total                                                                          | \$ 39,209                  | \$ 28,227 | \$ 72,264                | \$ 59,410 |
| Income tax expense                                                             | \$ 12,724                  | \$ 10,225 | \$ 23,242                | \$ 21,220 |
| Effective tax rate                                                             | 32.5%                      | 36.2%     | 32.2%                    | 35.7%     |

Our effective tax rate in the second quarter of 2011 was 32.5% , a decrease of 3.7 percentage points compared with the prior-year period. Year to date, our effective tax rate was 32.2% , compared with 35.7% in the first half of 2010. In the second quarter of 2011, we increased our estimate of U.S. cash tax benefits by a net amount of \$1,082,000 for domestic production activities (Internal Revenue Code Section 199), related to prior years. This net adjustment consists of \$2,187,000 of estimated U.S. cash tax benefits partially offset by a \$1,105,000 increase in unrecognized tax benefits. The net impact of this adjustment represents 2.8 percentage points of the decline in the effective tax rate in the quarter and 1.5 percentage points in the year-to-date period. The year-to-date effective tax rate also reflects the positive effect of certain deferred income tax benefits recorded in the first quarter of 2011.

*Unrecognized Tax Benefits*

The table below provides information concerning our gross unrecognized tax benefits as of June 30, 2011 and December 31, 2010. The table also provides the effect these gross unrecognized tax benefits would have on our income tax expense, if they were recognized.

| (\$000)                                                                                                | As of June 30 |         | As of December 31 |         |
|--------------------------------------------------------------------------------------------------------|---------------|---------|-------------------|---------|
|                                                                                                        | 2011          |         | 2010              |         |
| Gross unrecognized tax benefits                                                                        | \$            | 10,910  | \$                | 9,089   |
| Gross unrecognized tax benefits which would affect income tax expense                                  | \$            | 10,303  | \$                | 8,482   |
| Effect on income tax expense upon recognition of gross unrecognized tax benefits (increase (decrease)) | \$            | (8,669) | \$                | (6,895) |

In the first half of 2011, we recorded a net increase of \$1,821,000 of gross unrecognized tax benefits, which increased our income tax expense. The majority of this increase relates to the \$1,105,000 expense we recorded in the second quarter of 2011, discussed above.

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

| Liabilities for Unrecognized Tax Benefits (\$000) | As of June 30 |        | As of December 31 |       |
|---------------------------------------------------|---------------|--------|-------------------|-------|
|                                                   | 2011          |        | 2010              |       |
| Current liability                                 | \$            | 1,953  | \$                | 654   |
| Non-current liability                             |               | 8,791  |                   | 8,173 |
| Total liability for unrecognized tax benefits     | \$            | 10,744 | \$                | 8,827 |



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We conduct business globally and as a result, we file income tax returns in U.S. federal, state, local, and foreign jurisdictions. In the normal course of business we are subject to examination by tax authorities throughout the world. The open tax years for our U.S. federal tax returns and most state tax returns include the years 2007 to the present. In non-U.S. jurisdictions, the statute of limitations generally extends to years prior to 2004.

We are currently under audit by the U.S. federal and various state and local tax authorities in the United States, as well as tax authorities in certain non-U.S. jurisdictions. It is likely that the examination phase of some of these audits will conclude in 2011. It is not possible to estimate the effect of current audits on previously recorded unrecognized tax benefits.

Our effective tax rate reflects the fact that we are not recording an income tax benefit related to losses recorded by certain of our non-U.S. operations. The net operating losses (NOLs) may become deductible in certain non-U.S. tax jurisdictions to the extent these non-U.S. operations become profitable. In the year certain non-U.S. entities record a loss, we do not record a corresponding tax benefit, thus increasing our effective tax rate. For each of our operations, we evaluate whether it is more likely than not that the tax benefits related to NOLs will be realized. As part of this evaluation, we consider evidence such as tax planning strategies, historical operating results, forecasted taxable income, and recent financial performance. Upon determining that it is more likely than not that the NOLs will be realized, we reduce the tax valuation allowances related to these NOLs, which results in a reduction to our income tax expense and our effective tax rate in the period.

## **11. Contingencies**

### *InvestPic, LLC*

In November 2010, InvestPic, LLC filed a complaint in the United States District Court for the District of Delaware against Morningstar, Inc. and several other companies alleging that each defendant infringes U.S. Patent No. 6,349,291, which relates to methods for performing statistical analysis on investment data and displaying the analyzed data in graphical form. InvestPic seeks, among other things, unspecified damages because of defendants' alleged infringing activities and costs. While Morningstar is vigorously contesting the claims asserted, we cannot predict the outcome of the proceeding.

### *Egan-Jones Rating Co.*

In June 2010, Egan-Jones Rating Co. filed a complaint in the Court of Common Pleas of Montgomery County, Pennsylvania against Realpoint, LLC (now known as Morningstar Credit Ratings, LLC) and Morningstar, Inc. in connection with a December 2007 agreement between Egan-Jones and Morningstar Credit Ratings for certain data-sharing and other services. In addition to damages, Egan-Jones filed a petition seeking an injunction to temporarily prevent Morningstar from offering corporate credit ratings through December 31, 2010. In September 2010, the court denied Egan-Jones's request for a preliminary injunction against Morningstar's corporate credit ratings business. Morningstar Credit Ratings and Morningstar continue to vigorously contest liability on all of Egan-Jones' claims for damages. We cannot predict the outcome of the proceeding.

### *Business Logic Holding Corporation*

In November 2009, Business Logic Holding Corporation filed a complaint in the Circuit Court of Cook County, Illinois against Ibbotson Associates, Inc. and Morningstar, Inc. relating to Ibbotson's prior commercial relationship with Business Logic. Business Logic is alleging that Ibbotson Associates and Morningstar violated Business Logic's rights by using its trade secrets to develop a proprietary web-service software and user interface that connects plan participant data with the Ibbotson Wealth Forecasting Engine. Business Logic seeks, among other things, injunctive relief and unspecified damages. Ibbotson and Morningstar answered the complaint, and Ibbotson asserted a counterclaim against Business Logic alleging trade secret misappropriation and breach of contract, seeking damages and injunctive relief. While Morningstar and Ibbotson Associates are vigorously contesting the claims against them, we cannot predict the outcome of the proceeding.

### *Morningstar Associates, LLC Subpoena from the New York Attorney General's Office*

In December 2004, Morningstar Associates, LLC, a wholly owned subsidiary of Morningstar, Inc., received a subpoena from the New York Attorney General's office seeking information and documents related to an investigation the New York Attorney General's office is conducting. The subpoena asked for documents relating to

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the investment consulting services the company offers to retirement plan providers, including fund lineup recommendations for retirement plan sponsors. Morningstar Associates has provided the requested information and documents.

In 2005, Morningstar Associates received subpoenas seeking information and documents related to investigations being conducted by the SEC and United States Department of Labor. The subpoenas were similar in scope to the New York Attorney General subpoena. In January 2007 and September 2009, respectively, the SEC and Department of Labor each notified Morningstar Associates that it had ended its investigation, with no enforcement action, fines, or penalties.

In January 2007, Morningstar Associates received a Notice of Proposed Litigation from the New York Attorney General's office. The Notice centers on disclosure relating to an optional service offered to retirement plan sponsors (employers) that select 401(k) plan services from ING, one of Morningstar Associates' clients. The Notice gave Morningstar Associates the opportunity to explain why the New York Attorney General's office should not institute proceedings. Morningstar Associates promptly submitted its explanation and has cooperated fully with the New York Attorney General's office.

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

### *Other Matters*

In addition to these proceedings, we are involved in legal proceedings and litigation that have arisen in the normal course of our business. Although the outcome of a particular proceeding can never be predicted, we do not believe that the result of any of these other matters will have a material adverse effect on our business, operating results, or financial position.

## **12. Quarterly Dividend and Share Repurchase Programs**

In May 2011, our board of directors declared a quarterly dividend of 5 cents per share, payable on July 29, 2011 to shareholders of record as of July 15, 2011. As of June 30, 2011, we recorded a liability for dividends payable of \$2,529,000.

In September 2010, the board of directors approved a share repurchase program that authorizes the repurchase of up to \$100 million in shares of our outstanding common stock. We may repurchase shares from time to time at prevailing market prices on the open market or in private transactions in amounts that we deem appropriate. As of June 30, 2011, we had repurchased a total of 78,111 shares for \$3,894,000 under this authorization.

## **13. Recently Issued Accounting Pronouncements**

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU No. 2011-04 clarifies existing fair value measurement and disclosure requirements, amends certain fair value measurement principles and requires additional disclosures about fair value measurements. For Morningstar, ASU No. 2011-04 will be applied prospectively beginning on January 1, 2012. We do not expect the provisions of ASU No. 2011-04 will have a material impact on our consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. Under ASU No. 2011-05, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Entities will no longer be allowed to present other comprehensive income in the statement of stockholder's equity. For Morningstar, ASU No. 2011-05 is effective beginning on January 1, 2012. We do not expect the provisions of ASU No. 2011-05 will have a material impact on our consolidated financial statements.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

*The discussion included in this section, as well as other sections of this Quarterly Report on Form 10-Q, contains forward-looking statements as that term is used in the Private Securities Litigation Reform Act of 1995. These statements are based on our current expectations about future events or future financial performance. Forward-looking statements by their nature address matters that are, to different degrees, uncertain, and often contain words such as "may," "could," "expect," "intend," "plan," "seek," "anticipate," "believe," "estimate," "predict," "potential," or "continue." These statements involve known and unknown risks and uncertainties that may cause the events we discuss not to occur or to differ significantly from what we expect. For us, these risks and uncertainties include, among others:*

- *general industry conditions and competition, including ongoing economic weakness and uncertainty;*
- *the effect of market volatility on revenue from asset-based fees;*
- *damage to our reputation resulting from claims made about possible conflicts of interest;*
- *liability for any losses that result from an actual or claimed breach of our fiduciary duties;*
- *the increasing concentration of data and development work carried out at our offshore facilities in China and India;*
- *failing to differentiate our products and continuously create innovative, proprietary research tools;*
- *failing to successfully integrate acquisitions;*
- *challenges faced by our non-U.S. operations; and*
- *a prolonged outage of our database and network facilities.*

*A more complete description of these risks and uncertainties can be found in our other filings with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the year ended December 31, 2010. If any of these risks and uncertainties materialize, our actual future results may vary significantly from what we expect. We do not undertake to update our forward-looking statements as a result of new information or future events.*

*All dollar and percentage comparisons, which are often accompanied by words such as "increase," "decrease," "grew," "declined," "was up," "was down," "was flat," or "was similar" refer to a comparison with the same period in the prior year unless otherwise stated.*

### **Understanding our Company**

#### **Our Business**

Our mission is to create great products that help investors reach their financial goals. We offer an extensive line of Internet, software, and print-based products for individual investors, financial advisors, and institutional clients. We also offer asset management services for advisors, institutions, and retirement plan participants. Many of our products are sold through subscriptions or license agreements. As a result, we typically generate recurring revenue.

We emphasize a decentralized approach to running our business to create a culture of responsibility and accountability. Our company has two operating segments: The Investment Information segment includes all of our data, software, and research products and services. These products and services are typically sold through subscriptions or license agreements. The Investment Management segment includes all of our asset management operations, which are registered investment advisors and earn more than half of their revenue from asset-based fees.

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

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

## Industry Overview

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

After generally strong performance earlier in the year, continued worries about weak economic growth and sovereign debt in the United States and abroad weighed on the equity market in the second quarter of 2011. Morningstar's U.S. Market Index, a broad market benchmark, was essentially flat with a 0.14% return for the quarter. The Global Ex-U.S. Index posted a 0.9% return for the same period. Total U.S. mutual fund assets increased to \$12.2 trillion as of June 30, 2011, based on data from the Investment Company Institute (ICI), up from \$10.5 trillion as of June 30, 2010. Despite the year over year increase, though, net inflows were heavily weighted toward fixed-income funds, and risk aversion intensified toward the end of the quarter. Based on Morningstar's estimated asset flow data, U.S. stock funds had their worst monthly outflows in June 2011 since the peak of the credit crisis in October 2008.

