MORNINGSTAR, INC.

FORM S-1/A
(Securities Registration Statement)

Filed 2/3/2005

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CIK	0001289419
Fiscal Year	12/31

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As filed with the Securities and Exchange Commission on February 3, 2005

Registration No. 333-115209

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1
To

FORM S-1
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

MORNINGSTAR, INC.
(Exact Name of Registrant as Specified in Its Charter)

Illinois	**6282**	**36-3297908**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

225 West Wacker Drive
Chicago, Illinois 60606
(312) 696-6000
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Martha Dustin Boudos
Chief Financial Officer and Secretary
Morningstar, Inc.
225 West Wacker Drive
Chicago, Illinois 60606
(312) 696-6000
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

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Matthew F. Bergmann	**Andrew H. Shaw**
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Approximate date of commencement of proposed sale to the public: As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box: ☐

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ☐

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission acting pursuant to said Section 8(a) may determine.

The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion, Dated February 3, 2005

Shares of Common Stock

MORNINGSTAR®

This is our initial public offering and no public market currently exists for our shares. Of the shares offered hereby, we are offering selling shareholder identified in this prospectus is offering common shares. We expect that the public offering price will be between $.

The Offering	Per Share	Total
Public Offering Price	$	$
Underwriting Discount	$	$
Proceeds to Morningstar	$	$
Proceeds to Selling Shareholder	$	$

OpenIPO®: The method of distribution b underwriter in this offering differs somew employed in firm commitment underwritt particular, the public offering price and all determined primarily by an auction proces underwriter and other securities dealers pa The minimum size for any bid in the aucti detailed description of this process, know in "Underwriting" beginning on page 107.

Proposed Nasdaq National Market Symbol: MORN

We have granted the underwriter the right to purchase up to additional shares from us within 30 days after the date of this prospectus to c The underwriter expects to deliver shares of common stock to purchasers on , 2005.

This offering involves a high degree of risk. You should purchase shares only if you can afford a complete loss of your investment. See " on page 9.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determ truthful or complete. Any representation to the contrary is a criminal offense.

WR HAMBRECHT+CO

The date of this prospectus is , 2005

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Table of Contents

Prospectus Summary

This summary highlights selected information contained elsewhere in this prospectus. This summary may not contain all the information that you should consider before investing in our common stock. You should carefully read the entire prospectus, including "Risk Factors" and our Consolidated Financial Statements and related notes included elsewhere in this prospectus, before making an investment decision.

Overview

We are a leading provider of independent investment research in the United States and in major international markets. 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 provide data on more than 100,000 investment offerings, including more than 55,000 mutual funds and similar vehicles. We serve nearly 4 million individual investors, 100,000 financial advisors, and 500 institutional clients and have operations in 16 countries around the world.

Our business operations are divided into three segments:

- Individual, which focuses on products for individual investors;
- Advisor, which focuses on products for financial advisors; and
- Institutional, which focuses on products for institutional clients, including banks, brokerage firms, insurance companies, mutual fund companies, and retirement plan providers and sponsors.

In all three of our business segments, we believe our work helps individual investors reach their financial goals. Financial advisors use our research and tools to help them and their clients make better investment decisions. Similarly, institutions often make our information and advice available to individual investors who use their products and services.

We believe Morningstar is one of the most recognized and trusted names in the investment industry and our position as an industry leader results from our high-quality products and services, our strong market position in key market segments, our expertise in investment research, our history of product innovation, and recognition of our brand.

From 1999 through 2003 our revenue increased by a compound annual growth rate of 28.0%, largely because of strong internally generated growth. During this period, our lowest annual growth rate was 20.2% in 2002, and our highest annual growth rate was 44.2% in 2000. In 2003, revenue was $139.5 million, an increase of 27.3% over 2002. In the nine months ended September 30, 2004, we generated revenue of $130.9 million and net income of $9.9 million.

Competitive Strengths

We believe our company has the following competitive strengths:

- *Strong reputation and brand.* We believe Morningstar has built a trusted name among individual investors, financial advisors, and institutions, because of our independence and the high quality of our products and services.

- *Investor focus.* We have a history of investor advocacy and design our products to help investors make well-informed investment decisions.

- *Depth, breadth, and accuracy of data.* We maintain what we believe is one of the largest, most accurate, and most complete databases in our industry, with data on more than 100,000 investment offerings.

- *Innovative, proprietary research tools.* We have developed a number of proprietary research and analytical tools that support our fundamental approach to investing, including the Morningstar Rating, which helped popularize the concept of risk-adjusted returns among the general investing public, and the Morningstar Style Box, which classifies investment offerings based on their underlying size and investment style.

- *Expertise in research, technology, and design.* We have built a flexible technology platform that allows our products to work together across a full range of investment databases, delivery formats, and market segments. We develop most of our software and technology tools ourselves, which enables us to leverage our expertise and tailor our products to the needs of our customers.

- *Large and loyal customer base.* Our individual investor Web sites have nearly 3.8 million registered users worldwide, and our print publications reach more than 80,000 additional individuals. We also reach more than 100,000 financial advisors and work with approximately 500 institutional clients. We sell many of our products through annual subscriptions and multi-year contracts. In 2003, contracts and license and subscription renewals accounted for 77.4% of our revenue.

- *Diversified revenue base and broad reach within multiple segments.* We offer a range of products in each of our business segments, and our revenue base is diversified by segment. In 2003, our largest product, Principia, accounted for 20.7% of revenue, and our largest client accounted for less than 3% of revenue.

