

# MORNINGSTAR, INC.

## FORM 8-K (Unscheduled Material Events)

Filed 5/23/2006 For Period Ending 5/23/2006

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

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 8-K**

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**CURRENT REPORT**

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

Date of Report (Date of earliest event reported): **May 23, 2006**

**MORNINGSTAR, INC.**

(Exact name of registrant as specified in its charter)

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

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

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

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

**60606**  
(Zip Code)

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

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

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

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

**Item 7.01. Regulation FD Disclosure.**

On May 23, 2006, Joe Mansueto, Chairman and Chief Executive Officer, and Martha Dustin Boudos, Chief Financial Officer, of Morningstar, Inc. will make the presentation attached as Exhibit 99.1 at its Annual Shareholders’ Meeting, which will be held at The Conference Center at UBS Tower in Chicago, Illinois at 9:00 a.m. Central Standard Time.

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

(d) Exhibits:

<u>Exhibit No.</u>	<u>Description</u>
99.1	Annual Meeting Presentation.

## SIGNATURES

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

MORNINGSTAR, INC.

Date: May 23, 2006

By: /s/ Martha Dustin Boudos

Name: Martha Dustin Boudos

Title: Chief Financial Officer

## EXHIBIT INDEX

Exhibit No.	Description
99.1	Annual Meeting Presentation.
	4

**Annual Shareholders'  
Meeting 2006**

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## Update on Key Products and Growth Strategies

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Joe Mansueto  
Chairman &  
Chief Executive Officer

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## Morningstar Today

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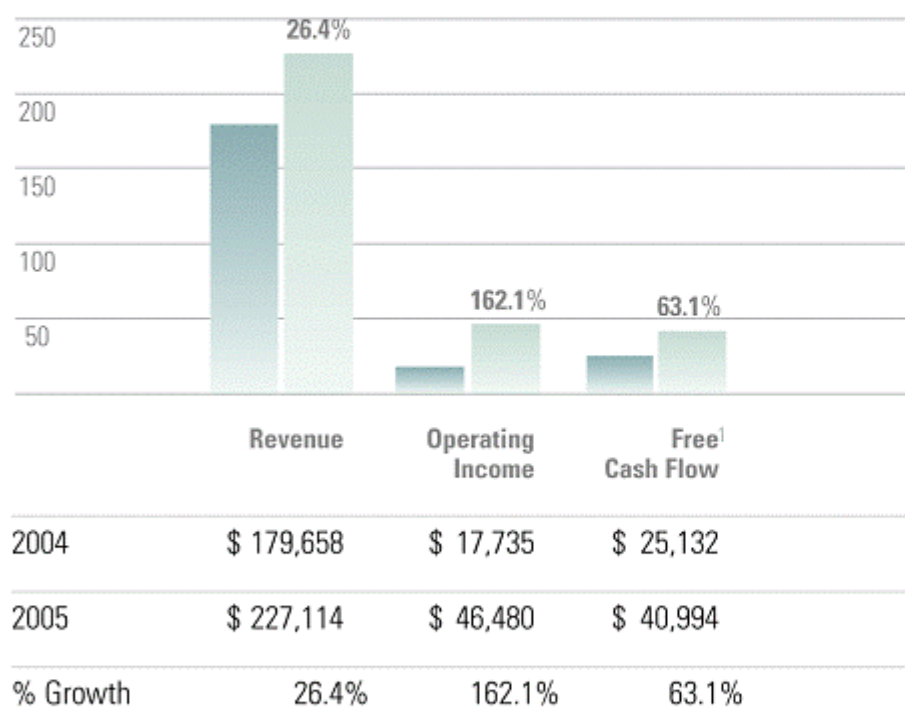


- ▶ Our mission: Create great products that help investors reach their financial goals
- ▶ Established, well-regarded national independent investment research firm
- ▶ Serving more than 4.9 million investors, 185,000 advisors, and 750 institutional investors
- ▶ Extensive research and data coverage of 145,000 investment offerings
- ▶ Operations in 13 countries and ownership positions in another 10
- ▶ 1,250 employees



## 2005 Highlights

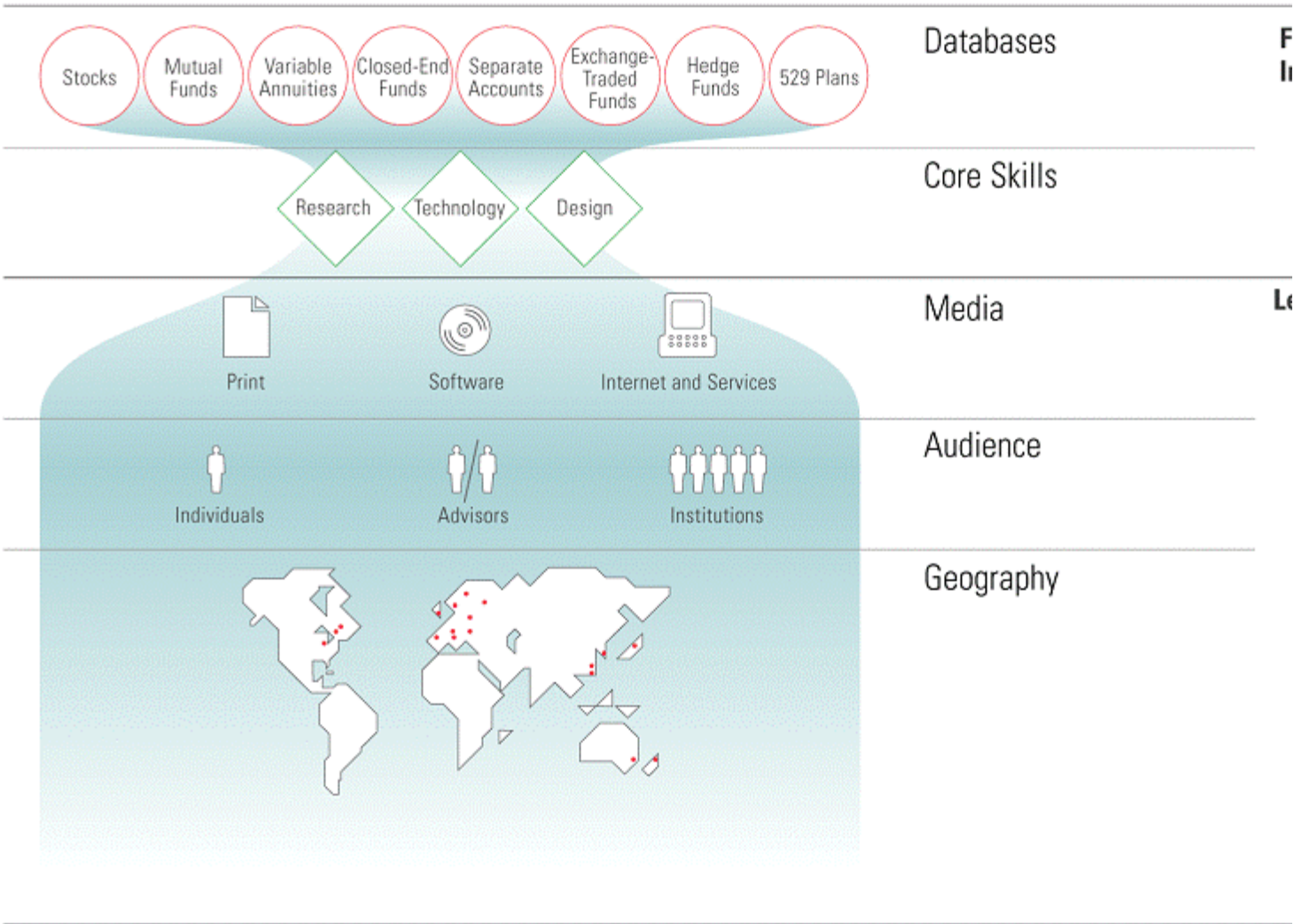
### Revenue, Operating Income, Free Cash Flow Year Ended December 31 (\$000)



- ▶ Increased revenue 26%, operating income 162%, and free cash flow 63.1%
- ▶ Completed IPO in May 2005
- ▶ Announced agreement to acquire Ibbotson Associates
- ▶ Retained all five equity research analysts related to Global Analyst Resignation Settlement and signed agreement with sixth investment bank
- ▶ Launched Morningstar Direct
- ▶ Completed acquisition of VAF
- ▶ Signed consulting agreement with Italy, and China
- ▶ Continued to expand development center in China

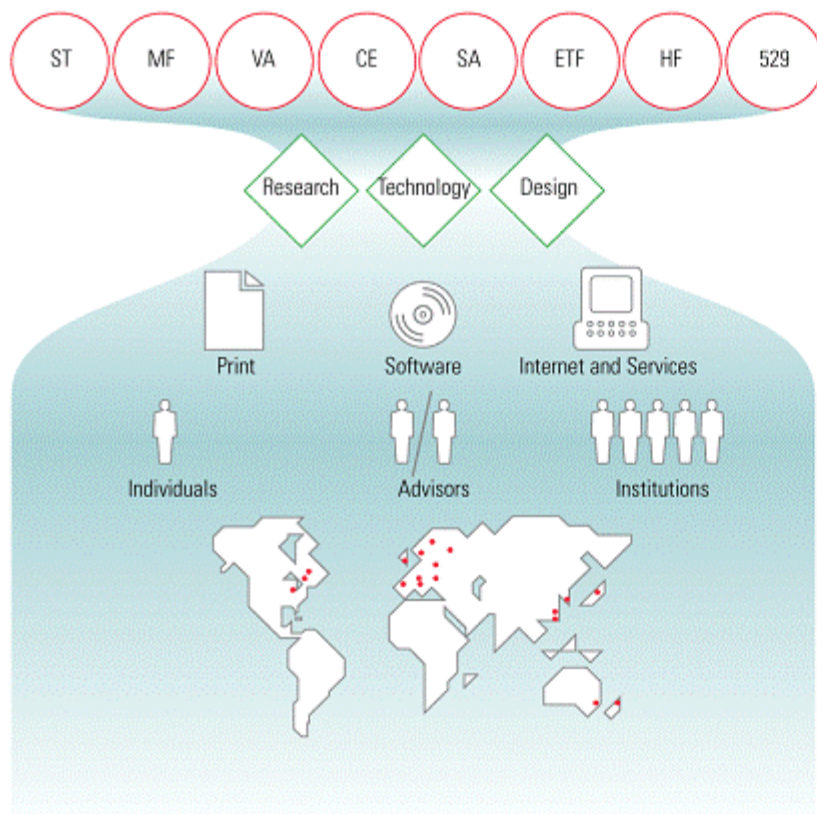
(1) Free cash flow is a measure that is not calculated in accordance with U.S. GAAP.