Assets in exchange-traded funds (ETFs) increased to \$1.1 trillion as of June 30, 2011, compared with \$772 billion as of June 30, 2010, based on data from the ICI.

Based on data from Nielsen/Net Ratings, aggregate page views, unique users, and pages viewed per visit for financial and investment sites all decreased compared with the second quarter of 2010. Overall, page views to finance and investment sites were down about 33% compared with the second quarter of 2010, based on Nielsen's data. We attribute this trend to individual investors' lower level of engagement with investing-related topics amid ongoing economic uncertainty. Based on Morningstar's internal data, metrics such as unique users and page views also declined for our investment website, Morningstar.com.

Despite weaker economic news, trends in online advertising generally remained strong. During the second quarter of 2011, industry publication eMarketer increased its forecast for U.S. online advertising spending, which is based on data from the Interactive Advertising Bureau and PricewaterhouseCoopers. The revised forecast projects an increase of 20.2% to \$31.3 billion in 2011, following a 14.9% increase in 2010.

Overall, we believe that business conditions in the financial services sector have remained fairly healthy in recent months, although some areas, such as consumer discretionary spending, remain under pressure. In addition, market volatility has increased in recent weeks because of uncertainty about global economic debt and the political stalemate over raising the U.S. government debt ceiling.

**Three and Six Months Ended June 30, 2011 vs. Three and Six Months Ended June 30, 2010**
**Consolidated Results**

| Key Metrics (\$000)                              | Three months ended June 30 |             |         | Six months ended June 30 |             |         |
|--------------------------------------------------|----------------------------|-------------|---------|--------------------------|-------------|---------|
|                                                  | 2011                       | 2010        | Change  | 2011                     | 2010        | Change  |
| Revenue                                          | \$ 161,011                 | \$ 136,091  | 18.3 %  | \$ 312,778               | \$ 264,381  | 18.3 %  |
| Operating income                                 | \$ 38,607                  | \$ 27,667   | 39.5 %  | \$ 70,416                | \$ 58,609   | 20.1 %  |
| Operating margin                                 | 24.0%                      | 20.3%       | 3.7 pp  | 22.5%                    | 22.2%       | 0.3 pp  |
| Cash used for investing activities               | \$ (45,307)                | \$ (60,134) | (24.7)% | \$ (55,351)              | \$ (25,552) | 116.6 % |
| Cash provided by (used for) financing activities | \$ (846)                   | \$ 1,203    | NMF     | \$ 5,489                 | \$ 8,060    | (31.9)% |
| Cash provided by operating activities            | \$ 46,810                  | \$ 30,580   | 53.1 %  | \$ 61,156                | \$ 45,030   | 35.8 %  |
| Capital expenditures                             | (3,381)                    | (2,189)     | 54.5 %  | (8,418)                  | (3,839)     | 119.3 % |
| Free cash flow                                   | \$ 43,429                  | \$ 28,391   | 53.0 %  | \$ 52,738                | \$ 41,191   | 28.0 %  |

*pp* — percentage points

*NMF* — Not meaningful

We define free cash flow as cash provided by or used for operating activities less capital expenditures. We present free cash flow solely as supplemental disclosure to help you better understand how much cash is available after we spend money to operate our business. Our management team uses free cash flow to evaluate our business. Free cash flow is not equivalent to any measure required to be reported under U.S. generally accepted accounting principles (GAAP). Also, the free cash flow definition we use may not be comparable to similarly titled measures used by other companies.

Because we've made several acquisitions in recent years, comparing our financial results from year to year is complex. To make it easier for investors to compare our results in different periods, we provide information on both organic revenue, which reflects our underlying business excluding acquisitions, and revenue from acquisitions. We include an acquired operation as part of our revenue from acquisitions for 12 months after we complete the acquisition. After that, we include it in organic revenue.

Consolidated organic revenue (revenue excluding acquisitions and the impact of foreign currency translations) is considered a non-GAAP financial measure. The definition of organic revenue we use may not be the same as similarly titled measures used by other companies. Organic revenue should not be considered an alternative to any measure of performance as promulgated under GAAP.

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The table below shows the period in which we included each acquired operation in revenue from acquisitions.

| Acquisition                                                               | Date of Acquisition | Six months ended June 30, 2011     |
|---------------------------------------------------------------------------|---------------------|------------------------------------|
| Footnoted business of Financial Fineprint Inc.                            | February 1, 2010    | January 1 through January 31, 2011 |
| Aegis Equities Research                                                   | April 1, 2010       | January 1 through March 31, 2011   |
| Old Broad Street Research Ltd.                                            | April 12, 2010      | January 1 through April 11, 2011   |
| Realpoint, LLC                                                            | May 3, 2010         | January 1 through May 2, 2011      |
| Seeds Group                                                               | July 1, 2010        | January 1 through June 30, 2011    |
| Morningstar Danmark A/S (Morningstar Denmark)                             | July 1, 2010        | January 1 through June 30, 2011    |
| Annuity intelligence business of Advanced Sales and Marketing Corporation | November 1, 2010    | January 1 through June 30, 2011    |

**Consolidated Revenue**

In the second quarter of 2011, our consolidated revenue increased 18.3% to \$161.0 million, compared with \$136.1 million in the second quarter of 2010. We had \$5.1 million in incremental revenue from acquisitions during the second quarter, which contributed about 3.7 percentage points to our consolidated revenue growth. Currency movements had a positive effect in the quarter, contributing approximately 3.4 percentage points to revenue growth.

Excluding acquisitions and the impact of foreign currency translations, our consolidated revenue increased by about \$15.3 million, or 11.2%, in the second quarter of 2011 with increases across all major product lines. Leading the growth were Morningstar Direct, our institutional research platform, and Investment Consulting. Advisor software, Data, individual software, and credit ratings also contributed to the organic revenue increase, although to a lesser extent. Within the credit ratings business, we had strong revenue growth from new issue rating assignments in the commercial mortgage-backed securities market.

Revenue for the first half of the year increased 18.3% to \$312.8 million. We had \$14.1 million in incremental revenue from acquisitions during the first six months of 2011, which contributed about 5.3 percentage points to our consolidated revenue growth. Currency movements also had a positive effect, contributing approximately 2.4 percentage points to revenue growth. Excluding acquisitions and the impact of foreign currency translations, our consolidated revenue increased by about \$28.0 million, or 10.6%, in the first six months of 2011.

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

| (\$000)                                       | Three months ended June 30 |                   |        | Six months ended June 30 |                   |        |
|-----------------------------------------------|----------------------------|-------------------|--------|--------------------------|-------------------|--------|
|                                               | 2011                       | 2010              | Change | 2011                     | 2010              | Change |
| Consolidated revenue                          | \$ 161,011                 | \$ 136,091        | 18.3%  | \$ 312,778               | \$ 264,381        | 18.3%  |
| Less: acquisitions                            | (5,097)                    | —                 | NMF    | (14,112)                 | —                 | NMF    |
| Less: impact of foreign currency translations | (4,573)                    | —                 | NMF    | (6,253)                  | —                 | NMF    |
| Organic revenue                               | <u>\$ 151,341</u>          | <u>\$ 136,091</u> | 11.2%  | <u>\$ 292,413</u>        | <u>\$ 264,381</u> | 10.6%  |

International revenue made up 29.6% of our consolidated revenue in the second quarter and 29.1% in the first half of 2011. Revenue from international operations rose \$10.5 million, or 28.2%, to \$47.6 million for the second quarter. Acquisitions contributed \$2.1 million of additional revenue outside the United States, and foreign currency translations also had a positive effect. Excluding acquisitions and the effect of foreign currency translations, non-U.S. revenue rose 10.3%, reflecting stronger product sales in Europe.

Revenue from international operations rose 25.3%, or \$18.4 million, to \$91.2 million in the first half of 2011. Acquisitions contributed \$5.6 million of additional revenue outside the United States, and foreign currency translations contributed an additional \$6.3 million. Excluding acquisitions and the effect of foreign currency translations, non-U.S. revenue rose 9.0%.

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In Japan, we have a majority-owned subsidiary, Ibbotson Associates Japan K.K., and hold a minority ownership position in Morningstar Japan K.K. Neither of these operations experienced significant disruption as a result of the Great East Japan Earthquake that occurred in March 2011.

International organic revenue (international revenue excluding acquisitions and the impact of foreign currency translations) is considered a non-GAAP financial measure. The definition of international organic revenue we use may not be the same as similarly titled measures used by other companies. International organic revenue should not be considered an alternative to any measure of performance as promulgated under GAAP.

The tables below present a reconciliation from international revenue to international organic revenue (international revenue excluding acquisitions and the impact of foreign currency translations):

| (\$000)                                       | Three months ended June 30 |           |        | Six months ended June 30 |           |        |
|-----------------------------------------------|----------------------------|-----------|--------|--------------------------|-----------|--------|
|                                               | 2011                       | 2010      | Change | 2011                     | 2010      | Change |
| International revenue                         | \$ 47,587                  | \$ 37,105 | 28.2%  | \$ 91,173                | \$ 72,785 | 25.3%  |
| Less: acquisitions                            | (2,076)                    | —         | NMF    | (5,561)                  | —         | NMF    |
| Less: impact of foreign currency translations | (4,573)                    | —         | NMF    | (6,253)                  | —         | NMF    |
| International organic revenue                 | \$ 40,938                  | \$ 37,105 | 10.3%  | \$ 79,359                | \$ 72,785 | 9.0%   |

**Consolidated Operating Expense**

| (\$000)           | Three months ended June 30 |            |          | Six months ended June 30 |            |          |
|-------------------|----------------------------|------------|----------|--------------------------|------------|----------|
|                   | 2011                       | 2010       | Change   | 2011                     | 2010       | Change   |
| Operating expense | \$ 122,404                 | \$ 108,424 | 12.9%    | \$ 242,362               | \$ 205,772 | 17.8%    |
| % of revenue      | 76.0%                      | 79.7%      | (3.7) pp | 77.5%                    | 77.8%      | (0.3) pp |

In the second quarter of 2011, our consolidated operating expense increased \$14.0 million, or 12.9%. For the first six months of 2011, operating expense increased \$36.6 million, or 17.8%. We completed seven acquisitions in 2010. Because of the timing of these acquisitions, our second quarter and year-to-date results include operating expense that did not exist in the same periods last year. Incremental operating expense from acquired businesses represented approximately one-fourth of the operating expense increase in the quarter and approximately one-third of the year-to-date increase.

Higher salary expense represented approximately 60% of the total operating expense increase in the quarter and 50% for the year to date, reflecting additional headcount from acquisitions and filling open positions, as well as salary increases that were effective in July 2010. We review employee salaries annually and generally implement salary adjustments in the third quarter. We had approximately 3,300 employees worldwide as of June 30, 2011 compared with 2,965 as of June 30, 2010. Almost 60% of the increase in headcount reflects continued hiring for our development centers in China and India. The remainder of the increase is due to continued hiring in the U.S. and, to a lesser extent, employees added through acquisitions we completed over the 12 months ending June 30, 2011.

Higher incentive compensation and employee benefit costs represented approximately another 11% of the total change in operating expense in the quarter and 20% year to date. Bonus expense increased about \$2.0 million in the quarter and \$4.9 million year to date. The year-to-date increase in bonus expense was partially offset because bonuses paid in the first quarter were approximately \$0.4 million lower than the amount accrued in 2010. Although the net difference was approximately \$0.4 million, there were some greater differences by cost category, which we describe below. In 2011, we reinstated some of the benefits we temporarily suspended in previous years. This included increasing the matching contributions to our 401(k) plan in the United States, representing approximately \$0.6 million of additional expense in the second quarter of 2011 and \$1.4 million year to date. Lower healthcare benefit costs and sales commission partially offset these expense increases in the quarter. In the second quarter of 2010, we had unusually high medical claims that did not recur in the second quarter of 2011. Sales commission expense declined because changes to our U.S. sales commission structure made in 2010 had a greater effect on prior-year period results.