- *Entrepreneurial culture and experienced management team.* Our philosophy is that people can and will do their best work when they have the freedom and tools to make their own decisions. Joe Mansueto, our chairman and chief executive officer, founded Morningstar more than 20 years ago. Our executive officers have an average tenure with Morningstar of more than 12 years.

Growth Strategies

Our mission is to create great products that help investors reach their financial goals. This mission guides our operations, in the United States and internationally, and our product offerings, whether designed for individual investors, financial advisors, or institutions. In keeping with this mission, we are pursuing four growth strategies:

- *Enhance our position in each of our three market segments by building on the strength of existing products;*

- *Expand the range of services we offer individual investors, financial advisors, and institutional clients;*

- *Continue to expand our international operations; and*

- *Seek growth through strategic acquisitions.*

Challenges and Risks

Our business is subject to challenges and risks that are more fully described in "Risk Factors" beginning on page 9. We incurred net losses in 2001 and 2003 and, as of September 30, 2004, we had an accumulated deficit of $80.6 million. We operate in a highly competitive market and our business depends on our ability to maintain and increase the number of subscriptions and license agreements we have with our clients. Demand for our products may be adversely impacted by increases in availability of free or low-cost investment information, changes in market and economic conditions, a downturn in the mutual fund industry generally or any perception that our ratings, research, or recommendations are not impartial or not accurate.

In addition, upon completion of this offering, Joe Mansueto, our chairman and chief executive officer, will beneficially own approximately % of our common stock and accordingly will be able to control the outcome of substantially all matters submitted to our shareholders for approval. This concentration of ownership may prevent a change in control, impede a business combination involving us, or result in actions that those who purchase the shares in this offering may oppose. You should carefully consider the information contained in "Risk Factors" before you decide to invest in our common stock.

Company Information

We were incorporated in Illinois on May 16, 1984. Our principal executive offices are located at 225 West Wacker Drive, Chicago, Illinois 60606. Our telephone number at that location is (312) 696-6000. Our Web site address is http://www.morningstar.com. The information contained on our Web site should not be considered part of this prospectus.

We have operations in numerous international markets, primarily through wholly-owned or majority-owned subsidiaries. In the United States, a portion of our business is conducted through subsidiaries registered with the Securities and Exchange Commission (SEC) as investment advisors or broker-dealers. See "Business—Government Regulation."

"Morningstar" and the Morningstar logo are registered marks of Morningstar in the United States and in certain other jurisdictions. The following are also trademarks or service marks of our company:

Morningstar® Advisor Workstation SM
Morningstar.com®
Morningstar Direct SM
Morningstar® FundInvestor TM
Morningstar Indexes SM
Morningstar® Investment Guides TM
Morningstar® Investment Profiles TM
Morningstar® Licensed Data SM
Morningstar Managed Portfolios SM
Morningstar Mutual Funds TM
Morningstar® Ownership Zone SM
Morningstar® Principia®
Morningstar Rating TM
Morningstar® Retirement Manager SM
Morningstar® StockInvestor TM
Morningstar Style Box TM
Portfolio X-Ray®

The Offering

Common Stock Offered

	# Shares
By us	
By the selling shareholder	
Total	

Common Stock Outstanding After This Offering

The number of shares of common stock to be outstanding after this offering will be , excluding options to acquire 9,370,467 shares of common stock that were outstanding as of September 30, 2004, 7,739,623 of which were exercisable at a weighted average exercise price of $9.79 per share. An additional 5,628,843 shares of common stock were reserved for issuance under our 2004 stock option plan.

Unless otherwise indicated, all information in this prospectus assumes no exercise by the underwriter of its over-allotment option.

Use of Proceeds

We intend to use the net proceeds to us from this offering for general corporate purposes, including working capital. We may also use a portion of the net proceeds to acquire complementary assets, technologies, or businesses; establish or invest in joint ventures; or acquire minority interests in complementary businesses. We will not receive any of the proceeds from the sale of shares by the selling shareholder. See "Use of Proceeds" on page 19.

Listing

We intend to apply to list our common stock on the Nasdaq National Market (NASDAQ) under the symbol "MORN".

Summary Historical Financial Data

The following table is a summary of our consolidated financial data for the periods presented. This summary financial data should be read in conjunction with "Selected Historical Financial Data," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and our Consolidated Financial Statements and related notes included elsewhere in this prospectus. We have derived our Consolidated Statements of Operations Data and Other Consolidated Financial Data for the years ended December 31, 2001, 2002, and 2003 from our audited Consolidated Financial Statements. We have derived our Consolidated Statements of Operations Data and Other Consolidated Financial Data for the nine months ended September 30, 2003 and 2004 and Consolidated Balance Sheet Data as of September 30, 2004 from our unaudited Consolidated Financial Statements included elsewhere in this prospectus. Historical results do not necessarily indicate the results you should expect for future periods.