**Business Model:  
Leveraging Fixed Invest**



# ibbotson.

- ▶ Completed acquisition on May 1, 2007 for \$86.4 million
- ▶ Started in 1977 by Professor Ibbotson
- ▶ Focused on providing clients with education and tools to reduce risk and improve returns for investors
- ▶ Serving more than 70,000 advisors and 700 institutions
- ▶ Key business lines:
  - ▷ Investment consulting and
  - ▷ Planning and analysis software
  - ▷ Investment advice
  - ▷ Educational and marketing
  - ▷ Presentation materials



**Ibbotson will add capabilities that complement our current business**

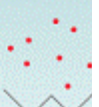
Capital Markets Database

Asset Allocation Expertise

Print, Software, Internet and Services

Advisors and Institutions

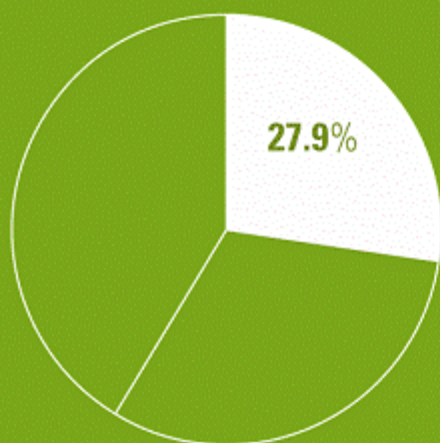
Existing presence in Japan and opportunities to expand in other non-U.S. markets





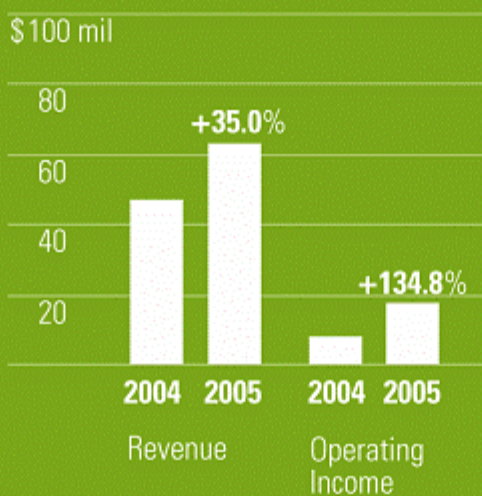
## Individual Segment

### 2005 Revenue



\$ 63.4 million  
27.9% total revenue

### Revenue and Operating Income Growth



35.0% revenue growth  
134.8% operating income growth

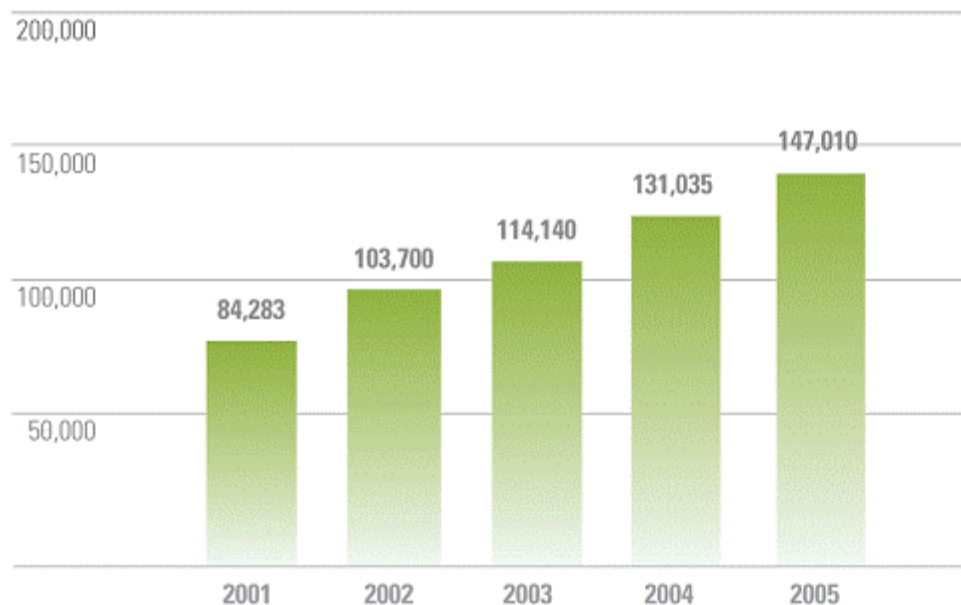
### 2005 Reach



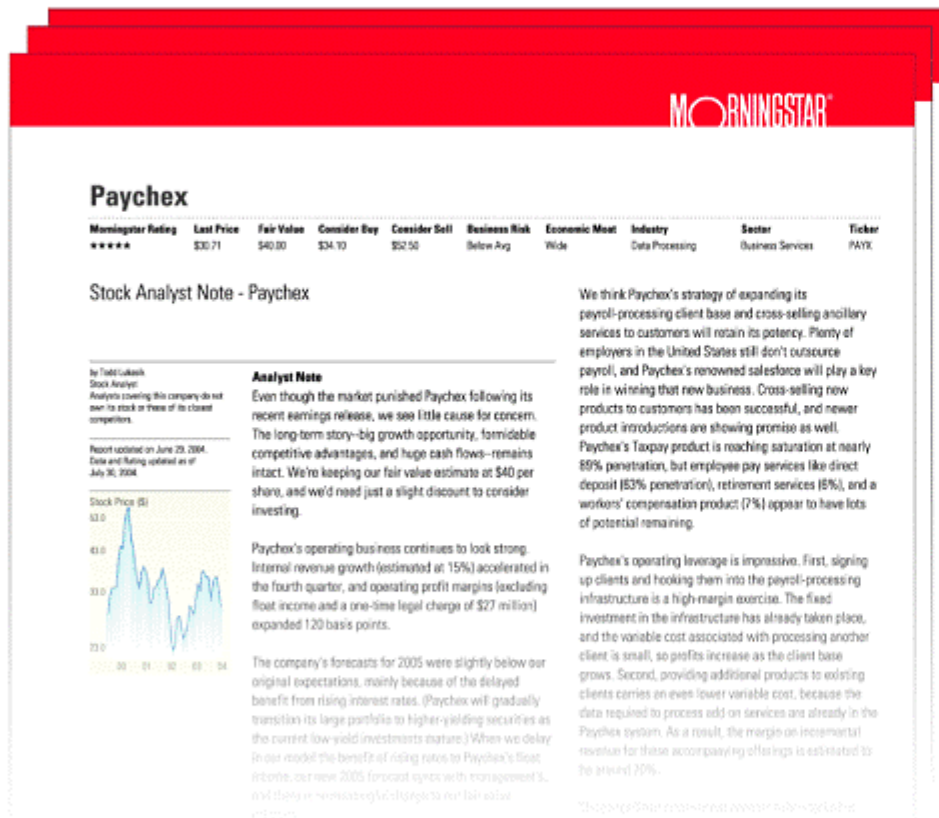
4.4 million Morningstar reach  
91 million investors (U.S. market)

Revenue and operating income for our three segments total more than 100% because they exclude eliminations and corporate items.

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**Growth of Morningstar.com Premium Memberships (U.S.)  
Year Ended December 31**

- ▶ Analyst research on 2,000 funds and 1,700 stocks
- ▶ Launched Morningstar Stewart Grade for Stocks
- ▶ Expanded analyst coverage of exchange-traded funds
- ▶ Created new home page to highlight most frequently used content
- ▶ Moderate increase in Premium now \$14.95/month or \$135/year
- ▶ 2006 priorities:
  - ▷ Improve site's speed
  - ▷ Expand base of enthusiasts
  - ▷ Increase Premium trials through sampling and other

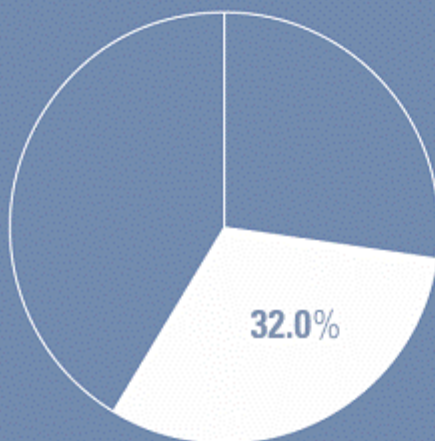


- Fundamental approach favors with discount to estimated in value and sustainable competitive advantage (economic moat)
- Expanded analyst staff from 7 in 2005 and increased coverage from 1,500 to more than 1,700 stocks
- Signed contract with sixth investment bank to provide research under Global Analyst Research Settlement
- 2006 priorities:
  - ▷ Great service and ongoing relationship for Global Settlement clients
  - ▷ Increase coverage outside of U.S. to expand non-U.S. client base
  - ▷ Expand reach with buy side