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General and administrative expense (G&A) in the second quarter includes \$1.4 million of business tax expense related to prior years. This operating expense was partially offset by a \$0.8 million reduction in sales tax accruals and a \$0.3 million business tax rebate for our operations in China. G&A in the first half of 2011 includes \$3.2 million of expense for a previously announced separation agreement with Tao Huang, our former chief operating officer. Our second quarter and year-to-date 2010 results included an expense of \$0.5 million and \$1.3 million, respectively, to increase liabilities for vacant office space. These expenses did not recur in the first half of 2011.

Intangible amortization expense increased \$0.8 million in the quarter and \$1.8 million year to date. The increase primarily reflects amortization expense from 2010 acquisitions.

### Cost of Goods Sold

| (\$000)            | Three months ended June 30 |           |          | Six months ended June 30 |            |          |
|--------------------|----------------------------|-----------|----------|--------------------------|------------|----------|
|                    | 2011                       | 2010      | Change   | 2011                     | 2010       | Change   |
| Cost of goods sold | \$ 45,186                  | \$ 39,738 | 13.7%    | \$ 85,855                | \$ 74,054  | 15.9%    |
| % of revenue       | 28.1%                      | 29.2%     | (1.1) pp | 27.4%                    | 28.0%      | (0.6) pp |
| Gross profit       | \$ 115,825                 | \$ 96,353 | 20.2%    | \$ 226,923               | \$ 190,327 | 19.2%    |
| Gross margin       | 71.9%                      | 70.8%     | 1.1 pp   | 72.6%                    | 72.0%      | 0.6 pp   |

Cost of goods sold is our largest category of operating expense, representing more than one-third of our total operating expense. Our business relies heavily on human capital, and cost of goods sold includes the compensation expense for employees who produce our products and services.

Cost of goods sold rose \$5.4 million in the second quarter of 2011 and \$11.8 million in the first half of 2011. Acquisitions contributed approximately 20% of the second quarter increase and 40% of the year-to-date increase in cost of goods sold. Higher salaries contributed the majority of the overall expense increase in both periods. Higher bonus expense of \$1.9 million for the first half of 2011 was offset by \$1.6 million because we paid a smaller portion of the 2010 bonus to employees in this category. Please refer to the section, *Bonus Expense*, for additional information.

Our gross margin improved in the second quarter and, to a lesser extent, in the first half of 2011 as expenses in this category increased at a lower rate compared with revenue growth.

### Development Expense

| (\$000)             | Three months ended June 30 |           |          | Six months ended June 30 |           |          |
|---------------------|----------------------------|-----------|----------|--------------------------|-----------|----------|
|                     | 2011                       | 2010      | Change   | 2011                     | 2010      | Change   |
| Development expense | \$ 13,681                  | \$ 11,899 | 15.0%    | \$ 25,669                | \$ 22,788 | 12.6%    |
| % of revenue        | 8.5%                       | 8.7%      | (0.2) pp | 8.2%                     | 8.6%      | (0.4) pp |

Development expense increased \$1.8 million in the second quarter and \$2.9 million in the first six months mainly because of higher salaries and compensation-related expense for our development teams. We capitalized \$0.4 million of operating expense in the quarter and \$1.0 million in the year-to-date period for software development, reducing the expense that we would otherwise report in this category.

As a percentage of revenue, development expense was down slightly in both the quarter and first half of 2011.

### Sales and Marketing Expense

| (\$000)                     | Three months ended June 30 |           |          | Six months ended June 30 |           |          |
|-----------------------------|----------------------------|-----------|----------|--------------------------|-----------|----------|
|                             | 2011                       | 2010      | Change   | 2011                     | 2010      | Change   |
| Sales and marketing expense | \$ 26,767                  | \$ 24,435 | 9.5%     | \$ 53,249                | \$ 46,996 | 13.3%    |
| % of revenue                | 16.6%                      | 18.0%     | (1.4) pp | 17.0%                    | 17.8%     | (0.8) pp |

Sales and marketing expense increased \$2.3 million in the second quarter and \$6.3 million in the first half of 2011 . Approximately 30% of the growth in sales and marketing expense for the first half of the year was related to recent acquisitions. Higher salary-related expense represents the majority of the overall expense increase. Travel expense also increased, although to a lesser extent. Commission expense declined in the second quarter as changes to our commission structure implemented in 2010 had a greater effect on expense in the prior-year period.

As a percentage of revenue, sales and marketing expense was down in both the quarter and first half, primarily reflecting lower sales commission expense.

### General and Administrative Expense

| (\$000)                            | Three months ended June 30 |           |          | Six months ended June 30 |           |        |
|------------------------------------|----------------------------|-----------|----------|--------------------------|-----------|--------|
|                                    | 2011                       | 2010      | Change   | 2011                     | 2010      | Change |
| General and administrative expense | \$ 26,207                  | \$ 23,106 | 13.4%    | \$ 56,824                | \$ 43,749 | 29.9%  |
| % of revenue                       | 16.3%                      | 17.0%     | (0.7) pp | 18.2%                    | 16.5%     | 1.7 pp |

G&A rose \$3.1 million in the second quarter of 2011 and \$13.1 million in the first half of 2011 .

The increase in both periods reflects higher compensation-related expense including higher salaries. Bonus expense included in G&A increased \$0.6 million in the quarter and \$3.9 million year to date. In the first quarter of 2011, we paid a greater portion of the 2010 bonus to employees in this category compared with our initial estimate, contributing \$2.6 million of the year-to-date increase. Please refer to the section, *Bonus Expense*, for additional information. Higher rent expense, mainly for our new office space in China, also contributed to the growth in G&A, although to a much lesser extent.

G&A in the second quarter also includes \$1.4 million of business tax expense related to prior years. This operating expense was partially offset by a \$0.8 million reduction in sales tax accruals and a \$0.3 million business tax rebate for our operations in China. G&A in the first half of the year includes \$3.2 million of expense for a previously announced separation agreement with Tao Huang, our former chief operating officer.

Our 2010 results include \$0.5 million in the second quarter and \$1.3 million in the first half to increase liabilities for vacant office space. In the second quarter of 2010, we increased our liability for vacant office space related to the acquisition of the equity research and data business from C.P.M.S. in Canada. In the first quarter of 2010, we increased our liability for vacant office space for the former Ibbotson headquarters when we finalized sub-lease arrangements for a portion of this space. This expense did not recur in 2011.

As a percentage of revenue, G&A expense declined 0.7 percentage points in the second quarter of 2011 . In the first six months of 2011 , G&A as a percentage of revenue increased 1.7 percentage points, primarily because of the \$3.2 million of expense for the separation agreement and higher bonus expense.

### Depreciation and Amortization Expense

| (\$000)                                     | Three months ended June 30 |          |          | Six months ended June 30 |           |          |
|---------------------------------------------|----------------------------|----------|----------|--------------------------|-----------|----------|
|                                             | 2011                       | 2010     | Change   | 2011                     | 2010      | Change   |
| Depreciation expense                        | \$ 3,931                   | \$ 3,398 | 15.7%    | \$ 7,620                 | \$ 6,869  | 10.9%    |
| Amortization expense                        | 6,632                      | 5,848    | 13.4%    | 13,145                   | 11,316    | 16.2%    |
| Total depreciation and amortization expense | \$ 10,563                  | \$ 9,246 | 14.2%    | \$ 20,765                | \$ 18,185 | 14.2%    |
| % of revenue                                | 6.6%                       | 6.8%     | (0.2) pp | 6.6%                     | 6.9%      | (0.3) pp |

The majority of the increase in this expense category arises from amortization expense from recent acquisitions. Amortization expense increased \$0.8 million in the second quarter and \$1.8 million in the first six months. Additional depreciation expense also contributed to the increase, but to a lesser extent.

We expect that amortization of intangible assets will be an ongoing cost for the remaining life of the assets. We estimate that aggregate amortization expense for intangible assets will be approximately \$25.9 million in 2011 and \$24.4 million in 2012. Our estimates of future amortization expense for intangible assets may be affected by changes to the preliminary purchase price allocations associated with the acquisitions we made in 2010, additional acquisitions, and currency translations.

As a percentage of revenue, depreciation and amortization expense was down slightly in the second quarter and year to date.

### Stock-Based Compensation Expense

| (\$000)                                | Three months ended June 30 |          |          | Six months ended June 30 |          |          |
|----------------------------------------|----------------------------|----------|----------|--------------------------|----------|----------|
|                                        | 2011                       | 2010     | Change   | 2011                     | 2010     | Change   |
| Restricted stock units                 | \$ 3,332                   | \$ 3,343 | (0.3)%   | \$ 6,117                 | \$ 6,280 | (2.6)%   |
| Restricted stock                       | 444                        | 312      | 42.3 %   | 1,308                    | 312      | 319.2 %  |
| Stock options                          | 67                         | —        | NMF      | 67                       | —        | NMF      |
| Total stock-based compensation expense | \$ 3,843                   | \$ 3,655 | 5.1 %    | \$ 7,492                 | \$ 6,592 | 13.7 %   |
| % of revenue                           | 2.4%                       | 2.7%     | (0.3) pp | 2.4%                     | 2.5%     | (0.1) pp |

Our stock-based compensation expense relates to grants of restricted stock units (RSUs), restricted stock, and stock options. We include this cost in each of our operating expense categories. Stock-based compensation expense increased \$0.2 million in the second quarter and \$0.9 million in the first half and was down slightly as a percentage of revenue compared with the same periods in 2010.

We began granting RSUs in May 2006 and make additional grants each year, primarily in the second quarter. We recognize the expense related to RSUs over the vesting period, which is generally four years. The expense recorded in the first half of 2011 was favorably affected by \$0.5 million for restricted stock units that were forfeited in the first quarter.

Beginning in the second quarter of 2010, we began recording expense related to restricted stock issued in conjunction with the acquisition of Realpoint, LLC. In May 2010, we issued 199,174 shares to the selling employee-shareholders. The restricted stock vests ratably over a five-year period from the acquisition date and may be subject to forfeiture if the holder terminates his or her employment during the vesting period. These grants resulted in an expense of \$0.4 million in the second quarter of 2011 and \$1.3 million in the first six months of 2011. The expense in the first six months of 2011 includes approximately \$0.4 million for accelerated vesting of a portion of these restricted stock grants.

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In May 2011, we granted 86,106 stock options to certain employees and our non-employee directors. These stock options generally vest ratably over a four-year period and expire 10 years after the date of grant. Using a Black-Scholes option pricing model, we estimated the fair value of these grants to be approximately \$2.0 million. We will amortize this value to stock-based compensation expense ratably over the options' vesting period.

We estimate forfeitures of these awards and typically adjust the estimated forfeitures to actual forfeiture experience in the second quarter, which is when most of our larger equity grants typically vest.

Based on grants of RSUs, stock options, and restricted stock made through June 30, 2011, we anticipate that stock-based compensation expense will be approximately \$15.4 million in 2011. This amount is subject to change based on additional equity grants or changes in our estimated forfeiture rate related to these grants.