	Year Ended December 31			**Nine Months Ended September 30**	
Consolidated Statements of Operations Data (in thousands except per share amounts)	**2001**	**2002**	**2003**	**2003**	**2004**
Revenue	$ 91,230	$ 109,619	$ 139,496	$ 102,393	$ 130,944
Operating expense:					
Cost of goods sold	39,536	39,035	43,521	32,227	41,032
Development	7,686	11,881	14,663	11,178	11,082
Sales and marketing	20,651	24,992	30,798	23,128	26,016
General and administrative	34,175	36,504	54,145	38,084	30,794
Depreciation and amortization	5,573	5,547	7,123	4,911	5,354
Total operating expense	107,621	117,959	150,250	109,528	114,278
Operating income (loss)	(16,391)	(8,340)	(10,754)	(7,135)	16,666
Non-operating income, net	676	4,463	1,110	304	1,040
Income (loss) before income taxes, equity in net income of unconsolidated entities, minority interest in net loss of consolidated entities, and extraordinary gain	(15,715)	(3,877)	(9,644)	(6,831)	17,706
Income tax expense (benefit)	(5,276)	(311)	2,950	3,732	8,349
Equity in net income of unconsolidated entities	359	750	697	420	591
Minority interest in net loss of consolidated entities	785	178	—	—	—
Income (loss) before extraordinary gain	(9,295)	(2,638)	(11,897)	(10,143)	9,948
Extraordinary gain—acquisition	—	3,084	—	—	—
Net income (loss)	$ (9,295)	$ 446	$ (11,897)	$ (10,143)	$ 9,948
Basic income (loss) per share:					
Income (loss) before extraordinary gain	$ (0.24)	$ (0.07)	$ (0.31)	$ (0.26)	$ 0.26
Extraordinary gain—acquisition	—	0.08	—	—	—
Basic income (loss) per share	$ (0.24)	$ 0.01	$ (0.31)	$ (0.26)	$ 0.26
Weighted average common shares outstanding—basic	38,298	38,345	38,382	38,377	38,410
Diluted income (loss) per share:					
Income (loss) before extraordinary gain	$ (0.32)	$ (0.17)	$ (0.31)	$ (0.26)	$ 0.24
Extraordinary gain—acquisition	—	0.08	—	—	—
Diluted income (loss) per share	$ (0.32)	$ (0.09)	$ (0.31)	$ (0.26)	$ 0.24
Weighted average common shares outstanding—diluted	41,364	40,361	38,382	38,377	41,654

Other Consolidated Financial Data ($000)	Year Ended December 31 2001	2002	2003	Nine Months Ended September 30 2003	2004
Stock-based compensation expense (income) under the liability method	$ (3,336)	$ (3,283)	$ 17,796	$ 13,223	$ 3,099
Stock-based compensation expense under the equity method	9,003	10,575	11,233	8,373	5,670
Total stock-based compensation expense (1)	$ 5,667	$ 7,292	$ 29,029	$ 21,596	$ 8,769
Operating income (loss) before stock-based compensation expense (2)	$ (10,724)	$ (1,048)	$ 18,275	$ 14,461	$ 25,435
Sales tax expense (3)	$ 2,294	$ 2,837	$ 3,079	$ 2,099	$ —
Cash provided by (used for) investing activities	$ 3,128	$ 1,435	$ (20,481)	$ (23,969)	$ (13,495)
Cash used for financing activities	$ (1,049)	$ (1,952)	$ (26)	$ (7)	$ (6,401)
Cash provided by (used for) operating activities	$ (5,183)	$ 16,542	$ 29,705	$ 17,477	$ 19,085
Capital expenditures	(5,932)	(5,989)	(8,607)	(6,361)	(5,758)
Free cash flow (4)	$ (11,115)	$ 10,553	$ 21,098	$ 11,116	$ 13,327

The "As Adjusted" column in the following table applies the net proceeds we anticipate receiving from this offering assuming an initial offering price of $ per share, the midpoint of the range set forth on the cover of this prospectus. See "Use of Proceeds" on page 19 of this prospectus.

Consolidated Balance Sheet Data ($000)	As of September 30, 2004 Actual	As Adjusted
Cash, cash equivalents, and investments (5)	$ 82,741	$
Working capital (6)	$ 12,975	
Total assets	$ 189,898	
Long-term liabilities (7)	$ 23,728	
Total shareholders' equity	$ 63,227	

(1) We have adopted Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* , in all periods presented. SFAS No. 123 (Revised 2004), *Share-Based Payment*, which will require all public companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, will be effective for interim or annual periods beginning after June 15, 2005. We are in the process of reviewing the impact of SFAS No. 123 (Revised 2004), *Share-Based Payment*, on our current practice of voluntarily recognizing stock-based compensation expense.

The total expense for stock-based compensation is distributed with other employee compensation costs in the appropriate expense categories of our Consolidated Statements of Operations. In accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* , we use two accounting methods. For options granted under plans that may require us to settle the options in cash, we use the liability method. Under this method we record a liability for a vested option equal to the difference between the option exercise price and the estimated fair market value of the shares of common stock underlying the option at the end of the reporting period. If this estimated fair market value increases over the reporting period we record an expense and, if it decreases, we record income.

For options granted under plans that do not require us to settle the options in cash, we use the equity method. Under this method we calculate expense based on fair value calculated using a Black-Scholes model at the time of grant and record expense as the options vest. In each year, our aggregate stock-based compensation expense reflects the impact of options granted in prior years. Following completion of this offering, we will no longer be required to settle any options for cash and anticipate that all of our options will be accounted for under the equity method of SFAS No. 123, *Accounting for Stock-Based Compensation* . See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Stock-Based Compensation."