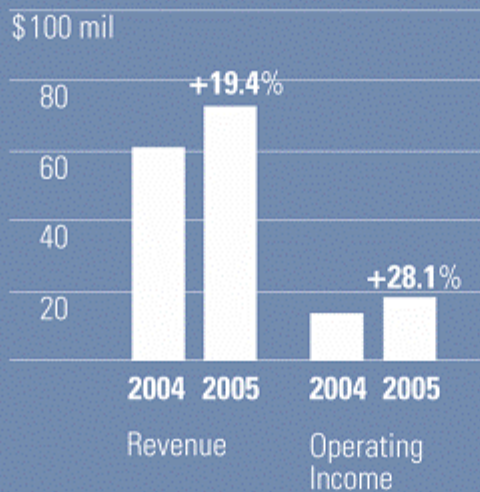
## Advisor Segment

### 2005 Revenue



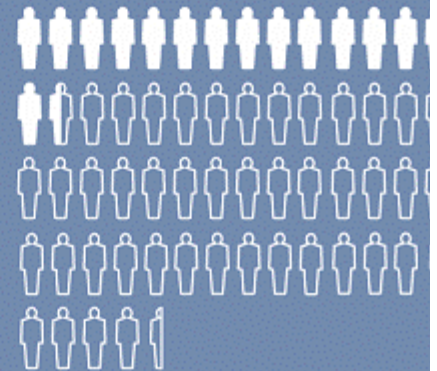
\$72.7 million  
32.0% total revenue

### Revenue and Operating Income Growth



19.4% revenue growth  
28.1% operating income growth

### 2005 Reach

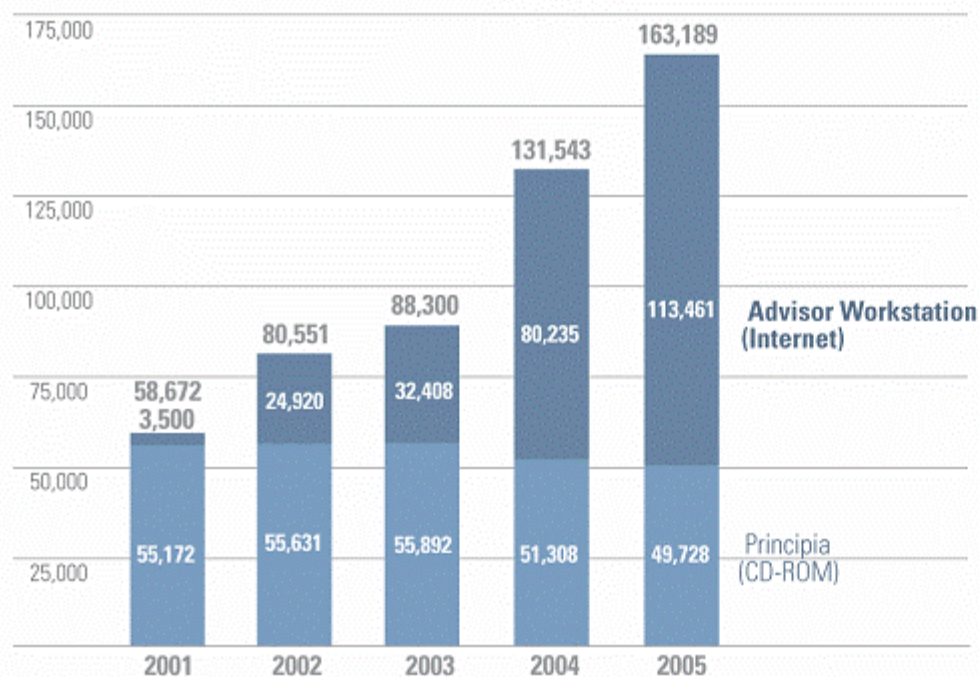


185,000 Morningstar reach (g)  
715,000 advisors (global)

Revenue and operating income for our three segments total more than 100% because they exclude eliminations and corporate items.



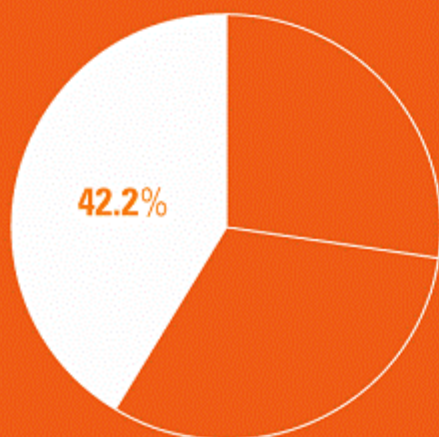
## Advisor Workstation Licenses Year Ended December 31



- ▶ Advisor Workstation has been a growth driver and now ranks #1 product in Advisor segment
- ▶ 2005 enhancements:
  - ▷ Advisor Compliance Tools
  - ▷ Share Class Analyzer Report
- ▶ 2006 priorities:
  - ▷ Retirement income solution
  - ▷ Suitability manager tool for funds, 529s, variable annuities
  - ▷ New portfolio planning tool
- ▶ Prices range up to \$5,000/user for Office Edition; \$80-\$2,500 for Enterprise Edition

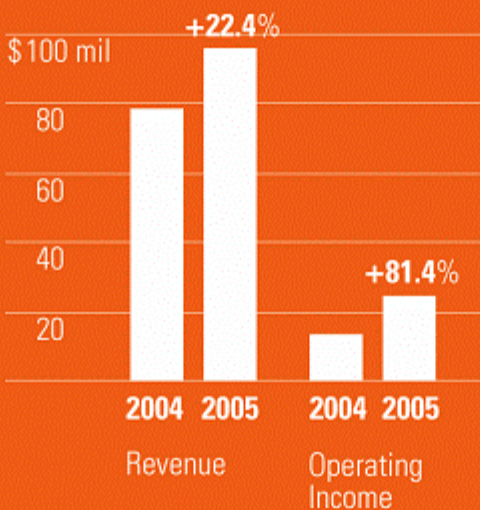
## Institutional Segment

### 2005 Revenue



\$95.9 million  
42.2% total revenue

### Revenue and Operating Income Growth



22.4% revenue growth  
81.4% operating income growth

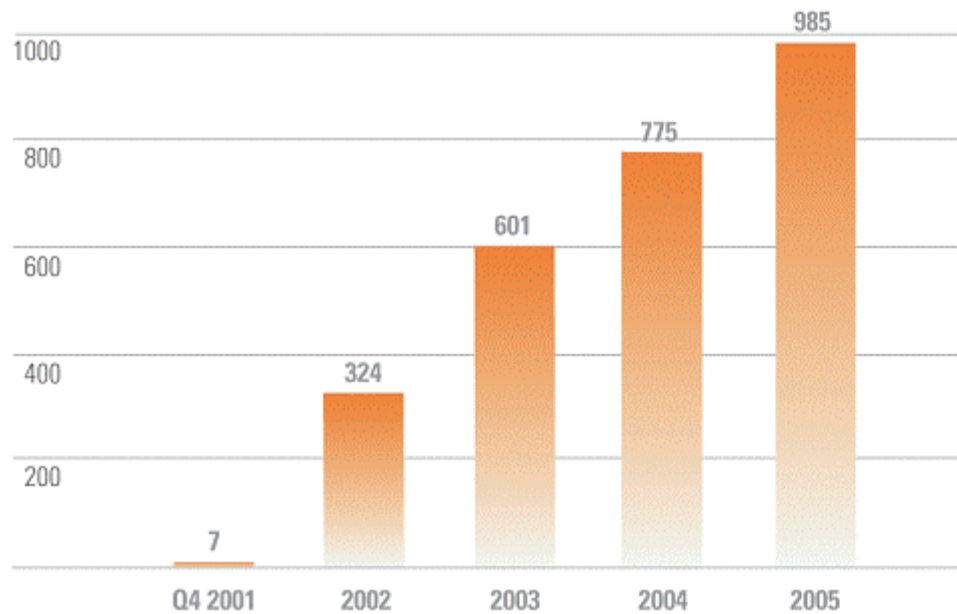
### 2005 Reach



750 Morningstar reach (global)  
9,000 Institutions (global)

Revenue and operating income for our three segments total more than 100% because they exclude eliminations and corporate items.