*Bonus Expense*

The size of our bonus pool varies each year based on a number of items, including changes in full-year operating income relative to the previous year. We review and update our estimates and the bonus pool size quarterly. We record bonus expense throughout the year and pay annual bonuses to employees in the first quarter of the following year.

| (\$000)       | Three months ended June 30 |          |        | Six months ended June 30 |           |        |
|---------------|----------------------------|----------|--------|--------------------------|-----------|--------|
|               | 2011                       | 2010     | Change | 2011                     | 2010      | Change |
| Bonus expense | \$ 10,982                  | \$ 8,993 | 22.1%  | \$ 21,115                | \$ 16,701 | 26.4%  |
| % of revenue  | 6.8%                       | 6.6%     | 0.2 pp | 6.8%                     | 6.3%      | 0.5 pp |

Bonus expense, which we include in each of our operating expense categories, increased \$2.0 million in the second quarter of 2011 and \$4.4 million in the first six months of 2011. The \$2.4 million increase in the first quarter of 2011 consists of 1) an increase of \$2.9 million in the quarter's bonus expense and 2) a difference of \$0.4 million between the amount of bonuses paid in 2011 (related to 2010 performance) compared with the annual bonus expense recorded in 2010. The table below presents the effect of these two factors by cost category and in total:

| (\$000)                            | Bonus Expense |          |          | Difference between bonuses paid in Q1 2011 (for 2010 performance) vs. 2010 bonus expense | Net Increase (Decrease) in Bonus Expense |
|------------------------------------|---------------|----------|----------|------------------------------------------------------------------------------------------|------------------------------------------|
|                                    | Q1 2011       | Q1 2010  | Change   |                                                                                          |                                          |
| Cost of sales                      | \$ 4,205      | \$ 2,821 | \$ 1,384 | \$ (1,577)                                                                               | \$ (193)                                 |
| Development                        | 1,715         | 1,152    | 563      | (959)                                                                                    | (396)                                    |
| Sales and Marketing                | 1,557         | 1,248    | 309      | (521)                                                                                    | (212)                                    |
| General and administrative expense | 3,104         | 2,487    | 617      | 2,609                                                                                    | 3,226                                    |
| Total bonus expense                | \$ 10,581     | \$ 7,708 | \$ 2,873 | \$ (448)                                                                                 | \$ 2,425                                 |

Although in total the 2010 bonuses paid were approximately \$0.4 million lower compared with the amount expensed in 2010, there were some larger differences by cost category. We paid a greater portion of the 2010 bonus to employees in the G&A category compared with our initial estimate.

## Consolidated Operating Income

| (\$000)          | Three months ended June 30 |           |        | Six months ended June 30 |           |        |
|------------------|----------------------------|-----------|--------|--------------------------|-----------|--------|
|                  | 2011                       | 2010      | Change | 2011                     | 2010      | Change |
| Operating income | \$ 38,607                  | \$ 27,667 | 39.5%  | \$ 70,416                | \$ 58,609 | 20.1%  |
| % of revenue     | 24.0%                      | 20.3%     | 3.7 pp | 22.5%                    | 22.2%     | 0.3 pp |

Consolidated operating income increased \$10.9 million in the second quarter of 2011 and \$11.8 million in the first six months of 2011. Our operating margin increased in both the quarter and year-to-date periods, primarily as second-quarter revenue growth outpaced the increase in operating expenses. The \$3.2 million of expense recorded in the first quarter related to a separation agreement lowered our year-to-date margin by approximately 1.0 percentage points.

We hired about 30 employees in the United States in July 2011 as part of the Morningstar Development Program, a two-year rotational training program for entry-level college graduates. We also expect to continue hiring in the second half of the year. In addition, we expect to make salary increases in the third quarter of 2011.

## Consolidated Free Cash Flow

As described in more detail above, we define free cash flow as cash provided by or used for operating activities less capital expenditures.

| (\$000)                               | Three months ended June 30 |           |        | Six months ended June 30 |           |        |
|---------------------------------------|----------------------------|-----------|--------|--------------------------|-----------|--------|
|                                       | 2011                       | 2010      | Change | 2011                     | 2010      | Change |
| Cash provided by operating activities | \$ 46,810                  | \$ 30,580 | 53.1%  | \$ 61,156                | \$ 45,030 | 35.8%  |
| Capital expenditures                  | (3,381)                    | (2,189)   | 54.5%  | (8,418)                  | (3,839)   | 119.3% |
| Free cash flow                        | \$ 43,429                  | \$ 28,391 | 53.0%  | \$ 52,738                | \$ 41,191 | 28.0%  |

We generated positive free cash flow in both the second quarter and year-to-date periods of 2011 and 2010. Free cash flow increased \$15.0 million in the second quarter of 2011, but increased only \$11.5 million in the first six months of 2011. Historically, free cash flow has been lower in the first quarter compared with the other three quarters of the year because of the timing of our annual bonus payments. We typically pay bonuses in the first quarter, and these payments reduce our cash flow from operations.

*Cash provided by operating activities:* Cash provided by operating activities increased \$16.2 million in the second quarter of 2011 reflecting higher net income (adjusted for non-cash items), a positive cash flow effect generated from accounts receivable, and timing of income tax payments. This increase represented substantially all of the \$16.1 million improvement in our cash flow from operations for the first half of the year.

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To provide investors with additional insight into our financial results, we provide a comparison between the change in consolidated net income and the change in operating cash flow:

| (\$000)                                                                                                                 | Three months ended June 30 |           |           | Six months ended June 30 |           |           |
|-------------------------------------------------------------------------------------------------------------------------|----------------------------|-----------|-----------|--------------------------|-----------|-----------|
|                                                                                                                         | 2011                       | 2010      | Change    | 2011                     | 2010      | Change    |
| Consolidated net income                                                                                                 | \$ 26,487                  | \$ 17,917 | \$ 8,570  | \$ 48,926                | \$ 38,074 | \$ 10,852 |
| Adjustments to reconcile consolidated net income to net cash flows from operating activities:                           |                            |           |           |                          |           |           |
| Excess tax benefits from stock-option exercises and vesting of restricted stock units                                   | (2,049)                    | (1,157)   | (892)     | (6,171)                  | (4,205)   | (1,966)   |
| Depreciation and amortization expense                                                                                   | 10,563                     | 9,246     | 1,317     | 20,765                   | 18,185    | 2,580     |
| Stock-based compensation expense                                                                                        | 3,843                      | 3,655     | 188       | 7,492                    | 6,592     | 900       |
| All other non-cash items included in net income                                                                         | 746                        | 609       | 137       | (532)                    | (113)     | (419)     |
| Changes in operating assets and liabilities, net of effects of acquisitions:                                            |                            |           |           |                          |           |           |
| Cash paid for bonuses                                                                                                   | —                          | —         | —         | (37,464)                 | (21,360)  | (16,104)  |
| Cash paid for income taxes                                                                                              | (14,142)                   | (17,831)  | 3,689     | (21,104)                 | (26,396)  | 5,292     |
| Cash paid related to adjusting the tax treatment of certain stock options originally considered incentive stock options | —                          | —         | —         | —                        | (4,887)   | 4,887     |
| Cash paid for separation agreements                                                                                     | (686)                      | —         | (686)     | (2,756)                  | —         | (2,756)   |
| Accounts receivable                                                                                                     | 3,974                      | (1,748)   | 5,722     | 617                      | (6,615)   | 7,232     |
| Deferred revenue                                                                                                        | (1,650)                    | (3,253)   | 1,603     | 8,197                    | 7,177     | 1,020     |
| Income taxes — current                                                                                                  | 11,587                     | 9,895     | 1,692     | 23,846                   | 22,141    | 1,705     |
| Accrued compensation                                                                                                    | 13,034                     | 11,362    | 1,672     | 25,692                   | 15,093    | 10,599    |
| Other assets                                                                                                            | (845)                      | (31)      | (814)     | 608                      | (511)     | 1,119     |
| Accounts payable and accrued liabilities                                                                                | (2,660)                    | 1,685     | (4,345)   | (5,260)                  | 2,859     | (8,119)   |
| All other                                                                                                               | (1,392)                    | 231       | (1,623)   | (1,700)                  | (1,004)   | (696)     |
| Cash provided by operating activities                                                                                   | \$ 46,810                  | \$ 30,580 | \$ 16,230 | \$ 61,156                | \$ 45,030 | \$ 16,126 |

In both the second quarter and year to date periods, the increase in cash from operations exceeded the increase in net income, primarily from the positive cash flow effect generated from accounts receivable and timing of income tax payments. In addition, the cash flow from operations in the first quarter of 2010 includes a \$4.9 million payment related to adjusting the tax treatment of certain stock options originally considered incentive stock options (ISOs). This payment did not recur in 2011. These items, which favorably impacted the year-over-year comparisons, were partially offset by the increase in bonus payments in 2011.

FASB ASC 718, *Compensation—Stock Compensation*, requires that we classify excess tax benefits as a financing activity, which contributes to the difference between net income and cash from operations. In the first half of 2011 and 2010, we classified \$6.2 million and \$4.2 million, respectively, of excess tax benefits, as financing activities. We describe these excess tax benefits in the Liquidity and Capital Resources section.

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*Capital expenditures:* We spent \$3.4 million for capital expenditures in the second quarter of 2011 and \$8.4 million in the first six months, primarily for leasehold improvements, computer hardware, and software. In the first half of 2011, capital expenditures increased \$4.6 million, primarily for our development center in China.

**Segment Results**

| Key Metrics (\$000)                                        | Three months ended June 30 |            |         | Six months ended June 30 |            |          |
|------------------------------------------------------------|----------------------------|------------|---------|--------------------------|------------|----------|
|                                                            | 2011                       | 2010       | Change  | 2011                     | 2010       | Change   |
| <b>Revenue</b>                                             |                            |            |         |                          |            |          |
| Investment Information                                     | \$ 128,116                 | \$ 109,021 | 17.5 %  | \$ 248,515               | \$ 212,545 | 16.9 %   |
| Investment Management                                      | 32,895                     | 27,070     | 21.5 %  | 64,263                   | 51,836     | 24.0 %   |
| Consolidated revenue                                       | \$ 161,011                 | \$ 136,091 | 18.3 %  | \$ 312,778               | \$ 264,381 | 18.3 %   |
| <b>Operating income (loss)</b>                             |                            |            |         |                          |            |          |
| Investment Information                                     | \$ 37,097                  | \$ 30,542  | 21.5 %  | \$ 69,404                | \$ 63,288  | 9.7 %    |
| Investment Management                                      | 18,491                     | 14,321     | 29.1 %  | 35,537                   | 27,614     | 28.7 %   |
| Intangible amortization and corporate depreciation expense | (8,476)                    | (7,620)    | 11.2 %  | (16,777)                 | (14,866)   | 12.9 %   |
| Corporate unallocated                                      | (8,505)                    | (9,576)    | (11.2)% | (17,748)                 | (17,427)   | 1.8 %    |
| Consolidated operating income                              | \$ 38,607                  | \$ 27,667  | 39.5 %  | \$ 70,416                | \$ 58,609  | 20.1 %   |
| <b>Operating margin</b>                                    |                            |            |         |                          |            |          |
| Investment Information                                     | 29.0%                      | 28.0%      | 1.0 pp  | 27.9%                    | 29.8%      | (1.9) pp |
| Investment Management                                      | 56.2%                      | 52.9%      | 3.3 pp  | 55.3%                    | 53.3%      | 2.0 pp   |
| Consolidated operating margin                              | 24.0%                      | 20.3%      | 3.7 pp  | 22.5%                    | 22.2%      | 0.3 pp   |

**Investment Information Segment**

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

The largest products in this segment based on revenue are Licensed Data, Morningstar Advisor Workstation, Morningstar.com, Morningstar Direct, Morningstar Integrated Web Tools (formerly Morningstar Site Builder), and Morningstar Principia. Licensed Data is a set of investment data spanning all of our investment databases, including real-time pricing data, and is available through electronic data feeds. Advisor Workstation is a web-based investment planning system for advisors. Advisor Workstation is available in two editions: Morningstar Office for independent financial advisors and an enterprise edition for financial advisors affiliated with larger firms. Morningstar.com includes both Premium Memberships and Internet advertising sales. Morningstar Direct is a web-based institutional research platform. Morningstar Integrated Web Tools is a set of services that help institutional clients build customized websites or enhance their existing sites with Morningstar's online tools and components. Principia is our CD-ROM-based investment research and planning software for advisors.

The Investment Information segment also includes Morningstar Equity Research, which we distribute through several channels. We also sell Equity Research to other companies that purchase our research for their own use or provide our research to their affiliated advisors or individual investor clients. The segment also includes Morningstar Credit Research and Morningstar Structured Credit Ratings. Morningstar Structured Credit Ratings is provided by Morningstar Credit Ratings, LLC (formerly Realpoint, LLC), an NRSRO specializing in structured finance. It offers securities ratings, research, surveillance services, and data to help institutional investors identify risk in commercial mortgage-backed securities (CMBS).