(2) "Operating income (loss) before stock-based compensation expense" is defined as operating income (loss) before the effect of our stock-based compensation expense. Information concerning our stock-based compensation expense is described in note (1) above. We expect stock-based compensation expense to be a recurring cost. We have presented operating income (loss) before stock-based compensation expense solely as a supplemental disclosure to help our investors better understand the performance of our business, to enhance comparison of our performance from period to period, and to allow better comparison of our performance with that of our competitors. We use operating income (loss) before stock-based compensation expense to evaluate the performance of our business. Operating income (loss) before stock-based compensation expense should not be considered as an alternative to any measure of performance as promulgated under U.S. generally accepted accounting principles (GAAP) (such as operating income (loss)), nor should this data be considered as an indicator of our overall financial performance or liquidity. Also, the calculation of operating income (loss) before stock-based compensation expense used by us may not be comparable to similarly titled measures reported by other companies. The table below includes a reconciliation from our operating income (loss) to operating income (loss) before stock-based compensation expense:

	Year Ended December 31			Nine Months Ended September 30	
($000)	2001	2002	2003	2003	2004
Operating income (loss)	$ (16,391)	$ (8,340)	$ (10,754)	$ (7,135)	$ 16,666
Add back: stock-based compensation expense	5,667	7,292	29,029	21,596	8,769
Operating income (loss) before stock-based compensation expense	$ (10,724)	$ (1,048)	$ 18,275	$ 14,461	$ 25,435

(3) During 2003, we participated in voluntary disclosure or similar programs related to state sales tax. Through these programs, we identified sales tax amounts due for prior years and negotiated or are in discussions with local tax authorities to settle these amounts. We have recorded expense in the years to which these sales tax amounts apply. The estimated amounts of sales tax expense recorded in 2001, 2002, and 2003 were not materially different from actual sales tax expense for those periods based on the most current information available and negotiations of sales tax expense for those periods. We do not expect to record any expense related to these programs after 2003.

(4) "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. We use free cash flow to evaluate the performance of our business. This table includes a reconciliation from cash provided by (used for) operating activities to free cash flow. Free cash flow should not be considered as 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 as an indicator of our overall financial performance or liquidity. Also, the free cash flow definition used by us may not be comparable to similarly titled measures reported by other companies.

(5) Includes $52,497 of cash and cash equivalents and $30,244 of investments as of September 30, 2004. Investments consisted of $13,674 in corporate bonds, $2,850 in senior notes, $10,104 in government obligations, $2,615 in a certificate of deposit, and $1,001 in other investments as of September 30, 2004.

(6) We frequently collect cash in advance of providing services or fulfilling subscriptions for our customers. These amounts, which are recorded as current liabilities on our Consolidated Balance Sheets and classified as deferred revenue, totaled $56,398 as of September 30, 2004.

(7) Includes $20,444 related to stock options accounted for as a long-term liability in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* , which is expected to be reclassified to shareholders' equity upon completion of this offering.

Risk Factors

You should carefully consider the risks described below and all of the other information included in this prospectus before deciding whether to invest in our common stock. If any of the following risks actually occur, our business, financial condition, or operating results could suffer. In this case, the trading price of our common stock could decline, and you may lose all or part of your investment.

Risks Related to Our Business

Intense competition could reduce our share of the investment research market and hurt our financial performance.

We operate in a highly competitive market, with many investment research providers competing for business from individual investors, financial advisors, and institutional clients. We compete with many different types of companies that vary in size, product scope, and media focus, including:

- large and well-established distributors of financial information, including Thomson Corporation, through its Thomson Financial Services division, The McGraw-Hill Companies, through its Standard & Poor's division, and Lipper, a division of Reuters;
- traditional media publishers and distributors, such as *The Wall Street Journal*, *Money*, and CNBC;
- online services or Web sites focused on business, finance, and investing, such as The Motley Fool and SmartMoney.com;
- providers of terminal-based financial news and data, such as Reuters News Service and Dow Jones Newswires;
- providers of advice for 401(k) and other retirement plan sponsors and participants, such as Financial Engines and Ibbotson Associates; and
- web "portal" companies, such as Yahoo! and America Online, a division of Time Warner.

Many of our competitors have larger customer bases and significantly greater resources than we do. This may allow our competitors to respond more quickly to new technologies and changes in market demand, to devote greater resources to developing and promoting their services, and to make more attractive offers to potential subscribers and strategic partners. Industry consolidation may also lead to more intense competition. Increased competition could result in price reductions, reduced gross margins, or loss of market share, any of which could hurt our business, operating results, or financial condition.

We have an accumulated deficit, have incurred net losses, and may incur losses in the future.

As of September 30, 2004, we had an accumulated deficit of $80.6 million. We had net losses of $9.3 million in 2001 and $11.9 million in 2003. We cannot assure you that we will not generate net losses in the future.

The availability of free or low-cost investment information could lead to lower demand for our products and adversely affect our financial results.

Investment research and information relating to publicly traded companies and mutual funds is widely available for little or no cost from various sources, including the Internet and public libraries. Investors can also access information directly from publicly traded companies and mutual funds. The EDGAR database available through the SEC Web site provides real-time access to SEC filings, including annual, semi-annual, and quarterly reports. Many brokerage firms also provide financial and investment research to their clients. The widespread availability of free or low-cost investment information may make it difficult for us to maintain or increase the prices we charge for our publications and services and could lead to a lower demand for our products. A loss of a significant number of customers would adversely affect our financial results.

Certain products have historically made up a large percentage of our revenue base. Our business could suffer if sales of these products decline or if our other products don't achieve successful revenue growth.