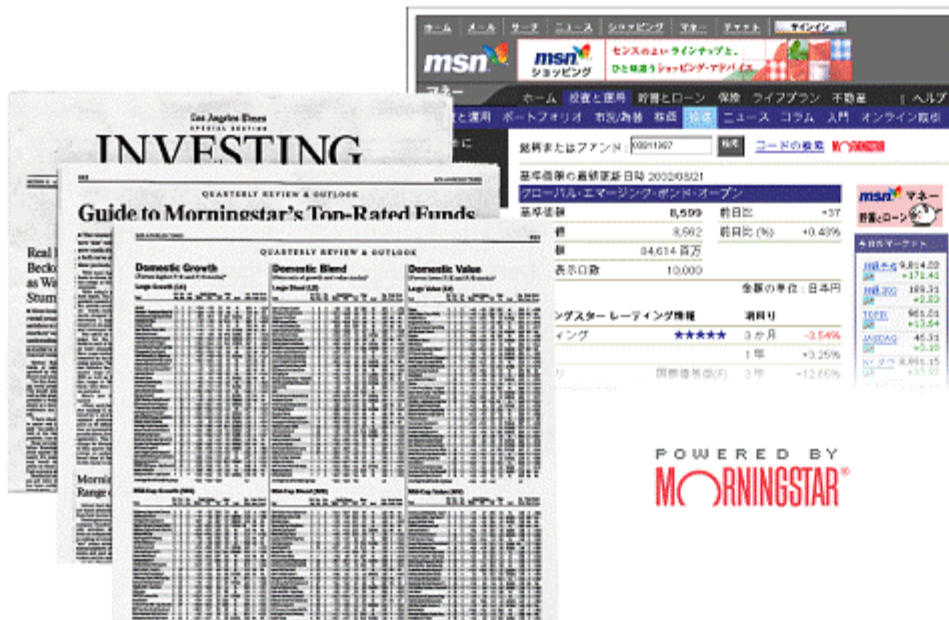
### Morningstar Direct Licenses Year Ended December 31



- ▶ Added global databases and fund data in 2005
- ▶ Expanded sales efforts outside United States
- ▶ 2006 priorities:
  - ▷ Transition clients to 3.0 version
  - ▷ Add Ibbotson's asset allocation capabilities to Morningstar
  - ▷ Add portfolio processing/analysis capabilities
  - ▷ Add global ownership data including portfolio data and
- ▶ Simple pricing: \$15,000 for first user, \$10,000 for second user, and \$5,000 for each additional user



## Licensed Data



- ▶ Enhancements in 2005:
  - ▷ Added equity database, separate accounts, owners and compliance data
  - ▷ Further penetration on large managers and broker-dealers
- ▶ Priorities for 2006:
  - ▷ Add Ibbotson time series data and other data feeds
  - ▷ Hedge fund database
  - ▷ Add real-time delivery options

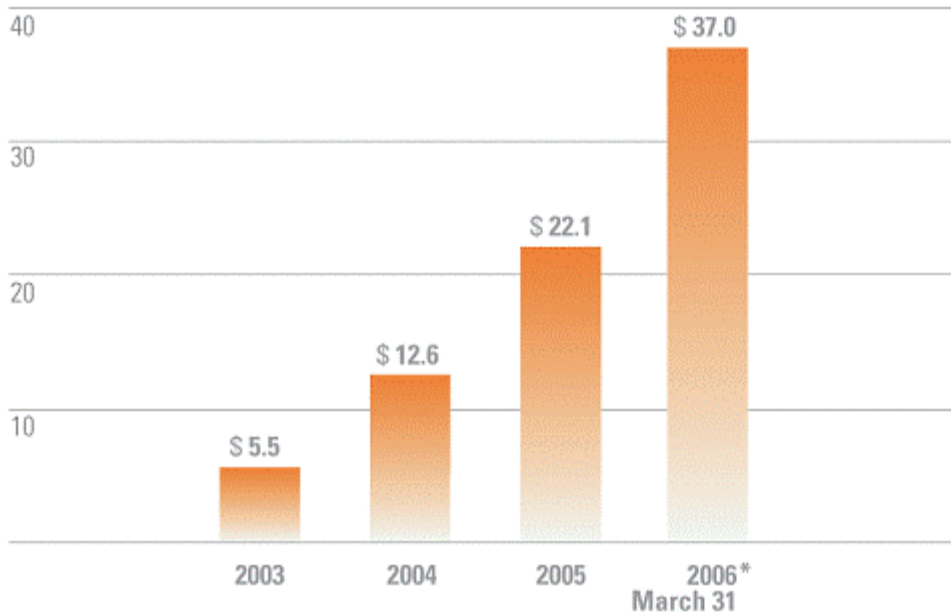






**Assets Under Advisement  
Year Ended December 31 (\$bil)**

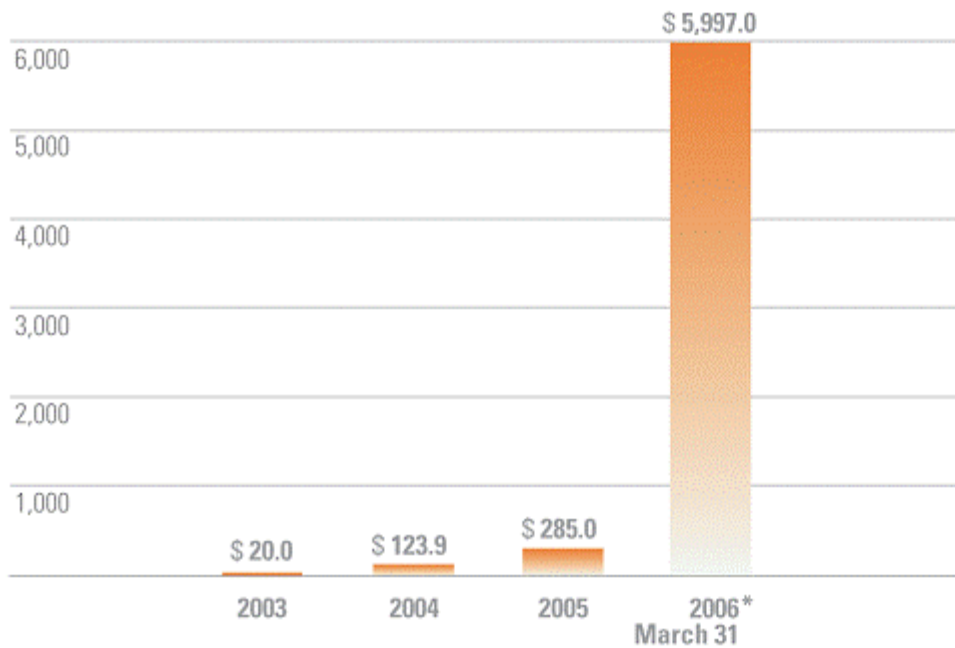


- ▶ Consulting has been a key driver of growth in revenue and operations
- ▶ Ibbotson Associates' acquisition of Ibbotson & Associates expanded range of services for institutional investors and expanded client base
- ▶ Fits new strategic initiative for growth through funds-of-funds investment management
- ▶ 2006 priorities:
  - ▷ Deliver outstanding service to existing investors and improve investors' results
  - ▷ Add new funds-of-funds relationships
  - ▷ Expand international business (Europe and Asia)

\* Includes Ibbotson

## Retirement Advice

**Assets Under Management in Managed Retirement Accounts  
Year Ended December 31 (\$mil)**



- ▶ Includes Morningstar Retirement and Advice by Ibbotson platform
- ▶ Significant growth potential in retirement accounts—appeal segment of 401(k) plan participants
- ▶ Ibbotson Associates significantly expanded assets under managed retirement accounts
- ▶ 2006 priority: help investors reach retirement goals by expanding and usage of managed accounts

\* Includes Ibbotson

## Growth Strategy: Build Leadership Position in Each Market Segment

- ▶ Meet need among individuals, advisors, and institutions for investment information
- ▶ Focus on building a flagship, \ platform for each of our audience
- ▶ Platforms use the same research methodologies, allowing users to access multiple databases
- ▶ For all growth platforms, deep relationships with existing audience extend to reach new audience

Morningstar.com (U.S.)  
& Other Global  
Investment Sites



**Individuals**

Opportunities:

Improve site speed

Expand base of  
enthusiast investors

Increase Premium trials

Morningstar  
Advisor Workstation



**Advisors**

Expand functionality  
to appeal to  
more advisors

Tap into international  
markets

Expand portfolio planning  
tools and retirement  
income solutions

Morningstar Direct  
Retirement Advice



**Institutions**

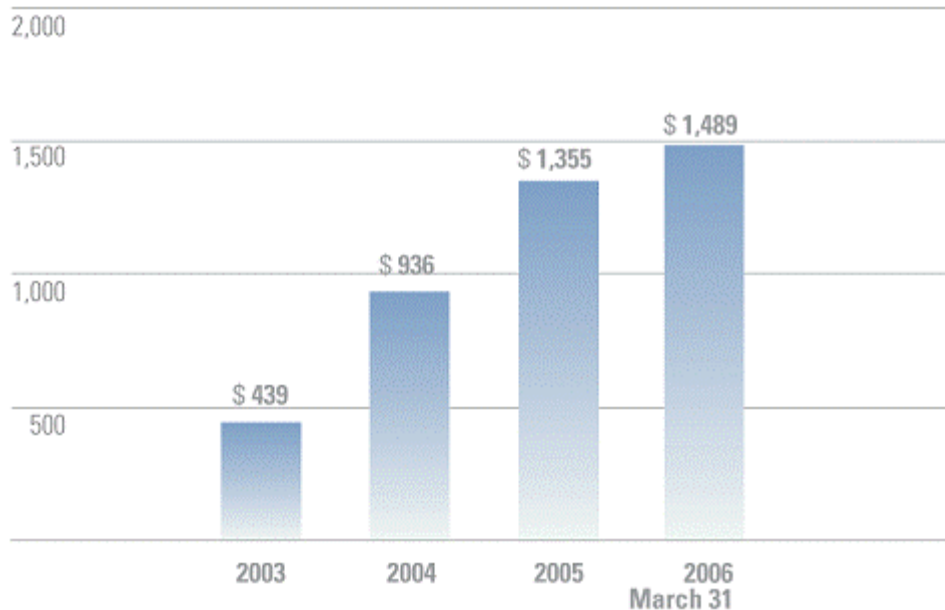
Expand to reach  
more institutions

Expand managed  
retirement accounts

Add asset allocation and  
ownership data

## Growth Strategy: Become Global Leader in Funds-and Investment Management

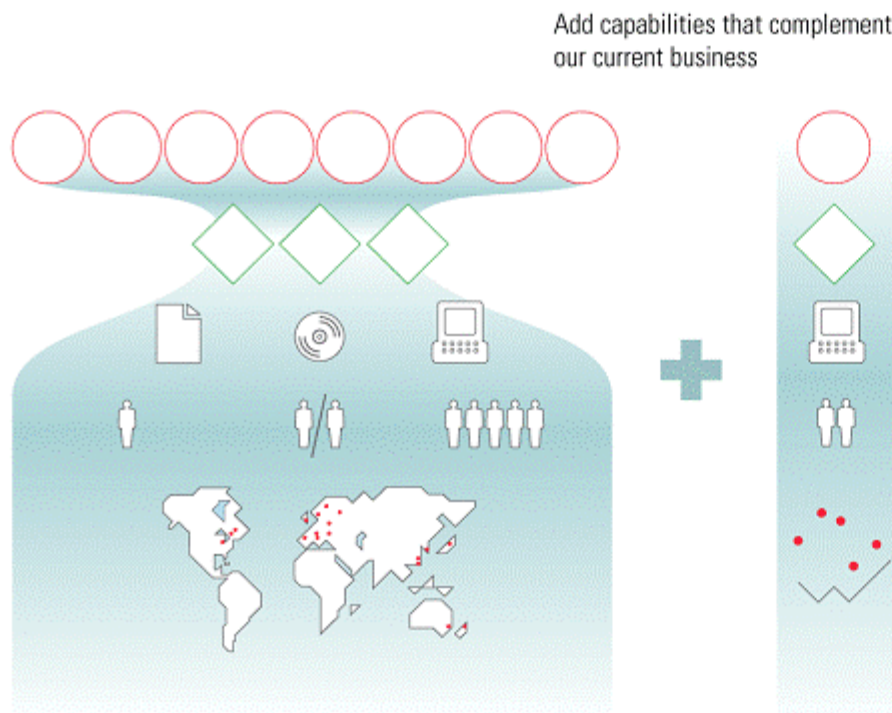
**Assets Under Management in Morningstar Managed Portfolios  
Year Ended December 31 (\$mil)**



- ▶ Morningstar Managed Portfolios
  - ▷ Broaden penetration in independent broker-dealer and registered advisor markets
  - ▷ Expand distribution through selling agreements
  - ▷ Expand ETF-based portfolios sensitive separate accounts in all of our markets
- ▶ Investment Consulting: \$37 billion in assets under advisory
- ▶ Managed retirement accounts: \$6 billion in assets under management

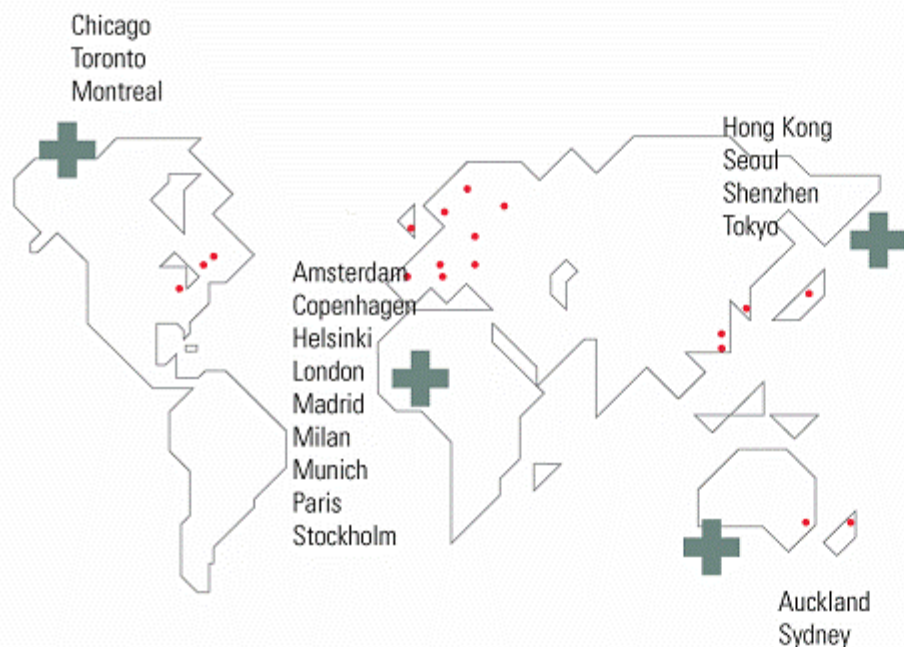


## Growth Strategy: Expand Range of Products and Services



- ▶ Leverage investment in equity
- ▶ Expand capabilities in hedge fund research
  - ▷ Roll out hedge fund research to qualified/accredited investors
  - ▷ Integrate research efforts with quantitative work
  - ▷ Continue expanding database
- ▶ Develop additional capabilities in managing retirement income
  - ▷ Launched Retirement Income Center for advisors
  - ▷ Currently developing a retirement income planning application

## Growth Strategy: Expand Internationally



- ▶ International revenue increased by 15.9% in 2005 and made up 13% of total revenue
- ▶ Focusing more resources on Advisor Workstation, Investment Consulting, and Morningstar Direct platforms to drive growth
- ▶ Also adding more analysts in international operations
- ▶ Broaden global databases and
- ▶ Expand usage of portfolio platform

## Business Model and Financials

Martha Dustin Boudos  
Chief Financial Officer

[Link to searchable text of slide shown above](#)

## Financial Results in 200

### Consolidated Income Statement Year Ended December 31 (\$000, except per share amounts)

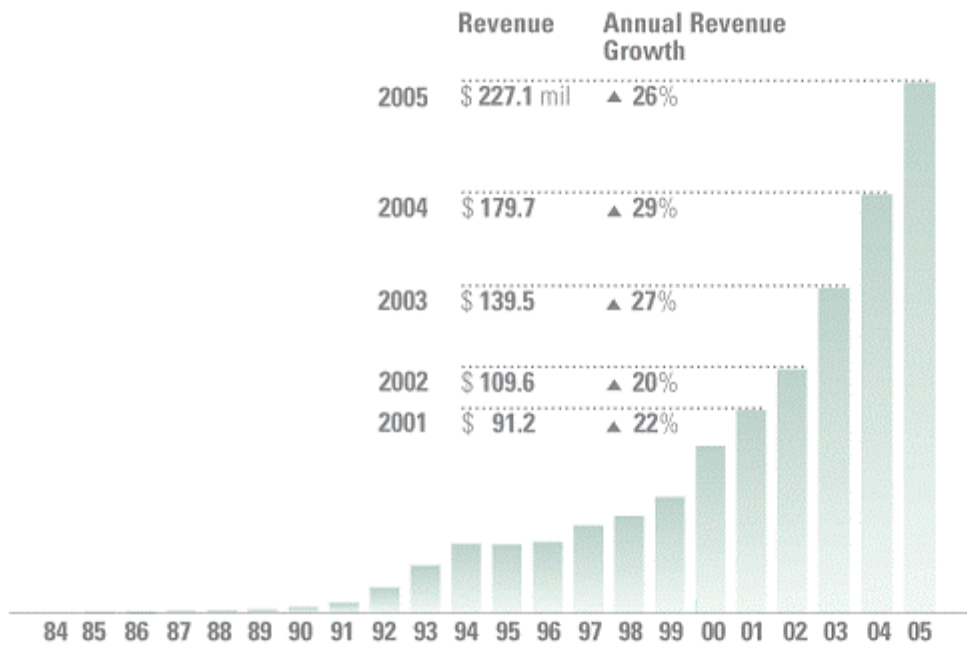
	2005	2004	% change
Revenue	\$227,114	\$179,658	26.4%
Operating Expense <sup>1</sup>	180,634	161,923	11.6%
Operating Income	46,480	17,735	162.1%
Operating Margin	20.5%	9.9%	10.6pp
Net Income	\$ 31,117	\$ 8,809	253.2%
Diluted Income per share	\$ 0.70	\$ 0.21	
Weighted Average Common Shares Outstanding (Diluted)	44,459	41,858	

- ▶ Strong revenue growth from all business segments
- ▶ Substantial growth in operating income
- ▶ Continued margin expansion and growth in Q1 2006

(1) Includes stock-based compensation expense

## Revenue: Consistent Growth Over 20 Years

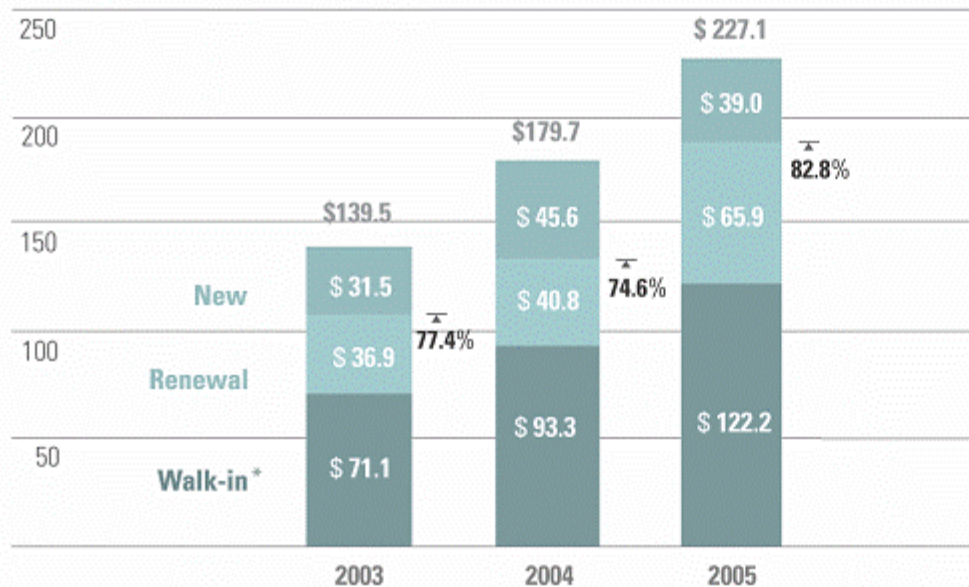
### Annual Growth Rates Over the Past Five Years