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We also offer a variety of financial communications and newsletters, real-time data, and investment indexes.

In the first six months of 2011 and 2010 , this segment represented approximately 80% of our consolidated revenue.

| Key Metrics (\$000)  | Three months ended June 30 |            |        | Six months ended June 30 |            |          |
|----------------------|----------------------------|------------|--------|--------------------------|------------|----------|
|                      | 2011                       | 2010       | Change | 2011                     | 2010       | Change   |
| Revenue              | \$ 128,116                 | \$ 109,021 | 17.5%  | \$ 248,515               | \$ 212,545 | 16.9 %   |
| Operating income     | \$ 37,097                  | \$ 30,542  | 21.5%  | \$ 69,404                | \$ 63,288  | 9.7 %    |
| Operating margin (%) | 29.0%                      | 28.0%      | 1.0 pp | 27.9%                    | 29.8%      | (1.9) pp |

### Revenue

In the second quarter of 2011 , Investment Information segment revenue increased \$19.1 million , or 17.5% , to \$128.1 million . Acquisitions contributed \$4.5 million of revenue in the quarter, primarily from Morningstar Structured Credit Ratings (formerly Realpoint), and, to a lesser extent, the Annuity Intelligence business and Morningstar Denmark. Excluding acquisitions, our software and data product lines were the main contributors to revenue growth. In the first half of 2011 , revenue increased \$36.0 million , or 16.9% , to \$248.5 million , with acquisitions contributing \$12.2 million .

Excluding acquisitions, Morningstar Direct was the largest contributor to the increase in segment revenue in both periods. The number of licenses for Morningstar Direct increased to 5,442 worldwide, compared with 4,109 as of June 30, 2010 , with strong growth in both the U.S. and internationally. The growth reflects additional licenses for both new and existing clients, as well as client migrations from Institutional Workstation to Morningstar Direct.

Advisor software, Licensed Data, and Morningstar.com, which includes Internet advertising sales and Premium Memberships, were also positive contributors to revenue growth in the second quarter and the first half of 2011.

Advisor software revenue increased as higher revenue from Advisor Workstation (mainly Morningstar Office) and Morningstar Integrated Web Tools more than offset slightly lower Principia revenue. The number of U.S. licenses for Morningstar Advisor Workstation increased to 156,258 as of June 30, 2011 compared with 153,170 as of December 31, 2010 , and 154,226 as of June 30, 2010 . Principia subscriptions totaled 32,335 as of June 30, 2011 , down from 32,681 as of December 31, 2010 and 34,715 as of June 30, 2010 .

Licensed Data's growth reflects strong renewal rates for managed products data. Licensed Data gives institutions access to a full range of proprietary investment data spanning numerous investment databases, including real-time pricing data. The data packages we offer include proprietary statistics, such as the Morningstar Style Box and Morningstar Rating, and a wide range of other data, including information on investment performance, risk, portfolios, operations data, fees and expenses, cash flows, and ownership.

Higher Internet advertising sales for Morningstar.com were partially offset by a decline in Premium Membership revenue in the United States. Premium subscriptions for the U.S. version of Morningstar.com declined to 136,008 as of June 30, 2011 , compared with 138,149 as of December 31, 2010 and 143,392 as of June 30, 2010 . Premium subscriptions have continued declining because of a weak trial pipeline. However, consistent with the trend over the past few years, we moderately increased subscription prices for U.S. Premium Membership in both January 2011 and 2010 , which partly offset the revenue decline associated with the lower subscription levels.

Morningstar credit ratings and the Morningstar Conference also contributed to the revenue growth in the second quarter, although to a lesser extent. Within the credit ratings business, we have had revenue growth from new issue rating assignments in the commercial mortgage-backed securities market.

### Operating Income

In the second quarter of 2011 , operating income for the Investment Information segment increased \$6.6 million , or 21.5% , and \$6.1 million , or 9.7% , in the first half of 2011 , as operating expense increased less than revenue.

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Operating expense was up \$12.5 million in the second quarter and \$29.9 million in the first half of 2011 . Additional costs from acquisitions contributed approximately 20% of the increase in the second quarter and 30% in the first six months of 2011. Higher salary-related expense and bonus contributed the majority of the overall expense increase in both periods. Matching contributions to our 401(k) plan in the United States, also contributed to the increase, although to a lesser extent. Lower employee benefits expense, including employee health benefits, and lower commission expense partially offset the increases.

The Investment Information segment's operating margin increased 1.0 percentage point in the second quarter , primarily from acquisitions. The segment's operating margin in the first half of the year declined 1.9 percentage points, primarily from higher compensation-related expense as a percentage of revenue. Acquisitions had only a minor effect on the segment margin in the first half of the year.

### **Investment Management Segment**

The Investment Management segment includes all of our asset management operations, which earn the majority of their revenue from asset-based fees.

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

Our Investment Consulting business has multiple fee structures, which vary by client. In general, we seek to receive asset-based fees for any work we perform that involves managing investments or acting as a subadvisor to investment portfolios. For any individual contract, we may receive flat fees, variable asset-based fees, or a combination of the two. Some of our contracts include minimum fee levels that provide us with a flat payment up to a specified asset level, above which we also receive variable asset-based fees. In the majority of our contracts that include variable asset-based fees, we bill clients quarterly in arrears based on average assets for the quarter. The method of calculation varies by client; some contracts include provisions for calculating average assets based on daily data, while others use weekly or monthly data. Other contracts may include provisions for monthly billing or billing based on assets as of the last day of the billing period rather than on average assets.

In our Retirement Solutions business, our contracts may include one-time setup fees, technology licensing fees, asset-based fees for managed retirement accounts, fixed and variable fees for advice and guidance, or a combination of these fee structures. Our Retirement Solutions business also includes plan sponsor and custom target date consulting arrangements. Fees for these services may be based on the level of assets under advisement in these arrangements.

We do not disclose a fee range for our Investment Consulting and Retirement Solutions businesses because our fee structures are customized by client. In addition, we believe disclosing a fee range would be detrimental to our competitive position. We disclose changes in the nature of the underlying services we provide or their associated fee structures (for example, a change from flat fees to asset-based fees) in our periodic filings to the extent that they are material to our financial results.

For Morningstar Managed Portfolios, we charge asset-based fees, which are based on a tiered schedule that depends on the client's account balance. Fees for our mutual fund and ETF portfolios generally range from 30 to 40 basis points. We charge 55 basis points for our customized stock portfolios.

In the first six months of 2011 and 2010 , this segment represented approximately 20% of our consolidated revenue.

| Key Metrics (\$000)  | Three months ended June 30 |           |        | Six months ended June 30 |           |        |
|----------------------|----------------------------|-----------|--------|--------------------------|-----------|--------|
|                      | 2011                       | 2010      | Change | 2011                     | 2010      | Change |
| Revenue              | \$ 32,895                  | \$ 27,070 | 21.5%  | \$ 64,263                | \$ 51,836 | 24.0%  |
| Operating income     | \$ 18,491                  | \$ 14,321 | 29.1%  | \$ 35,537                | \$ 27,614 | 28.7%  |
| Operating margin (%) | 56.2%                      | 52.9%     | 3.3 pp | 55.3%                    | 53.3%     | 2.0 pp |

[Table of Contents](#)*Revenue*

Investment Management segment revenue increased \$5.8 million in the second quarter and \$12.4 million year to date. Revenue from acquisitions was \$0.6 million in the quarter and \$1.9 million year to date. Excluding acquisitions, revenue was up across all product lines in the second quarter and first-half periods. Investment Consulting was the primary driver of the revenue increase. Retirement Solutions and Managed Portfolios also contributed to the revenue increase, but to a lesser extent.

Within the Investment Management segment, revenue from asset-based fees made up approximately 62% of segment revenue in the first half of 2011 and 66% in the the first half of 2010 .

*Assets under Advisement and Management for Investment Consulting*

| (\$ billions)                                          | As of June 30 |         |
|--------------------------------------------------------|---------------|---------|
|                                                        | 2011          | 2010    |
| Assets under advisement - U.S.                         | \$ 136.6      | \$ 94.8 |
| Assets under advisement and management - International | 4.9           | 3.9     |
| Total                                                  | \$ 141.5      | \$ 98.7 |

These assets include relationships for which we receive basis-point fees, including consulting arrangements and other agreements where we act as a portfolio construction manager for a mutual fund or variable annuity. We also provide Investment Consulting services for some assets for which we receive a flat fee; we do not include these assets in the total reported above. Excluding changes related to new contracts and cancellations, changes in the value of assets under advisement can come from two primary sources: gains or losses related to overall trends in market performance, and net inflows or outflows caused when investors add to or redeem shares from these portfolios.

We provided Investment Consulting advisory services on approximately \$141.5 billion in assets as of June 30, 2011 compared with approximately \$116.6 billion as of December 31, 2010 and approximately \$98.7 billion as of June 30, 2010 . Assets under advisement for Investment Consulting rose compared with the prior year, primarily reflecting positive market performance.

We cannot quantify cash inflows and outflows for these portfolios because we do not have custody of the assets in the majority of our investment management businesses. The information we receive from many of our clients does not separately identify the effect of cash inflows and outflows on asset balances for each period. We also cannot precisely quantify the effect of market appreciation or depreciation because the majority of our clients have discretionary authority to implement their own portfolio allocations.

*Assets under Advisement and Management for Retirement Solutions*

| (\$ billions)           | As of June 30 |         |
|-------------------------|---------------|---------|
|                         | 2011          | 2010    |
| Assets under management | \$ 21.4       | \$ 16.1 |
| Assets under advisement | 17.0          | 12.2    |
| Total                   | \$ 38.4       | \$ 28.3 |

Assets under management for managed retirement accounts increased to \$21.4 billion as of June 30, 2011 compared with \$19.6 billion as of December 31, 2010 and \$16.1 billion as of June 30, 2010 . Assets under advisement for plan sponsor and custom target-date arrangements increased to \$17.0 billion as of June 30, 2011 , 2011 compared with \$15.5 billion as of December 31, 2010 and \$12.2 billion as of June 30, 2010 .

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We cannot separately quantify the factors affecting assets under management for our managed retirement accounts. These factors primarily consist of employer and employee contributions, plan administrative fees, market movements, and participant loans and hardship withdrawals. We cannot quantify the impact of these other factors because the information we receive from the plan providers does not separately identify these transactions or the changes in balances caused by market movement.

### *Morningstar Managed Portfolios*

Morningstar Managed Portfolios contributed to the segment's revenue increase in the second quarter and first half of 2011 . The higher revenue mainly reflects higher average asset levels during the first half of 2011 compared with the same period in 2010 . Assets under management for Morningstar Managed Portfolios rose to \$3.0 billion as of June 30, 2011 , from \$2.2 billion as of June 30, 2010 , reflecting positive equity market returns and strong net inflows.

### *Operating Income*

Operating income for the Investment Management segment increased \$4.2 million , or 29.1% , in the second quarter and \$7.9 million , or 28.7% , in the first half of 2011 .

Operating expense in the segment rose \$1.7 million , or 13.0% , in the second quarter and \$4.5 million , or 18.6% , in the first six months of 2011 . Additional costs from acquisitions contributed approximately 30% of the increase in the second quarter and 40% in the first six months of 2011. Higher salaries and bonus expense contributed the majority of the overall operating expense increase.

Operating margin increased 3.3 percentage points in the second quarter and 2.0 percentage points in the first half of 2011 , as revenue growth exceeded the growth in operating expenses. Lower commission, salary, and benefits expense as a percentage of revenue contributed to the increase. Acquisitions partially offset the margin increase in both periods.