In 2003, Principia, Morningstar Licensed Data, and Morningstar.com accounted for approximately 20.7%, 16.1%, and 11.7%, respectively, of our revenue. We believe that sales of these products will continue to have a material impact on our revenue for the foreseeable future. If we experience a significant decline in sales of any of these products for any reason, it would have a material adverse impact on our revenue and could harm our business.

Our future success depends on our ability to retain our executive officers.

Our future success depends on the continued service of our executive officers (including Joe Mansueto, our chairman and chief executive officer). The loss of one or more of our executive officers could hurt our business, operating results, or financial condition. We do not carry any life insurance on our executive officers. Because we do not have employment agreements or non-compete agreements with U.S.-based executive officers, they may leave us and work for our competitors or start their own competing businesses.

Our future success depends on our ability to recruit and retain qualified employees.

Our success and future growth depend on our ability to recruit and retain qualified analysts, programmers, designers, sales and marketing experts, customer support representatives, and finance and accounting personnel. We experience competition for analysts and other qualified employees from financial institutions and financial services organizations. These organizations generally have greater resources than we do and therefore may be able to offer significantly higher compensation packages to potential employees. Competition for these employees is intense, and we cannot assure you that we will be able to retain our existing employees or that we will be able to recruit and retain other highly qualified personnel in the future.

If we do not maintain and increase the number of subscriptions and license agreements, our operating results could suffer.

A substantial portion of our revenue is generated from subscriptions and license agreements. In general, our subscriptions are paid in advance, but may be canceled by the customer at any time. We may be obligated to refund a portion of prepaid subscription fees when a customer cancels. Cancellations may have a negative impact on our revenue and cash position. Our license agreements, which typically do not allow for cancellation, have terms ranging from one to three years. Our future success depends on our maintaining (through renewals) and increasing (through new subscriptions and license agreements) the number of customers who pay for our research and investment services. Further, if the market for our services develops more slowly than we expect, or declines, and the number of customers who pay for our services does not increase, or declines, our business, operating results, or financial condition could suffer.

Our reputation and business may be harmed by perceived conflicts of interest.

We offer products and services to mutual fund companies and other financial institutions. We also provide ratings, analyst research, and investment recommendations on mutual funds and other investment products offered and securities issued by the same companies. The fact that fund companies and other financial institutions pay us for certain products and services may create the perception that our ratings, research, and recommendations are not impartial. The perception that we may be subject to a conflict of interest may undermine the confidence of our customers and potential customers in our reputation as a provider of independent research. Any such loss of confidence or damage to our reputation could hurt our business.

We could be subject to fines, penalties, or other sanctions as a result of an investigation by the Securities and Exchange Commission related to incorrect total return data that we published with respect to a mutual fund.

The Securities and Exchange Commission (SEC) is conducting an investigation related to incorrect total return data that we published during a short period in early 2004 with respect to a single mutual fund, the Rock Canyon Top Flight Fund. On May 24, 2004, we received a "Wells Notice" from the Division of Enforcement of the SEC indicating that it intended to recommend that the SEC take legal action against us alleging that we violated U.S. securities laws. See "Legal Proceedings" for additional information. We cannot predict the scope, timing, or outcome of the investigation, 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, these matters may have on our business, financial condition, results of operations, and cash flow.

We could face liability for the information we publish, including information based on data we obtain from other parties.

We may be subjected to claims for securities law violations, defamation (including libel and slander), negligence, or other claims relating to the information we publish. For example, investors may take legal action against us if they rely on a factual error in our published information, or a company may claim that we have made a defamatory statement about it or its employees. We rely on a variety of third parties as the original sources for information that is incorporated into our published data. These sources include securities exchanges, fund companies, and transfer agents. Accordingly, in addition to possible exposure for publishing incorrect information that results directly from our own errors, we could face liability based on inaccurate data furnished to us by others. We could also be subjected to claims based upon the content that is accessible from our Web site through links to other Web sites. Defending claims based on the information we publish could be expensive and time-consuming and could adversely impact our business and operating results.

We could be subject to fines, penalties, or other sanctions as a result of an investigation by the New York Attorney General's Office and an examination by the SEC related to the investment consulting services Morningstar Associates, LLC provides to retirement plan providers, including fund lineup recommendations for retirement plan sponsors.

On December 13, 2004, Morningstar Associates, LLC, a wholly owned subsidiary of Morningstar, Inc., received a request in the form of a subpoena from the New York Attorney General's office, seeking information and documents from Morningstar Associates, LLC related to an investigation the New York Attorney General's office is conducting. While the subpoena is very broad, it specifically asks for information and documents about the investment consulting services Morningstar Associates, LLC offers to retirement plan providers, including fund lineup recommendations for retirement plan sponsors. Shortly after the New York Attorney General's office issued the subpoena, the SEC notified Morningstar Associates, LLC that it had begun an examination of the investment consulting services Morningstar Associates, LLC offers to retirement plan providers. See "Legal Proceedings" for additional information. We cannot predict the scope, timing, or outcome of the investigation or examination, 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, these matters may have on our business, financial condition, results of operations, and cash flow.

Many of our business ventures are relatively new. Our new ventures (including any products yet to be launched) may not be successful.

A key aspect of our growth strategy is to expand our research capabilities and introduce new products and services. We cannot assure you that a viable market for such product offerings exists or that our offerings will be well received by potential customers. In addition, certain of our existing businesses, including our retirement advice and asset management operations, have limited operating histories and are not currently profitable. If these businesses do not develop, they could have an adverse impact on our business, operating results, or financial condition.