- ▶ Have continued to generate strong organic growth
- ▶ Ibbotson Associates contributed \$4.4 million of revenue in Q1
- ▶ Recent growth drivers:
  - ▷ Morningstar Advisor Work
  - ▷ Equity Research
  - ▷ Investment Consulting
  - ▷ Licensed Data
  - ▷ Morningstar.com

## Recurring and Visible R

**Revenue Composition**  
**Year Ended December 31 (\$mil)**



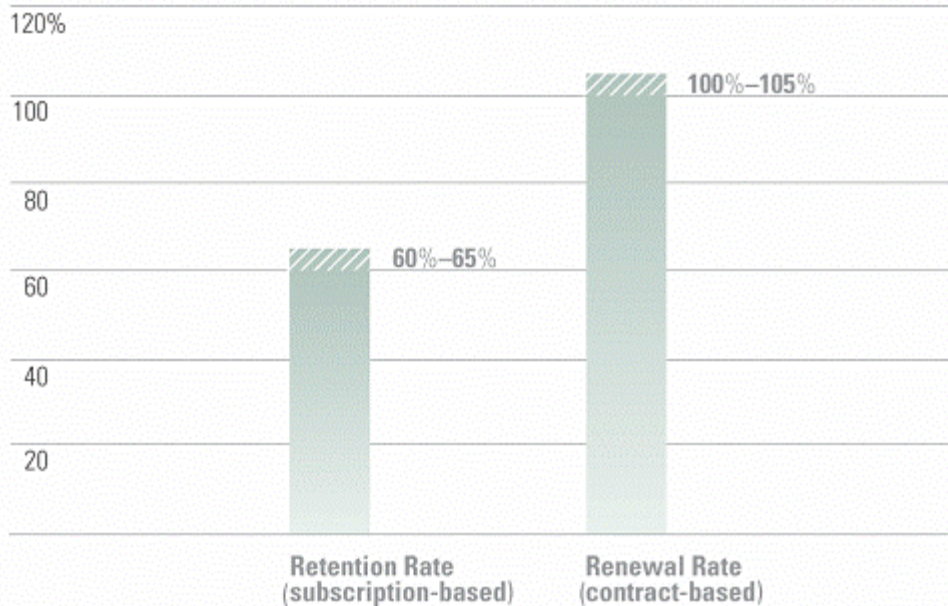
- ▶ “Walk-in” and renewal revenue high revenue visibility
- ▶ Many products sold through subscriptions or license agreements leading to significant recurring revenue
- ▶ Remaining portion of revenue from new sales generated during the year
- ▶ At the start of 2005, we had approximately \$100 million of “walk-in” revenue
- ▶ Cancellations and other routine adjustments reduced this amount by approximately 2% during 2005
- ▶ Estimated “walk-in” revenue \$138.8 million as of January 1, 2006

\* Net of cancellations



## New Metrics: Retention and Renewal

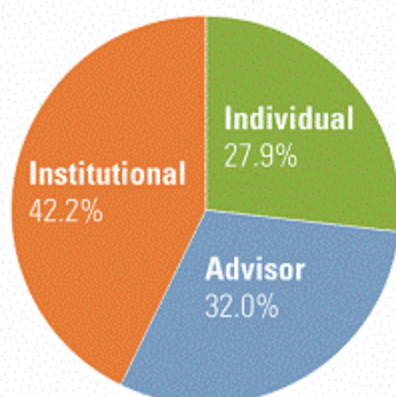
**Retention and Renewal Rates  
Year Ended December 31, 2005**



- ▶ For subscription-based product calculated retention based on of subscriptions retained
- ▶ Estimate that retention rate for subscription products averaged 60% and 65% in 2005
- ▶ For products sold through contract licenses, track dollar value of dollar value of contracts up for
- ▶ Weighted average renewal rate for contract-based products and services ranged from 100% to 105%, in impact of price increases

## Diversified Revenue

**Revenue Composition by Segment**  
**Year Ended December 31, 2005**



**Revenue for Top Five Products**  
**Year Ended December 31, 2005**

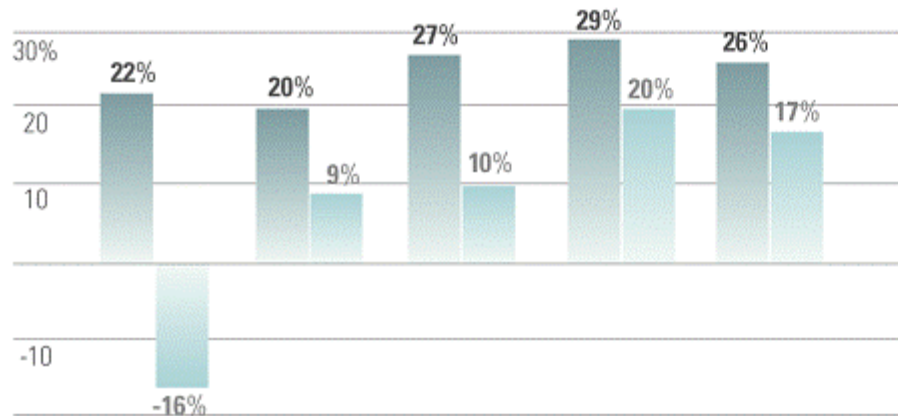
	Revenue (\$mil)	% of Total
Licensed Data	\$ 32.4	14.3%
Advisor Workstation	29.3	12.9
Principia	28.8	12.7
Morningstar.com	25.5	11.2
Investment Consulting	21.9	9.6
Total	\$137.9	60.7%

- ▶ Diversified across multiple segments, products, and increasingly regional
- ▶ Largest client relationship represents less than 5% of revenue in 2005
- ▶ Not dependent on any one segment, product, or client for a major portion of our revenue

Totals to more than 100% because of intersegment revenue



## Revenue and Operating Expense Year Ended December 31 (\$000)



2001	2002	2003	2004	2005
\$ 91,230	\$ 109,619	\$139,496	\$ 179,658	\$227,114
22%	20%	27%	29%	26%
\$107,621	\$ 117,959	\$150,250	\$ 161,923	\$180,634
5,667	7,292	29,029	16,723	10,895
101,954	110,667	121,221	145,200	169,739
-16%	9%	10%	20%	17%
\$ (10,724)	\$ (1,048)	\$ 18,275	\$ 34,458	\$ 57,375
\$ (16,391)	\$ (8,340)	\$ (10,754)	\$ 17,735	\$ 46,480
NMF	NMF	NMF	9.9%	20.5%

- ▶ Substantial expansion in operating income as revenue has grown faster
- ▶ Operating income growth reflects operating leverage (the relatively low variable costs of adding new customers)
- ▶ Expect operating leverage to continue to expand operations over the long term

Revenue
<b>Revenue growth</b>
Operating expense
Stock-based compensation expense
*Operating expense before stock-based compensation
<b>Operating expense growth before stock-based compensation</b>
*Operating income before stock-based compensation
Operating income (loss)
Operating margin (%)

\*Operating expense and income before stock-based compensation are measures that are not calculated in accordance with U.S. GAAP.

## Stock-Based Compensation Expense

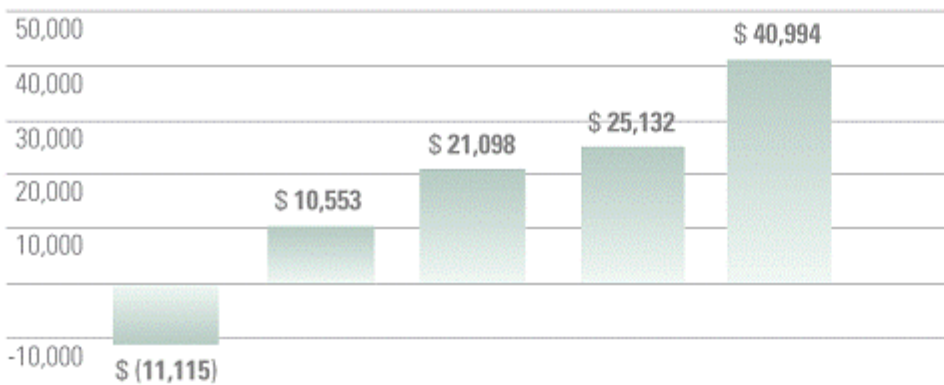
### Stock-Based Compensation Expense Year Ended December 31 (\$000)

	2001	2002	2003	2004	2005
Liability method	\$(3,336)	\$(3,283)	\$17,796	\$ 8,963	\$ 2,810
Equity method	9,003	10,575	11,233	7,760	8,085
Total expense	\$ 5,667	\$ 7,292	\$29,029	\$16,723	\$10,895

- ▶ Have consistently included stock-based compensation in reported financial results
- ▶ Two methods of recording stock-based compensation:
  - Liability method (no longer used following IPO)
  - Equity method
- ▶ Stock-based compensation expense has declined primarily because liability method expense was recorded under liability method in 2006
- ▶ Began granting restricted stock units (RSUs) with annual equity incentive plan in May 2006
- ▶ Expect to record approximate \$8.6 million in stock-based compensation expense in 2006 (including expense from May 15 RSU grant)

## Free Cash Flow

### Free Cash Flow Year Ended December 31 (\$000)



- ▶ Healthy free cash flow as revenue grows faster than expense
- ▶ Business does not require significant ongoing capital investment
- ▶ Capital expenditures consist primarily of computer equipment, capitalized software development, and leasehold improvements
- ▶ Free cash flow increased to \$40,994 in Q1 2006, driven by increase in revenue

	2001	2002	2003	2004	2005	
	\$ (5,183)	\$ 16,542	\$ 29,705	\$ 32,862	\$ 48,445	Cash provided by (used for) operating activities
	(5,932)	(5,989)	(8,607)	(7,730)	(7,451)	Capital expenditures
	\$ (11,115)	\$ 10,553	\$ 21,098	\$ 25,132	\$ 40,994	<b>Free cash flow</b>
	2,777	(6,068)	(29,634)	(22,750)	(16,913)	Cash provided by (used for) investing activities
	(1,049)	(1,952)	(26)	(6,367)	25,256	Cash provided by (used for) financing activities

"Free cash flow" is defined as cash provided by (used for) operating activities less capital expenditures. We have presented free cash flow solely as a supplemental disclosure to help you better understand how much cash is available after we spend money to operate our business. This table includes a reconciliation from cash provided by (used for) operating activities to free cash flow. We use free cash flow to evaluate the performance of our business. Free cash flow should not be considered an alternative to any measure of performance as provided in our financial statements (such as cash provided by (used for) operating, investing, and financing activities), nor should this data be considered an indicator of our overall financial performance or liquidity. Free cash flow definition may not be comparable to similarly titled measures reported by other companies.