## **Corporate Items**

We do not allocate corporate costs to our business segments. The corporate items category also includes amortization expense related to intangible assets recorded for acquisitions. The table below shows the components of corporate items that affected our consolidated operating income:

| (\$000)               | Three months ended June 30 |                  |         | Six months ended June 30 |                  |        |
|-----------------------|----------------------------|------------------|---------|--------------------------|------------------|--------|
|                       | 2011                       | 2010             | Change  | 2011                     | 2010             | Change |
| Amortization expense  | \$ 6,632                   | \$ 5,848         | 13.4 %  | \$ 13,145                | \$ 11,316        | 16.2%  |
| Depreciation expense  | 1,844                      | 1,772            | 4.1 %   | 3,632                    | 3,550            | 2.3%   |
| Corporate unallocated | 8,505                      | 9,576            | (11.2)% | 17,748                   | 17,427           | 1.8%   |
| Corporate items       | <u>\$ 16,981</u>           | <u>\$ 17,196</u> | (1.3)%  | <u>\$ 34,525</u>         | <u>\$ 32,293</u> | 6.9%   |

Amortization of intangible assets increased \$0.8 million in the second quarter of 2011 and \$1.8 million in the first half of 2011 , mainly reflecting expense related to acquisitions completed in 2010 . As of June 30, 2011 , we had \$156.9 million of net intangible assets. We amortize these assets over their estimated lives, ranging from one to 25 years. We estimate that aggregate amortization expense for intangible assets will be approximately \$25.9 million in 2011 . Some of the purchase price allocations are preliminary, and the values assigned to intangible assets and the associated amortization expense may change in future periods.

Depreciation expense for corporate items increased slightly in the quarter and year-to-date periods.

Corporate unallocated expense decreased \$1.1 million in the second quarter of 2011 and increased \$0.3 million in the first half of 2011 . We capitalized \$0.4 million of expense for software development in the second quarter of 2011. In the second quarter of 2010, we recorded an expense of \$0.5 million to increase our liability for vacant office space for the equity research and data business acquired from C.P.M.S. in Canada; this expense did not recur in the second quarter of 2011.

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The increase in the first half of the year reflects the \$3.2 million of expense for the separation agreement with our former chief operating officer. This expense was partially offset as we capitalized \$1.0 million of software development expenses in the first half of the year. Reduced spending on professional fees also offset the increase in expense, although to a lesser extent. Also, a \$1.3 million expense related to vacant office space recorded in the first half of 2010 did not recur in the first half of 2011, favorably affecting the comparison with the prior year.

**Equity in Net Income of Unconsolidated Entities, Non-Operating Income (Expense), and Income Tax Expense****Equity in Net Income of Unconsolidated Entities**

| (\$000)                                         | Three months ended June 30 |        | Six months ended June 30 |        |
|-------------------------------------------------|----------------------------|--------|--------------------------|--------|
|                                                 | 2011                       | 2010   | 2011                     | 2010   |
| Equity in net income of unconsolidated entities | \$ 595                     | \$ 454 | \$ 969                   | \$ 843 |

Equity in net income of unconsolidated entities includes our portion of the net income (loss) of Morningstar Japan K.K. (MJKK) and Morningstar Sweden AB. In the first six months of 2010, this category also included our portion of the net income (loss) of Morningstar Denmark. Equity in net income of unconsolidated entities is primarily from our position in MJKK.

In July 2010, we acquired an additional 75% ownership interest in Morningstar Denmark, increasing our ownership percentage to 100%. As a result, we no longer account for our investment in Morningstar Denmark using the equity method. Beginning in the third quarter of 2010, we consolidate the assets, liabilities, and results of operations of Morningstar Denmark in our Consolidated Financial Statements.

We describe our investments in unconsolidated entities in more detail in Note 7 of the Notes to our Unaudited Condensed Consolidated Financial Statements.

**Non-Operating Income (Expense)**

The following table presents the components of net non-operating income (expense):

| (\$000)                             | Three months ended June 30 |        | Six months ended June 30 |          |
|-------------------------------------|----------------------------|--------|--------------------------|----------|
|                                     | 2011                       | 2010   | 2011                     | 2010     |
| Interest income                     | \$ 810                     | \$ 657 | \$ 1,386                 | \$ 1,318 |
| Interest expense                    | (989)                      | (64)   | (1,041)                  | (138)    |
| Other income (expense), net         | 188                        | (572)  | 438                      | (1,338)  |
| Non-operating income (expense), net | \$ 9                       | \$ 21  | \$ 783                   | \$ (158) |

Interest income mainly reflects interest from our investment portfolio. Interest income in both the second quarter and first half of 2011 increased compared with the prior-year periods, primarily due to higher balances of cash equivalents and investments.

The interest expense of \$1.0 million relates primarily to the \$1.4 million of business tax expense for prior years recorded in the second quarter of 2011, as discussed above in the section, *Consolidated Operating Expense*.

Other income (expense), net primarily represents foreign currency exchange gains and losses arising from the ordinary course of business related to our U.S. and non-U.S. operations. It also includes royalty income from MJKK and realized gains and losses from our investment portfolio.

## Income Tax Expense

The following table summarizes the components of our effective tax rate:

| (\$000)                                                                        | Three months ended June 30 |           | Six months ended June 30 |           |
|--------------------------------------------------------------------------------|----------------------------|-----------|--------------------------|-----------|
|                                                                                | 2011                       | 2010      | 2011                     | 2010      |
| Income before income taxes and equity in net income of unconsolidated entities | \$ 38,616                  | \$ 27,688 | \$ 71,199                | \$ 58,451 |
| Equity in net income of unconsolidated entities                                | 595                        | 454       | 969                      | 843       |
| Net (income) loss attributable to the noncontrolling interest                  | (2)                        | 85        | 96                       | 116       |
| Total                                                                          | \$ 39,209                  | \$ 28,227 | \$ 72,264                | \$ 59,410 |
| Income tax expense                                                             | \$ 12,724                  | \$ 10,225 | \$ 23,242                | \$ 21,220 |
| Effective tax rate                                                             | 32.5%                      | 36.2%     | 32.2%                    | 35.7%     |

Our effective tax rate in the second quarter of 2011 was 32.5% , a decrease of 3.7 percentage points compared with 36.2% in the prior-year period. Year to date, our effective tax rate was 32.2% , compared with 35.7% in the first half of 2010. In the second quarter of 2011, we increased our estimate of cash tax benefits by a net amount of \$1.1 million, for domestic production activities (Internal Revenue Code Section 199), related to prior years. The net adjustment consists of \$2.2 million of estimated cash tax benefits partially offset by a \$1.1 million increase in unrecognized tax benefits. The net effect of this adjustment represents 2.8 percentage points of the decline in the effective tax rate in the quarter and 1.5 percentage points in the year-to-date period. The year-to-date effective tax rate also reflects the positive effect of certain deferred income tax benefits recorded in the first quarter of 2011.

In the first half of 2011, we recorded a net increase of \$1.8 million of gross unrecognized tax benefits, which increased our income tax expense. The majority of this increase relates to the \$1.1 million expense we recorded in the second quarter of 2011 (discussed above). As of June 30, 2011, we had \$10.9 million of gross unrecognized tax benefits, of which \$10.3 million , if recognized, would reduce our effective income tax rate and decrease our income tax expense by \$8.7 million . As of December 31, 2010, we had \$9.1 million of gross unrecognized tax benefits, of which \$8.5 million , if recognized, would reduce our effective income tax rate and decrease our income tax expense by \$6.9 million .

As of June 30, 2011, our Consolidated Balance Sheet included a current liability of approximately \$2.0 million and a non-current liability of \$8.8 million for unrecognized tax benefits. As of December 31, 2010 , our Condensed Consolidated Balance Sheet included a current liability of \$0.7 million and a non-current liability of \$8.2 million for unrecognized tax benefits. These amounts include interest and penalties, less any associated tax benefits.

We have not provided federal and state income taxes on accumulated undistributed earnings of certain foreign subsidiaries, because these earnings have been permanently reinvested. Approximately 20% of our cash, cash equivalents, and investments as of June 30, 2011 are held by our operations outside of the United States. As such, we believe that our cash balances and investments in the United States, along with cash generated from our U.S. operations, will be sufficient to meet our U.S. operating and cash needs for the foreseeable future, without requiring us to repatriate earnings from these foreign subsidiaries. It is not practicable to determine the amount of the unrecognized deferred tax liability related to the undistributed earnings.

We are currently under audit by the U.S. federal and various state and local tax authorities in the United States, as well as tax authorities in certain non-U.S. jurisdictions. It is likely that the examination phase of some of these audits will conclude in 2011 . It is not possible to estimate the effect of current audits on previously recorded unrecognized tax benefits.

## **Liquidity and Capital Resources**

We believe our available cash balances and investments, along with cash generated from operations, will be sufficient to meet our operating and cash needs for the foreseeable future. We invest our cash reserves in cash equivalents and investments, consisting primarily of fixed-income securities. We maintain a conservative investment policy for our investments and invest a portion of these assets in municipal securities with high-quality stand-alone credit ratings. Investments in our portfolio have a maximum maturity of two years; the weighted average maturity is approximately one year. Approximately 80% of our cash, cash equivalents, and investments as of June 30, 2011 are held by our operations in the United States.

We intend to use our cash, cash equivalents, and investments for general corporate purposes, including working capital and funding future growth. To date, we have not needed to access any significant commercial credit and have not attempted to borrow or establish any lines of credit.

We expect to make a recurring quarterly dividend payment of 5 cents per share. In the first six months of 2011, we paid dividends of \$5.0 million. In May 2011, our board of directors approved a payment of a regular quarterly dividend of 5 cents per share payable on July 29, 2011 to shareholders of record as of July 15, 2011. As of June 30, 2011, we recorded a liability for dividends payable of \$2.5 million.

In September 2010, our board of directors also approved a share repurchase program that authorizes the repurchase of up to \$100 million of our outstanding common stock. From time to time we may repurchase shares at prevailing market prices on the open market or in private transactions in amounts that we deem appropriate. In the first six months of 2011, we repurchased 1,893 shares for approximately \$0.1 million. In total, we have repurchased 78,111 shares for \$3.9 million as part of this program.

### **Cash and Cash Equivalents**

As of June 30, 2011, we had cash, cash equivalents, and investments of \$430.2 million, an increase of \$64.8 million compared with December 31, 2010. The increase reflects \$61.2 million of cash provided by operating activities, \$10.8 million of cash from stock-option proceeds and excess tax benefits, and a positive effect of foreign currency translations. These items, which increased our cash balances, were partially offset by \$8.4 million of capital expenditures and \$5.0 million of dividends paid.

### **Cash Provided by Operating Activities**

Our main source of capital is cash generated from operating activities.

In the first six months of 2011, cash provided by operating activities was \$61.2 million, an increase of \$16.1 million compared with the same period in 2010. The increase reflects higher net income (adjusted for non-cash items), favorable cash flow from operating assets and liabilities, and the timing of income tax payments. These items, which increased cash from operations, were partially offset by a \$16.1 million increase in bonus payments. We paid \$37.5 million in annual bonuses in the first quarter of 2011, compared with \$21.4 million in the prior-year period. Cash provided by operating activities in the first half of 2011 also reflects \$2.8 million for previously announced separation agreements with two former executives.

In the first six months of 2010, we paid \$4.9 million to one former and, at the time, two current executives to adjust the tax treatment of certain stock options originally considered incentive stock options.

### **Cash Used for Investing Activities**

Cash used for investing activities consists primarily of cash used for acquisitions, purchases of investments less proceeds from the maturity or sale of investments, and cash used for capital expenditures. The level of investing activities varies from period to period depending on activity in these three categories. In the first half of 2011, cash used for investing activities was \$55.4 million, compared with \$25.6 million in the same period of 2010.

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In the first half of 2011 , purchases of investments exceeded the proceeds from the maturity and sale of investments by \$48.3 million . In contrast, in the first half of 2010 , proceeds from the maturity and sale of investments exceeded the purchases of investments by \$44.9 million . As of June 30, 2011 and December 31, 2010 , we had investments, consisting primarily of fixed-income securities, of \$235.2 million and \$185.2 million, respectively. As of June 30, 2011 and December 31, 2010 , our investments represented approximately half of our total cash, cash equivalents, and investments.