Changes in market and economic conditions could lower demand for our products and services.

We provide our products and services to individual investors, financial advisors, and institutional clients. Consequently, our performance may be affected by conditions in the financial and securities markets. For example, in the event that the U.S. or international financial markets suffer a downturn that results in a significant decline in investor activity, demand for our products and services may decline and our revenue and profitability levels could be adversely affected. The financial markets and many businesses operating in the financial services industry are highly volatile and are affected by factors such as U.S. and foreign economic conditions and general trends in business and finance that are beyond our control.

Our results could suffer if the mutual fund industry experiences a downturn or a slowdown in growth.

A significant portion of our revenue is generated from products and services related to mutual funds. The mutual fund industry has experienced substantial growth over the past 20 years. We cannot assure you that mutual fund assets will continue to expand in the future. Scandals in the mutual fund industry in recent years regarding late trading, market timing, and advisory fees could cause a decline in investor interest in mutual funds.

If the mutual fund industry experiences a downturn or a slower growth rate than in the past, it could negatively impact the demand for our products.

Our international operations are in early stages of development and involve special challenges that we may not be able to meet.

In 2003, 14.4% of our revenue was generated from outside the United States, which was an increase from 12.6% in 2002. We expect that international revenue will continue to increase as a percentage of our revenue base. There are certain risks inherent in doing business in some jurisdictions internationally, including the following:

- difficulties in penetrating new markets due to established and entrenched competitors;
- difficulties in developing products and services that are tailored to the needs of local customers;
- difficulties in staffing, managing, and integrating foreign operations;
- lack of local acceptance or knowledge of our products and services;
- lack of recognition of our brand;
- difficulties or delays in translating products and related documentation into foreign languages;
- instability of international economies and governments;
- changes in laws and policies affecting trade and investment;
- exposure to varying legal standards, including intellectual property protection laws, in other jurisdictions; and
- foreign currency exchange rates and exchange controls.

These risks could hamper our ability to expand successfully internationally, which may adversely affect our financial performance and ability to grow.

Changes in laws applicable to our investment advisory operations, compliance failures or regulatory action could adversely affect our business.

Our investment advisory operations are relatively new and a growing part of our overall business. The securities laws and other laws that govern our activities as a registered investment advisor are complex. The activities of our investment advisory operations are primarily subject to provisions of the Investment Advisers Act of 1940 (Advisers Act), and the Employee Retirement and Investment Security Act of 1974 (ERISA). In addition, our investment management business is conducted through a broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act) and is subject to the rules of the National Association of Securities Dealers, Inc. (NASD). It is difficult to predict the future impact of the broad and expanding legislative and regulatory requirements affecting our business. We cannot assure you that the laws, rules, and regulations applicable to our business will not change in the future or that we will be able to comply with any such changes. If we fail to comply with any applicable law, rule, or regulation, we could be fined, sanctioned, or barred from providing investment advisory services in the future, which could materially adversely affect our business, operating results, or financial condition.

Our investment advisory operations may subject us to liability for any losses that result from a breach of our fiduciary duties.

Our investment advisory operations involve fiduciary obligations that require us to act in the best interests of our clients. We may face liabilities for actual or claimed breaches of our fiduciary duties. We may not be able to prevent clients from taking legal action against us for an actual or claimed breach of a fiduciary duty. Because we currently provide investment advisory services on substantial assets, we could face substantial liability to our clients if we breach our fiduciary duties. In addition, we may face other legal liabilities based on the quality and outcome of our investment advisory recommendations, even in the absence of an actual or claimed breach of fiduciary duty.

Our failure to successfully integrate any future acquisitions, investments, or joint ventures could strain our managerial, operational, and financial resources.

We expect to continue to acquire or invest in businesses, joint ventures, customer lists, products, services, or technologies that complement or expand our existing business. Acquisitions, investments, and joint ventures involve a number of risks, including the diversion of management's attention from day-to-day operations. They could also result in dilution from equity securities issued, the incurrence of significant debt or other liabilities, or the loss of key employees. We cannot assure you that any acquisitions, investments, or joint ventures will be successfully completed or that any acquired businesses, customer lists, products, services, or technologies will generate enough revenue to offset the associated costs.

Failure to protect our intellectual property rights could harm our brand-building efforts and ability to compete effectively.

The steps we have taken to protect our intellectual property may not be adequate to safeguard our proprietary information. Further, effective trademark, copyright, and trade secret protection may not be available in every country in which we offer our services. Our continued ability to market one or more of our products under their current names could be adversely affected in those jurisdictions where another person registers, or has a pre-existing registration on, one or more of them. Failure to adequately protect our intellectual property could harm our brand, devalue our proprietary content, and affect our ability to compete in the marketplace.

We could face liability related to our storage of personal information about our users.

Customers routinely input personal investment and financial information, including portfolio holdings and credit card information, on our Web sites. We could be subject to liability if we were to inappropriately disclose any user's personal information or if third parties were able to penetrate our network security or otherwise misappropriate any user's name, address, portfolio holdings, or credit card information. Any such disclosure or breach could subject us to claims for unauthorized purchases with credit card information, impersonation, or other similar fraud claims, or claims for other misuses of personal information, such as unauthorized marketing or unauthorized access to personal portfolio information.

A prolonged outage of our database and network facilities could result in reduced revenue and the loss of customers.