## Solid Balance Sheet

### Consolidated Balance Sheet Data (\$000)

	as of December 31, 2005	as of March 31, 2006
Cash, cash equivalents, and investments	\$ 153,190	\$ 82,906
Total current assets	\$ 206,215	\$ 150,911
Total assets	\$ 296,311	\$ 323,849
Total current liabilities	\$ 115,841	\$ 123,055
Total long-term liabilities	\$ 6,756	\$ 4,762
Total liabilities	\$ 122,597	\$ 127,817
Total shareholders' equity	\$ 173,714	\$ 196,032

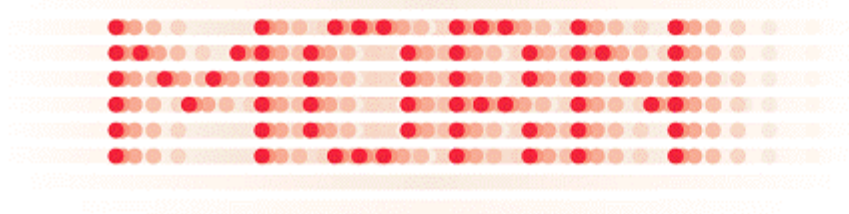
- ▶ \$82.9 million in cash, cash equivalents and investments
- ▶ Used \$86.4 million in cash to acquire Ibbotson
- ▶ No external debt
- ▶ Advance cash collections from model generate deferred revenue
- ▶ Liabilities consist largely of deferred revenue (\$87.5 million) and accrued compensation (\$16.6 million)

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## Conclusion

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**NASDAQ®**



- ▶ “Wide-moat” companies have enduring competitive advantage
- ▶ Strive to create and maintain wide moat for Morningstar
- ▶ Emphasis on managing our business to maximize long-term results
- ▶ Aim to communicate with candor and give the unvarnished truth about our business

# MORNINGSTAR<sup>®</sup>

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**Annual Shareholders'  
Meeting 2006**

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## Update on Key Products and Growth Strategies

Joe Mansueto,  
Chairman &  
Chief Executive Officer

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## **Morningstar Today**

- Our mission: Create great products that help investors reach their financial goals
  - Established, well-regarded name in independent investment research
  - Serving more than 4.9 million individuals, 185,000 advisors, and 750 institutions
  - Extensive research and data on more than 145,000 investment offerings
  - Operations in 13 countries and minority ownership positions in another three
  - 1,250 employees
-

## 2005 Highlights

### Revenue, Operating Income, Free Cash Flow Year Ended December 31 (\$000)

[GRAPHIC]

	Revenue	Operating Income	Free Cash Flow(1)
2004	\$179,658	\$17,735	\$25,132
2005	\$227,114	\$46,480	\$40,994
% Growth	26.4 %	162.1 %	63.1 %

(1) Free cash flow is a measure that is not calculated in accordance with U.S. GAAP.

- Increased revenue 26%, operating income 162%, and free cash flow 63%
  - Completed IPO in May 2005
  - Announced agreement to acquire Ibbotson Associates
  - Retained all five equity research contracts related to Global Analyst Research Settlement and signed agreement with sixth investment bank
  - Launched Morningstar Direct 2.0
  - Completed acquisition of VARDS
  - Signed consulting agreements in France, Italy, and China
  - Continued to expand development center in China
-

**Business Model:**  
**Leveraging Fixed Investments**

[GRAPHIC]

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## **Ibbotson Associates**

[GRAPHIC]

- Completed acquisition on March 1, 2006 for \$86.4 million
  - Started in 1977 by Professor Roger Ibbotson
  - Focused on providing clients with education and tools to reduce risk and improve returns for investors
  - Serving more than 70,000 advisors and 700 institutions
  - Key business lines:
    - Investment consulting and research
    - Planning and analysis software
    - Investment advice
    - Educational and marketing services
    - Presentation materials
-



## **Ibbotson Associates**

[GRAPHIC]

### **Ibbotson will add capabilities that complement our current business**

- Capital Markets Database
  - Asset Allocation Expertise
  - Print, Software, Internet and Services
  - Advisors and Institutions
  - Existing presence in Japan and opportunities to expand in other non-U.S. markets
-

## Individual Segment

### 2005 Revenue

[GRAPHIC]

\$ 63.4 million  
27.9% total revenue

### Revenue and Operating Income Growth:

[GRAPHIC]

35.0% revenue growth  
134.8% operating income growth

### 2005 Reach

[GRAPHIC]

4.4 million Morningstar reach (U.S. market)  
91 million investors (U.S. market)

Revenue and operating income for our three segments total more than 100% because they exclude eliminations and corporate items.

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**Growth of Morningstar.com Premium Memberships (U.S.) Year Ended December 31**

[GRAPHIC]

- Analyst research on 2,000 funds and 1,700 stocks
  - Launched Morningstar Stewardship Grade for Stocks
  - Expanded analyst coverage on exchange-traded funds
  - Created new home page to highlight most frequently used content
  - Moderate increase in Premium pricing: now \$14.95/month or \$135/year
  - 2006 priorities:
    - Improve site's speed
    - Expand base of enthusiast users
    - Increase Premium trials through sampling and other programs
-

## Independent Equity Research

[GRAPHIC]

- Fundamental approach favors companies with discount to estimated intrinsic value and sustainable competitive advantage (economic moat)
  - Expanded analyst staff from 73 to 87 in 2005 and increased coverage list from 1,500 to more than 1,700 stocks
  - Signed contract with sixth investment bank to provide research under Global Analyst Research Settlement
  - 2006 priorities:
    - Great service and ongoing training for Global Settlement clients
    - Increase coverage outside U.S. and expand non-U.S. client base
    - Expand reach with buy side
-

## Advisor Segment

### 2005 Revenue

[GRAPHIC]

\$72.7 million  
32.0% total revenue

### Revenue and Operating Income Growth

[GRAPHIC]

19.4% revenue growth  
28.1% operating income growth

### 2005 Reach

[GRAPHIC]

185,000 Morningstar reach (global)  
715,000 advisors (global)

Revenue and operating income for our three segments total more than 100% because they exclude eliminations and corporate items.

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## Morningstar Advisor Workstation

[GRAPHIC]

- Advisor Workstation has been a key growth driver and now ranks as largest product in Advisor segment
  - 2005 enhancements:
    - Advisor Compliance Tools
    - Share Class Analyzer Report
  - 2006 priorities:
    - Retirement income solutions
    - Suitability manager tool for mutual funds, 529s, variable annuities
    - New portfolio planning tool
  - Prices range up to \$5,000/user for Office Edition; \$80-\$2,500/user for Enterprise Edition
-

## Institutional Segment

### 2005 Revenue

[GRAPHIC]

\$95.9 million  
42.2% total revenue

### Revenue and Operating Income Growth

[GRAPHIC]

22.4% revenue growth  
81.4% operating income growth

### 2005 Reach

[GRAPHIC]

750 Morningstar reach (global)  
9,000 Institutions (global)

Revenue and operating income for our three segments total more than 100% because they exclude eliminations and corporate items.

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## Morningstar Direct

[GRAPHIC]

- Added global databases and hedge fund data in 2005
  - Expanded sales efforts outside the United States
  - 2006 priorities:
    - Transition clients to 3.0 version
    - Add Ibbotson's asset allocation capabilities to Morningstar Direct
    - Add portfolio processing/accounting capabilities
    - Add global ownership database, including portfolio data and 13-F filings
  - Simple pricing: \$15,000 for first user, \$10,000 for second user, and \$7,500 for each additional user
-

## Licensed Data

[GRAPHIC]

- Enhancements in 2005:
    - Added equity database, separate accounts, ownership and compliance data
    - Further penetration on large asset managers and broker-dealers
  - Priorities for 2006:
    - Add Ibbotson time series data and other data feeds
    - Hedge fund database
    - Add real-time delivery option
-

## Investment Consulting

### Assets Under Advisement Year Ended December 31 (\$bil)

[GRAPHIC]

- Consulting has been a key driver of growth in revenue and operating income
  - Ibbotson Associates acquisition expanded range of services for asset allocation and expanded client base
  - Fits new strategic initiative for funds-of-funds investment management
  - 2006 priorities:
    - Deliver outstanding services to improve investors' results
    - Add new funds-of-funds relationships
    - Expand international business (Europe and Asia)
-



## Retirement Advice

### Assets Under Management in Managed Retirement Accounts Year Ended December 31 (\$mil)

[GRAPHIC]

- Includes Morningstar Retirement Manager and Advice by Ibbotson platforms
  - Significant growth potential in managed retirement accounts—appeal to broader segment of 401(k) plan participants
  - Ibbotson Associates significantly expanded assets under management in managed retirement accounts
  - 2006 priority: help investors reach retirement goals by expanding awareness and usage of managed accounts
-