Capital expenditures were \$8.4 million in the first half of 2011 , an increase of \$4.6 million compared with the first half of 2010 . The majority of the increase reflects remaining payments for our development center in China. We expect to make capital expenditures of approximately \$16.0 million to \$19.0 million in 2011 , primarily for leasehold improvements at new and existing office locations and computer hardware.

We did not complete any acquisitions in the first half of 2011 , but received cash of approximately \$0.6 million as an adjustment to the purchase price of one of our recent acquisitions. In the first half of 2010 , we completed four acquisitions for \$67.5 million , net of cash acquired.

### **Cash Provided by Financing Activities**

Cash provided by financing activities consists primarily of proceeds from stock-option exercises and excess tax benefits related to stock-option exercises and vesting of restricted stock units. These cash inflows may be offset by dividend payments and cash used to repurchase outstanding common stock through our share repurchase program. We did not make any significant purchases under this program in the second quarter of 2011 .

Excess tax benefits occur at the time a stock option is exercised when the intrinsic value of the option (the difference between the fair value of our stock on the date of exercise and the exercise price of the option) is greater than the fair value of the option at the time of grant. Similarly, the vesting of restricted stock units generates excess tax benefits when the market value of our common stock on the vesting date exceeds the grant price of the restricted stock units. These excess tax benefits reduce the cash we pay for income taxes in the year they are recognized. It is not possible to predict the timing of stock-option exercises or the intrinsic value that will be achieved at the time options are exercised or upon vesting of restricted stock units. As a result, we expect cash flow from financing activities to vary over time. Note 9 in the Notes to our Unaudited Condensed Consolidated Financial Statements includes additional information concerning stock options and restricted stock units outstanding as of June 30, 2011 .

Cash provided by financing activities was \$5.5 million in the first six months of 2011 . Proceeds from stock-option exercises totaled \$4.7 million, while excess tax benefits related to stock-option exercises and vesting of restricted stock units totaled \$6.2 million. Partially offsetting these cash inflows was \$5.0 million of dividends paid. Cash provided by financing activities was \$8.1 million in the first six months of 2010, primarily from proceeds from stock option exercised and excess tax benefits. We did not pay any dividends in the first half of 2010.

Employees exercised approximately 0.5 million and 0.4 million stock options in the first six months of 2011 and 2010 , respectively. The total intrinsic value (the difference between the market value of our stock on the date of exercise and the exercise price of the option) of options exercised during the first six months of 2011 and 2010 was \$20.1 million and \$14.5 million, respectively.

## **Reclassifications**

Beginning in 2011, as a part of the new Investment Management organization structure, we reviewed the revenue classification between Investment Consulting and Retirement Advice. We reclassified the prior-year information for consistency with the current-year presentation. As presented in the tables below, this reclassification changed the order of Advisor Workstation and Investment Consulting in our top five products in 2010, but did not have any effect on the order of our top five products in 2009.

| <b>Top Five Products 2010</b> | <b>Reclassified for Consistency with 2011 Product Revenue (\$000)</b> | <b>As Reported Revenue (\$000)</b> |
|-------------------------------|-----------------------------------------------------------------------|------------------------------------|
| Licensed Data                 | \$ 98,186                                                             | \$ 98,186                          |
| Advisor Workstation           | 69,321                                                                | 69,321                             |
| Investment Consulting         | 66,114                                                                | 72,798                             |
| Morningstar.com               | 49,673                                                                | 49,673                             |
| Morningstar Direct            | 38,069                                                                | 38,069                             |

  

| <b>Top Five Products 2009</b> | <b>Reclassified for Consistency with 2011 Product Revenue (\$000)</b> | <b>As Reported Revenue (\$000)</b> |
|-------------------------------|-----------------------------------------------------------------------|------------------------------------|
| Licensed Data                 | \$ 91,524                                                             | \$ 91,524                          |
| Advisor Workstation           | 65,673                                                                | 65,673                             |
| Investment Consulting         | 56,344                                                                | 62,531                             |
| Morningstar.com               | 39,454                                                                | 39,454                             |
| Principia                     | 29,968                                                                | 29,968                             |

## **Application of Critical Accounting Policies and Estimates**

We discuss our critical accounting policies and estimates in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the SEC on February 28, 2011. We also discuss our significant accounting policies in Note 3 of our Consolidated Financial Statements included in our Annual Report.

Effective January 1, 2011, we adopted Financial Accounting Standards Board Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*. ASU 2009-13 supersedes Emerging Issues Task Force Issue 00-21, *Revenue Arrangements with Multiple Deliverables* and establishes the accounting and reporting guidance for arrangements when a vendor performs multiple revenue-generating activities, addresses how to separate deliverables, and specifies how to measure and allocate arrangement consideration. We are applying this guidance for revenue arrangements entered into or materially modified from January 1, 2011. The adoption of ASU 2009-13 does not significantly affect either the timing or amount of our revenue recognition.

## **Recently Issued Accounting Pronouncements**

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU No. 2011-04 clarifies existing fair value measurement and disclosure requirements, amends certain fair value measurement principles and requires additional disclosures about fair value measurements. For Morningstar, ASU No. 2011-04 will be applied prospectively beginning on January 1, 2012. We do not expect the provisions of ASU No. 2011-04 will have a material impact on our consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. Under ASU No. 2011-05, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single

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continuous statement of comprehensive income or in two separate but consecutive statements. Entities will no longer be allowed to present other comprehensive income in the statement of stockholder's equity. For Morningstar, ASU No. 2011-05 is effective beginning on January 1, 2012. We do not expect the provisions of ASU No. 2011-05 will have a material impact on our consolidated financial statements.

**Rule 10b5-1 Sales Plans**

Our directors and executive officers may exercise stock options or purchase or sell shares of our common stock in the market from time to time. We encourage them to make these transactions through plans that comply with Exchange Act Rule 10b5-1(c). Morningstar will not receive any proceeds, other than proceeds from the exercise of stock options, related to these transactions. The following table, which we are providing on a voluntary basis, shows the Rule 10b5-1 sales plans entered into by our directors and executive officers that were in effect as of July 31, 2011 :

| <b>Name and Position</b>                                                                    | <b>Date of Plan</b> | <b>Plan Termination Date</b> | <b>Number of Shares to be Sold under the Plan</b> | <b>Timing of Sales under the Plan</b>                                   | <b>Number of Shares Sold under the Plan through July 31, 2011</b> | <b>Projected Beneficial Ownership (1)</b> |
|---------------------------------------------------------------------------------------------|---------------------|------------------------------|---------------------------------------------------|-------------------------------------------------------------------------|-------------------------------------------------------------------|-------------------------------------------|
| Scott Cooley<br>Chief Financial Officer                                                     | 3/22/2011           | 5/31/2012                    | 10,000                                            | Shares to be sold under the plan if the stock reaches a specified price | —                                                                 | 41,335                                    |
| Bevin Desmond<br>President,<br>International<br>Operations and<br>Global Human<br>Resources | 5/27/2011           | 5/31/2013                    | 92,243                                            | Shares to be sold under the plan if the stock reaches specified prices  | —                                                                 | 101,803 (2)                               |
| Steve Kaplan,<br>Director                                                                   | 2/23/2011           | 2/28/2012                    | 7,500                                             | Shares to be sold under the plan on specified dates                     | —                                                                 | 60,644                                    |
| Liz Kirscher<br>President, Data<br>Division                                                 | 11/23/2009          | 2/28/2012                    | 63,750                                            | Shares to be sold under the plan if the stock reaches specified prices  | 24,000                                                            | 73,847                                    |
| Cathy Odelbo<br>President, Equity &<br>Credit Research                                      | 8/13/2008           | 12/31/2011                   | 100,000                                           | Shares to be sold under the plan if the stock reaches specified prices  | —                                                                 | 92,458                                    |
| Don Phillips<br>President,<br>Fund Research                                                 | 3/11/2011           | 5/1/2012                     | 95,000                                            | Shares to be sold under the plan if the stock reaches specified prices  | 41,603                                                            | 342,808                                   |
| Don Phillips<br>President,<br>Fund Research                                                 | 5/25/2011           | 7/31/2012                    | 27,640                                            | Shares to be sold under the plan if the stock reaches specified prices  | —                                                                 | 315,168                                   |
| David Williams<br>Managing Director,<br>Design                                              | 9/10/2008           | 2/28/2012                    | 20,000                                            | Shares to be sold under the plan if the stock reaches specified prices  | 5,000                                                             | 91,413                                    |

During the second quarter, Richard Robbins' previously disclosed Rule 10b5-1 sales plan expired in accordance with its terms.

(1) This column reflects an estimate of the number of shares each identified director and executive officer will beneficially own following the sale of all shares under the Rule 10b5-1 sales plans identified above. This information reflects the beneficial ownership of our common stock on June 30, 2011, and includes shares of our common stock subject to options that were then exercisable or that will have become exercisable by August 29, 2011 and restricted stock units that will vest by August 29, 2011. The estimates do not reflect any changes to beneficial ownership that may have occurred since June 30, 2011. Each director and executive officer identified in the table may amend or terminate his or her Rule 10b5-1 sales plan and may adopt additional Rule 10b5-1 plans in the future.

(2) Consists of two Rule 10b5-1 sales plans, one for Bevin and one for her spouse. Projected beneficial ownership also includes shares owned by her spouse.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Our investment portfolio is actively managed and may suffer losses from fluctuating interest rates, market prices, or adverse security selection. We invest our investment portfolio mainly in high-quality fixed-income securities. As of June 30, 2011, our cash, cash equivalents, and investments balance was \$430.2 million. Based on our estimates, a 100 basis-point change in interest rates would impact the fair value of our investment portfolio by approximately \$0.7 million.

As our non-U.S. revenue increases as a percentage of our consolidated revenue, fluctuations in foreign currencies present a greater potential risk. To date, we have not engaged in currency hedging, and we do not currently have any positions in derivative instruments to hedge our currency risk. Our results could suffer if certain foreign currencies decline relative to the U.S. dollar. In addition, because we use the local currency of our subsidiaries as the functional currency, we are affected by the translation of foreign currencies into U.S. dollars.

### **Item 4. Controls and Procedures**

#### **(a) Evaluation and Disclosure Controls and Procedures**

Disclosure controls and procedures are designed to reasonably assure that information required to be disclosed in the reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to reasonably assure that information required to be disclosed in the reports filed under the Exchange Act is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as of June 30, 2011. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported as and when required and is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

#### **(b) Changes in Internal Controls Over Financial Reporting**

There were no changes in our internal controls over financial reporting during the quarter ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART 2. OTHER INFORMATION****Item 1. Legal Proceedings**

We incorporate by reference the information regarding legal proceedings set forth in Note 11, Contingencies, of the Notes to our Unaudited Condensed Consolidated Financial Statements contained in Part 1, Item 1 of this Quarterly Report on Form 10-Q.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors disclosed in Item 1A—Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010 .

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**Issuer Purchases of Equity Securities\*

The following table presents information related to repurchases of common stock we made during the three months ended June 30, 2011 :

| Period:                           | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced programs (1) | Approximate dollar value of shares that may yet be purchased under the programs (1) |
|-----------------------------------|----------------------------------|------------------------------|-----------------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| Cumulative through March 31, 2011 | 76,218                           | \$ 49.64                     | 76,218                                                                      | \$ 96,216,778                                                                       |
| April 1, 2011 – April 30, 2011    | —                                | —                            | —                                                                           | \$ 96,216,778                                                                       |
| May 1, 2011 – May 31, 2011        | —                                | —                            | —                                                                           | \$ 96,216,778                                                                       |
| June 1, 2011 – June 30, 2011      | 1,893                            | 57.57                        | 1,893                                                                       | \$ 96,106,235                                                                       |
| Total                             | <u>78,111</u>                    | \$ 49.83                     | <u>78,111</u>                                                               |                                                                                     |

\* Subject to applicable law, we may repurchase shares at prevailing market prices directly on the open market or in privately negotiated transactions in amounts that we deem appropriate.