The success of our business depends upon our ability to deliver time-sensitive, up-to-date data and information. We rely on our computer equipment, database storage facilities, and other office equipment, which are located primarily in our Chicago headquarters or elsewhere in the Chicago area. Our operations and those of our suppliers and customers are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, terrorist attacks, wars, Internet failures, computer viruses, and other events beyond our control, including disasters affecting Chicago. Although we maintain an off-site back-up facility for our database and network facilities, that facility may be subject to the same interruptions as may affect our headquarters. We do not currently have the capability to switch over all of our systems to a back-up facility immediately. In the event of a significant database or network facility outage, our business could experience some or complete disruption until we could fully implement our back-up systems. Any losses, service disruption, or damages incurred by us could have a material adverse effect on our business, operating results, or financial condition.

Our business relies heavily on electronic delivery systems and the Internet. Any failures or disruptions could result in reduced revenue and the loss of customers.

Many of our products and services depend heavily on our electronic delivery systems and the Internet. Our ability to deliver information using the Internet may be impaired due to infrastructure failures, service outages at third-party Internet providers, or increased government regulation. If disruptions, failures, or slowdowns of our electronic delivery systems or the Internet occur, our ability to distribute our products and services effectively and to serve our customers may be impaired.

Risks Related to the Auction Process for This Offering

Potential investors should not expect to sell our shares for a profit shortly after our common stock begins trading.

We will determine our initial public offering price for the shares sold in this offering through an auction conducted by WR Hambrecht + Co, our underwriter. We believe that the auction process will reveal a clearing price for the shares of our common stock offered in this offering. The clearing price is the highest price at which all of the shares offered (including the shares subject to the underwriter's over-allotment option) may be sold to potential investors. Although our underwriter, the selling shareholder, and we may elect to set the initial public offering price below the auction clearing price, the public offering price may be at or near the clearing price. If there is little to no demand for our shares at or above the initial public offering price once trading begins, the price of our shares would decline following our initial public offering. If your objective is to make a short-term profit by selling the shares you purchase in the offering shortly after trading begins, you should not submit a bid in the auction.

Some bids made at or above the initial public offering price may not receive an allocation of shares.

Our underwriter may require that bidders confirm their bids before the auction for our initial public offering closes. If a bidder is requested to confirm a bid and fails to do so within a required time frame, that bid will be rejected and will not receive an allocation of shares even if the bid is at or above the initial public offering price. Further, if the auction process leads to a pro rata reduction in allocated shares and a rounding down of share allocations pursuant to the rules of the auction, a bidder may not receive any shares in the offering despite having bid at or above the initial public offering price. In addition, we, in consultation with our underwriter, may determine, at our sole discretion, that some bids that are at or above the initial public offering price are manipulative of or disruptive to the bidding process or otherwise not in our best interest, in which case such bids will be rejected.

Potential investors may receive a full allocation of the shares they bid for if their bids are successful and should not bid for more shares than they are prepared to purchase.

If the initial public offering price is at or near the clearing price for the shares offered in this offering, the number of shares represented by successful bids will equal or nearly equal the number of shares offered by this prospectus. Successful bidders may therefore be allocated all or nearly all of the shares that they bid for in the auction. Therefore, we caution investors against submitting a bid that does not accurately represent the number of shares of our common stock that they are willing and prepared to purchase.

Other Risks Related to This Offering

Control by a principal shareholder could adversely affect our other shareholders.

Upon completion of this offering, our chairman and chief executive officer, Joe Mansueto, will beneficially own approximately % of our outstanding common stock, or approximately % of our outstanding common stock if the underwriter's over-allotment option is exercised in full. As a result, he will have the ability to control substantially all matters submitted to our shareholders for approval, including the election and removal of directors and any merger, consolidation, or sale of our assets. He will also have the ability to control our management and affairs. This concentration of ownership may delay or prevent a change in control; impede a merger, consolidation, takeover, or other business combination involving us; discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of us; or result in actions that may be opposed by other shareholders, including those who purchase shares in this offering.

Moreover, because of Joe Mansueto's substantial ownership, we are a "controlled company" for purposes of the NASDAQ Marketplace Rules. This means that, if in the future we elect to be treated as a controlled company under the NASDAQ Marketplace Rules, we will not be required by NASDAQ to have a majority of independent directors or to maintain compensation and nominating and corporate governance committees composed entirely of independent directors to continue to list our shares on NASDAQ.

Fluctuations in our operating results may negatively impact our stock price.

We believe our business has relatively large fixed costs and low variable costs, which magnifies the impact of revenue fluctuations on our operating results. As a result, a decline in our revenue may lead to a relatively larger impact on operating results. A substantial portion of our operating expense is related to personnel costs, marketing programs, and corporate overhead, none of which can be adjusted quickly. Our operating expense levels are based on our expectations for future revenue. If actual revenue is below management's expectations, or if our expenses increase before revenues do, both gross margins and operating results would be materially and adversely affected. Because of these fluctuations, it is possible that our operating results or other operating metrics may fail to meet the expectations of outside stock analysts and investors. If this happens, the market price of our common stock is likely to decline.

We have broad discretion to use the proceeds from this offering and our use of these proceeds may not yield a favorable return.

We have not identified specific uses for any portion of the proceeds from this offering. Accordingly, our management will have significant flexibility in determining how to spend these proceeds. Although we are not currently engaged in any active discussions with respect to any acquisitions, we may seek to acquire, invest in, or establish joint ventures with respect to businesses, products, services, or technologies that complement or expand our existing business, and a portion of the net proceeds may be used for such acquisitions, investments, or joint ventures. If management fails to use the proceeds effectively, our business and operating results could suffer.