## **Growth Strategy: Build Leadership Position in Each Market Segment**

[GRAPHIC]

- Meet need among individuals, advisors, and institutions for integrated investment information
  - Focus on building a flagship, Web-based platform for each of our audiences
  - Platforms use the same research methodologies, allowing users to combine multiple databases
  - For all growth platforms, deepen relationships with existing audiences and extend to reach new audiences
-

## **Growth Strategy: Become a Global Leader in Funds-of-Funds Investment Management**

### **Assets Under Management in Morningstar Managed Portfolios Year Ended December 31 (\$mil)**

[GRAPHIC]

- Morningstar Managed Portfolios
    - Broaden penetration in independent broker-dealer and registered investment advisor markets
    - Expand distribution through additional selling agreements
    - Expand ETF-based portfolios and tax-sensitive separate account portfolios to all of our markets
  - Investment Consulting:  
\$37 billion in assets under advisement
  - Managed retirement accounts:  
\$6 billion in assets under management
-

## **Growth Strategy: Expand Range of Products and Services**

[GRAPHIC]

- Leverage investment in equity research
  - Expand capabilities in hedge fund research
    - Roll out hedge fund research to qualified/accredited investors
    - Integrate research efforts with Ibbotson's quantitative work
    - Continue expanding database
  - Develop additional capabilities in managing retirement income
    - Launched Retirement Income Education Center for advisors
    - Currently developing a retirement income planning application
-

## **Growth Strategy: Expand Internationally**

[GRAPHIC]

- International revenue increased by 15.9% in 2005 and made up about 13% of total revenue
  - Focusing more resources on Advisor Workstation, Investment Consulting, and Morningstar Direct platforms to drive growth
  - Also adding more analysts in international operations
  - Broaden global databases and tools
  - Expand usage of portfolio planning tool
-



## **Business Model and Financials**

Martha Dustin Boudos  
Chief Financial Officer

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## Financial Results in 2005

### Consolidated Income Statement Year Ended December 31 (\$000, except per share amounts)

	2005	2004	% change
Revenue	\$ 227,114	\$ 179,658	26.4 %
Operating Expense(1)	180,634	161,923	11.6 %
Operating Income	46,480	17,735	162.1 %
Operating Margin	20.5 %	9.9 %	10.6pp
Net Income	\$ 31,117	\$ 8,809	253.2 %
Diluted Income per share	\$ 0.70	\$ 0.21	
Weighted Average Common Shares Outstanding (Diluted)	44,459	41,858	

(1) Includes stock-based compensation expense

- Strong revenue growth from all three business segments
  - Substantial growth in operating margin
  - Continued margin expansion and organic growth in Q1 2006
-

## Revenue: Consistent Growth Over 20 Years

### Annual Growth Rates Over the Past Five Years

[GRAPHIC]

- Have continued to generate strong organic growth
  - Ibbotson Associates contributed \$4.4 million of revenue in Q1 2006
  - Recent growth drivers:
    - Morningstar Advisor Workstation
    - Equity Research
    - Investment Consulting
    - Licensed Data
    - Morningstar.com
-

## Recurring and Visible Revenue

### Revenue Composition Year Ended December 31 (\$mil)

[GRAPHIC]

- “Walk-in” and renewal revenue create high revenue visibility
  - Many products sold through subscriptions or license agreements, leading to significant recurring revenue
  - Remaining portion of revenue is from new sales generated during the year
  - At the start of 2005, we had \$124.9 million of “walk-in” revenue
  - Cancellations and other routine adjustments reduced this amount by 2% during 2005
  - Estimated “walk-in” revenue of \$138.8 million as of January 1, 2006
-

## **New Metrics: Retention and Renewal Rates**

### **Retention and Renewal Rates Year Ended December 31, 2005**

[GRAPHIC]

- For subscription-based products, calculated retention based on number of subscriptions retained
  - Estimate that retention rate for subscription products averaged between 60% and 65% in 2005
  - For products sold through contracts and licenses, track dollar value of renewals vs. dollar value of contracts up for renewal
  - Weighted average renewal rate for contract-based products and services ranged from 100% to 105%, including impact of price increases
-

## **Diversified Revenue**

### **Revenue Composition by Segment Year Ended December 31, 2005**

[GRAPHIC]

### **Revenue for Top Five Products Year Ended December 31, 2005**

[GRAPHIC]

- Diversified across multiple segments, products, and increasingly regions
  - Largest client relationship represented less than 5% of revenue in 2005
  - Not dependent on any one segment, product, or client for a majority of our revenue
-

## Significant Operating Leverage

### Revenue and Operating Expense Year Ended December 31 (\$000)

[GRAPHIC]

- Substantial expansion in operating margin as revenue has grown faster than expenses
- Operating income growth reflects operating leverage (the relatively low variable cost of adding new customers)
- Expect operating leverage to be evident in operations over the long term

2001	2002	2003	2004	2005	
\$ 91,230	\$ 109,619	\$ 139,496	\$ 179,658	\$ 227,114	Revenue
22 %	20 %	27 %	29 %	26 %	Revenue growth
<b>\$ 107,621</b>	<b>\$ 117,959</b>	<b>\$ 150,250</b>	<b>\$ 161,923</b>	<b>\$ 180,634</b>	<b>Operating expense</b>
5,667	7,292	29,029	16,723	10,895	Stock-based compensation expense
101,954	110,667	121,221	145,200	169,739	* Operating expense before stock-based compensation
<b>-16 %</b>	<b>9 %</b>	<b>10 %</b>	<b>20 %</b>	<b>17 %</b>	<b>Operating expense growth before stock-based compensation</b>
					* Operating income before stock-based compensation expense
\$ (10,724)	\$ (1,048)	\$ 18,275	\$ 34,458	\$ 57,375	Operating income (loss)
\$ (16,391)	\$ (8,340)	\$ (10,754)	\$ 17,735	\$ 46,480	Operating margin (%)
NMF	NMF	NMF	9.9 %	20.5 %	

\* Operating expense and income before stock-based compensation are measures that are not calculated in accordance with U.S. GAAP.



## Stock-Based Compensation Expense

### Stock-Based Compensation Expense Year Ended December 31 (\$000)

	2001	2002	2003	2004	2005
Liability method	\$ (3,336)	\$ (3,283)	\$ 17,796	\$ 8,963	\$ 2,810
Equity method	9,003	10,575	11,233	7,760	8,085
Total expense	\$ 5,667	\$ 7,292	\$ 29,029	\$ 16,723	\$ 10,895

- Have consistently included stock-based compensation in reported financials
  - Two methods of recording stock-based compensation:
    - Liability method (no longer used following IPO)
    - Equity method
  - Stock-based compensation expense has declined primarily because no expenses was recorded under liability method in 2006
  - Began granting restricted stock units (RSUs) with annual equity awards in May 2006
  - Expect to record approximately \$8.6 million in stock-based compensation expense in 2006 (including expense for May 15 RSU grant)
-

## Free Cash Flow

### Free Cash Flow Year Ended December 31 (\$000)

[GRAPHIC]

- Healthy free cash flow as revenue grows faster than expense
- Business does not require significant ongoing capital investment
- Capital expenditures consist mainly of computer equipment, capitalized software development, and leasehold improvements
- Free cash flow increased to \$9.1 million in Q1 2006, driven by increase in net income

2001	2002	2003	2004	2005	
\$ (5,183 )	\$ 16,542	\$ 29,705	\$ 32,862	\$ 48,445	Cash provided by (used for operating activities)
(5,932 )	(5,989 )	(8,607 )	(7,730 )	(7,451 )	Capital expenditures
<b>\$ (11,115 )</b>	<b>\$ 10,553</b>	<b>\$ 21,098</b>	<b>\$ 25,132</b>	<b>\$ 40,994</b>	<b>Free cash flow</b>
2,777	(6,068 )	(29,634 )	(22,750 )	(16,913 )	Cash provided by (used for investing activities)
(1,049 )	(1,952 )	(26 )	(6,367 )	25,256	Cash provided by (used for financing activities)

“Free cash flow” is defined as cash provided by (used for) operating activities less capital expenditures. We have presented free cash flow solely as a supplemental disclosure to help our investors better understand how much cash is available after we spend money to operate our business. This table includes a reconciliation from cash provided by (used for) operating activities to free cash flow. We use free cash flow to evaluate the performance of our business. Free cash flow should not be considered an alternative to any measure of performance as promulgated under GAAP (such as cash provided by (used for) operating, investing, and financing activities), nor should this data be considered an indicator of our overall financial performance or liquidity. Also, our free cash flow definition may not be comparable to similarly titled measures reported by other companies.

## Solid Balance Sheet

### Consolidated Balance Sheet Data (\$000)

	as of December 31, 2005		as of March 31, 2006	
Cash, cash equivalents, and investments	\$	153,190	\$	82,906
Total current assets	\$	206,215	\$	150,911
Total assets	\$	296,311	\$	323,849
Total current liabilities	\$	115,841	\$	123,055
Total long-term liabilities	\$	6,756	\$	4,762
Total liabilities	\$	122,597	\$	127,817
Total shareholders' equity	\$	173,714	\$	196,032

- \$82.9 million in cash, cash equivalents, and investments
  - Used \$86.4 million in cash to acquire Ibbotson
  - No external debt
  - Advance cash collections from subscription model generate deferred revenue
  - Liabilities consist largely of deferred revenue (\$87.5 million) and accrued compensation (\$16.6 million)
-

## Conclusion

[GRAPHIC]

- “Wide-moat” companies have enduring competitive advantages
  - Strive to create and maintain a wide moat for Morningstar
  - Emphasis on managing our business to maximize long-term results
  - Aim to communicate with candor and give the unvarnished truth about our business
-

[LOGO]