(1) In September 2010, our board of directors approved a share repurchase program that authorizes the purchase of up to \$100 million of the outstanding common stock with an expiration date of December 31, 2012.

**Item 6. Exhibits**

(a) Exhibits

| <b>Exhibit No</b> | <b>Description of Exhibit</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|-------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1              | Form of Morningstar 2004 Stock Incentive Plan Stock Option Agreement for awards made on May 15, 2011                                                                                                                                                                                                                                                                                                                                                                                                  |
| 10.2              | Form of Morningstar 2004 Stock Incentive Plan Director Stock Option Agreement for awards made on May 15, 2011                                                                                                                                                                                                                                                                                                                                                                                         |
| 10.3              | Morningstar, Inc. 2011 Stock Incentive Plan is incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K that we filed with the SEC on May 18, 2011                                                                                                                                                                                                                                                                                                                                 |
| 31.1              | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended                                                                                                                                                                                                                                                                                                                                                                  |
| 31.2              | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended                                                                                                                                                                                                                                                                                                                                                                  |
| 32.1              | Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                             |
| 32.2              | Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                             |
| 101*              | The following financial information from Morningstar Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, filed with the SEC on August 2, 2011, formatted in XBRL: (i) Condensed Consolidated Statements of Income, (ii) Condensed Consolidated Balance Sheets, (iii) Condensed Consolidated Statement of Equity and Comprehensive Income (Loss), (iv) Condensed Consolidated Statements of Cash Flows and (v) the Notes to Unaudited Condensed Consolidated Financial Statement |

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\* Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections

**SIGNATURE**

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

MORNINGSTAR, INC.

Date: August 2, 2011

By: /s/ Scott Cooley  
Scott Cooley  
Chief Financial Officer



**NONSTATUTORY STOCK OPTION AWARD AGREEMENT  
UNDER THE  
MORNINGSTAR, INC. 2004 STOCK INCENTIVE PLAN, AS AMENDED**

This NONSTATUTORY STOCK OPTION AWARD AGREEMENT ("Agreement") is made effective [•] (the "Grant Date"), and is between Morningstar, Inc., an Illinois corporation (the "Company"), and «Employee» (the "Participant"). Any term capitalized but not defined in this Agreement will have the meaning set forth in the Morningstar, Inc. 2004 Stock Incentive Plan, as amended (the "Plan").

1. Option Grant and Number of Shares. In accordance with the terms of the Plan and subject to the terms and conditions of the Plan and this Agreement, the Company grants to the Participant a Nonstatutory Stock Option to purchase all or any part of an aggregate of «Q2\_Grant\_» Shares of the Company (the "Option").

2. Exercise Price and Payment of Exercise Price. The Exercise Price of each Share subject to the Option shall be \$ «Exercise Price» .

After the Option has become exercisable, and before the Expiration Date indicated in Section 3 of this Agreement or, if earlier, the date on which the Option expires pursuant to Section 4 of this Agreement, the Participant may exercise this Option in accordance with Sections 6.6 and 6.7 of the Plan.

3. Term and Exercisability of an Option. The Option will become exercisable in installments, with each installment becoming exercisable on the "First Exercisable Date" shown below, if the Participant has remained in continuous Service until that date.

| Shares Subject to Option | First Exercisable Date | Expiration Date |
|--------------------------|------------------------|-----------------|
| «Vest1»                  | «VestDate1»            | «ExpDate»       |
| «Vest2»                  | «VestDate2»            | «ExpDate»       |
| «Vest3»                  | «VestDate3»            | «ExpDate»       |
| «Vest4»                  | «VestDate4»            | «ExpDate»       |

4. Termination of Service.

(a) If the Participant's Service is terminated by the Company for any reason other than Cause, the portion of the Option that is exercisable at the time of such termination shall remain exercisable until the earlier of (i) the Expiration Date set forth in Section 3 of this Agreement or (ii) the first anniversary of such termination. The portion of the Option that is not exercisable at the time of such termination shall expire at the close of business on the date of such termination.

(b) If the Participant's Service terminates on account of Disability or death of the Participant, the portion of the Option that is exercisable at the time of such termination shall remain exercisable until the earlier of (i) the Expiration Date set forth in Section 3 of this Agreement or (ii) the first anniversary of such termination. The portion of the Option that is not exercisable at the time of such termination shall expire at the close of business on the date of such termination.

(c) If the Participant's Service is terminated for Cause, the Option shall expire in its entirety as of the commencement of business on the date of such termination.

(d) If the Participant's Service is terminated for any reason other than those described in subsections (a), (b) and (c) of this Section 4, the portion of the Option that is exercisable at the time of such termination shall remain exercisable until the earlier of (i) the Expiration Date set forth in Section 3 of this Agreement or (ii) 90 days from the date of such termination. The portion of the Option that is not exercisable at the time of such termination shall expire at the close of business on the date of such termination.

5. Notice. Except as otherwise specified by the Company in its administrative procedures under the Plan, any notice or other communication required or permitted under this Agreement must be in writing and must be delivered personally, sent by certified, registered or express mail, or sent by overnight courier, at the sender's expense. Notice will be deemed given when delivered personally or, if mailed, three days after the date of deposit in the United States mail or, if sent by overnight courier, on the regular business day following the date sent. Notice to the Company should be sent to Morningstar, Inc., 22 West Washington Street, Chicago, Illinois, 60602, Attention: General Counsel. Notice to the Participant should be sent to the address in the records of the Company. Either party may change the person and/or address to whom the other party must give notice under this Section by giving such other party written notice of such change, in accordance with the procedures described above.

6. Plan Document Controls. The rights granted under this Agreement are in all respects subject to the provisions set forth in the Plan to the same extent and with the same effect as if set forth fully in this Agreement. The Plan is incorporated herein by reference and made a part hereof, but the terms of the Plan shall not be considered an enlargement of any benefits under this Agreement. Wherever a conflict may arise between the terms of this Agreement and the terms of the Plan, the terms of the Plan shall control solely to the extent necessary to resolve such conflict. In addition, the Option granted hereunder is subject to any rules and regulations promulgated by the Committee pursuant to the Plan, now or hereafter in effect.

7. Amendment of Agreement. The Company and the Participant may amend this Agreement only by a written instrument signed by both parties.

8. Counterparts. The parties may execute this Agreement in one or more counterparts, all of which together shall constitute but one Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Nonstatutory Stock Option Award Agreement as of the Grant Date set forth above.

**PARTICIPANT**

«Employee»

Please return by: «Return Date»

**MORNINGSTAR, INC.**

By: \_\_\_\_\_

Its: \_\_\_\_\_

**DIRECTOR NONSTATUTORY STOCK OPTION AWARD AGREEMENT**  
**UNDER THE**  
**MORNINGSTAR, INC. 2004 STOCK INCENTIVE PLAN, AS AMENDED**

This DIRECTOR NONSTATUTORY STOCK OPTION AWARD AGREEMENT ("Agreement") is made effective [•] (the "Grant Date"), and is between Morningstar, Inc., an Illinois corporation (the "Company"), and «**Director**» (the "Participant"). Any term capitalized but not defined in this Agreement will have the meaning set forth in the Morningstar, Inc. 2004 Stock Incentive Plan, as amended (the "Plan").

1. Option Grant and Number of Shares . In accordance with the terms of the Plan and subject to the terms and conditions of the Plan and this Agreement, the Company grants to the Participant a Nonstatutory Stock Option to purchase all or any part of an aggregate of «**Q2\_Grant\_**» Shares of the Company (the "Option").

2. Exercise Price and Payment of Exercise Price . The Exercise Price of each Share subject to the Option shall be \$ «**Exercise Price**» .

After the Option has become exercisable, and before the Expiration Date indicated in Section 3 of this Agreement or, if earlier, the date on which the Option expires pursuant to Section 4 of this Agreement, the Participant may exercise this Option in accordance with Sections 6.6 and 6.7 of the Plan.

3. Term and Exercisability of an Option . The Option will become exercisable in installments, with each installment becoming exercisable on the "First Exercisable Date" shown below, if the Participant has remained in continuous Service until that date.

| Shares Subject to Option | First Exercisable Date | Expiration Date |
|--------------------------|------------------------|-----------------|
| «Vest1»                  | «VestDate1»            | «ExpDate»       |
| «Vest2»                  | «VestDate2»            | «ExpDate»       |
| «Vest3»                  | «VestDate3»            | «ExpDate»       |

4. Termination of Service .

(a) If the Participant's Service terminates on account of Disability or death of the Participant, the portion of the Option that is exercisable at the time of such termination shall remain exercisable until the earlier of (i) the Expiration Date set forth in Section 3 of this Agreement or (ii) the first anniversary of such termination. The portion of the Option that is not exercisable at the time of such termination shall expire at the close of business on the date of such termination.

(b) If the Participant's Service is terminated for any reason other than those described in subsection (a) of this Section 4, the portion of the Option that is exercisable at the time of such termination shall remain exercisable until the earlier of (i) the Expiration Date set forth in Section 3 of this Agreement or (ii) 90 days from the date of such termination. The portion of the Option that is not exercisable at the time of such termination shall expire at the close of business on the date of such termination.

5. Notice . Except as otherwise specified by the Company in its administrative procedures under the Plan, any notice or other communication required or permitted under this Agreement must be in writing

and must be delivered personally, sent by certified, registered or express mail, or sent by overnight courier, at the sender's expense. Notice will be deemed given when delivered personally or, if mailed, three days after the date of deposit in the United States mail or, if sent by overnight courier, on the regular business day following the date sent. Notice to the Company should be sent to Morningstar, Inc., 22 West Washington Street, Chicago, Illinois, 60602, Attention: General Counsel. Notice to the Participant should be sent to the address in the records of the Company. Either party may change the person and/or address to whom the other party must give notice under this Section by giving such other party written notice of such change, in accordance with the procedures described above.

6. Plan Document Controls. The rights granted under this Agreement are in all respects subject to the provisions set forth in the Plan to the same extent and with the same effect as if set forth fully in this Agreement. The Plan is incorporated herein by reference and made a part hereof, but the terms of the Plan shall not be considered an enlargement of any benefits under this Agreement. Wherever a conflict may arise between the terms of this Agreement and the terms of the Plan, the terms of the Plan shall control solely to the extent necessary to resolve such conflict. In addition, the Option granted hereunder is subject to any rules and regulations promulgated by the Committee pursuant to the Plan, now or hereafter in effect.

7. Amendment of Agreement. The Company and the Participant may amend this Agreement only by a written instrument signed by both parties.

8. Counterparts. The parties may execute this Agreement in one or more counterparts, all of which together shall constitute but one Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Director Nonstatutory Stock Option Award Agreement as of the Grant Date set forth above.

**PARTICIPANT**

«Director»

Please return by: «Return Date»

**MORNINGSTAR, INC.**

By: \_\_\_\_\_  
Its: \_\_\_\_\_

## CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Joe Mansueto, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Morningstar, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2011

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/s/ Joe Mansueto  
Joe Mansueto  
Chairman of the Board and Chief Executive Officer

## CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Scott Cooley, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Morningstar, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2011

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/s/ Scott Cooley  
Scott Cooley  
Chief Financial Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF  
THE SARBANES-OXLEY ACT OF 2002

Joe Mansueto, as Chairman of the Board and Chief Executive Officer of Morningstar, Inc. (the Company), certifies, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2011 as filed with the Securities and Exchange Commission on the date hereof (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

---

/s/ Joe Mansueto

Joe Mansueto

Chairman of the Board and Chief Executive Officer

Date: August 2, 2011

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF  
THE SARBANES-OXLEY ACT OF 2002

Scott Cooley, as Chief Financial Officer of Morningstar, Inc. (the Company), certifies, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2011 as filed with the Securities and Exchange Commission on the date hereof (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

---

/s/ Scott Cooley  
Scott Cooley  
Chief Financial Officer

Date: August 2, 2011