The future sale of shares of our common stock may negatively affect our stock price.

If our shareholders sell substantial amounts of our common stock in the public market following this offering, the market price of our common stock could fall. We and the holders of substantially all of our shares of common stock have agreed not to sell, directly or indirectly, any common stock without the prior written consent of WR Hambrecht + Co for a period of 180 days from the date of this prospectus. However, WR Hambrecht + Co may, in its sole discretion and at any time or from time to time, without notice, release all or any portion of the securities subject to the lock-up agreements. In addition, Softbank Finance Corporation (Softbank) is expected to beneficially own approximately   % of our outstanding shares upon completion of this offering. The market price of our common stock could fall if Softbank or another major shareholder sells substantial amounts of our common stock. After this offering, we will have   shares of common stock outstanding. Of these shares, all of the shares being offered pursuant to this prospectus are expected to be freely tradable. Sales of substantial amounts of common stock (including shares issued in connection with future acquisitions that may be issued with registration rights) may adversely affect the prevailing market price for our common stock and could impair our ability to obtain additional capital by offering equity securities.

You will incur immediate and substantial dilution and may experience further dilution.

The initial public offering price of our common stock is substantially higher than the net tangible book value per share of the outstanding common stock. If you purchase common stock in this offering, you will incur immediate and substantial dilution in the net tangible book value per share of the common stock from the price you pay for the stock. New investors will experience an immediate dilution of $ per share assuming an initial public offering price of $ per share (the midpoint of the range set forth on the cover of this prospectus). In addition, as of September 30, 2004, there were options to acquire 9,370,467 shares of common stock outstanding, 7,739,623 of which were exercisable at a weighted average exercise price of $9.79 per share. An additional 5,628,843 shares of common stock were reserved for issuance under our 2004 stock option plan. To the extent that option holders exercise outstanding options to purchase common stock, there may be further dilution. Moreover, there can be no assurance that we will not raise additional funds through future sales of our common stock. Any such financing may result in additional dilution to our shareholders.

Forward-Looking Statements

This prospectus, including the sections titled "Prospectus Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Business," contains forward-looking statements. These statements relate to future events or to our future financial performance and involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by the use of words such as "may," "could," "expect," "intend," "plan," "seek," "anticipate," "believe," "estimate," "predict," "potential," or "continue" or the negative of these terms or other comparable terminology. You should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond our control and that could materially affect actual results, levels of activity, performance, or achievements.

If any of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we projected. Any forward-looking statement you read in this prospectus reflects our current views with respect to future events and is subject to these and other risks, uncertainties, and assumptions relating to our operations, results of operations, growth strategies, and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

Notice to Investors

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. We are offering to sell, and seeking offers to buy, shares of our common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock.

Use of Proceeds

We estimate that the net proceeds to us from the sale of the shares of common stock offered by us pursuant to this prospectus will be approximately $ (or approximately $ if the underwriter's over-allotment option is exercised in full), assuming an initial public offering price of $ per share (the midpoint of the range set forth on the cover of this prospectus) and after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us. We will not receive any proceeds from the sale of shares by the selling shareholder.

The principal purposes of this offering are to obtain additional working capital, provide liquidity for our shareholders and optionholders, facilitate our future access to public markets, and enable us to use our common stock to acquire businesses that complement or expand our existing business. We intend to use the net proceeds to us from this offering for general corporate purposes, including working capital. We do not have more specific plans for the net proceeds to us from this offering. We may seek to acquire, invest in, or establish joint ventures with respect to businesses, products, services, or technologies that complement or expand our existing business, and we may use a portion of the net proceeds for such acquisitions, investments, or joint ventures.

We will retain broad discretion in the allocation of the net proceeds of this offering. Pending the uses described above, we expect to invest the net proceeds in investment-grade instruments or securities.

Dividend Policy

We have not declared or paid cash dividends on our common stock over the past three years. We currently do not intend to pay any cash dividends on our common stock. Rather, we currently plan to retain any future earnings for funding our growth. Future dividends, if any, will be determined by our board of directors. Because we currently do not intend to pay any dividends, there is a risk that you will not experience a return on your investment unless you sell your shares of common stock at a price higher than the price you paid for the shares.

Capitalization

The following table sets forth our cash, cash equivalents, and investments and our capitalization as of September 30, 2004:

- on an Actual basis; and
- on an As Adjusted basis to reflect the sale of shares of common stock by us in this offering at an assumed initial public offering price of $ per share of common stock (the midpoint of the range set forth on the cover of this prospectus), after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us.

You should read this table together with "Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as our Consolidated Financial Statements and related notes included elsewhere in this prospectus.

	As of September 30, 2004	
Capitalization ($000)	**Actual**	**As Adjusted**
Cash, cash equivalents, and investments (1)	$ 82,741	$
Long-term liabilities (2)	$ 23,728	$
Shareholders' equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 38,438,610 shares were outstanding at September 30, 2004 and shares outstanding assuming completion of this offering	4	
Treasury stock	(3,280)	
Additional paid-in capital	145,456	
Accumulated deficit	(80,586)	
Accumulated other comprehensive income	1,633	
Total shareholders' equity	63,227	
Total capitalization	$ 86,955	$

(1) Includes $52,497 of cash and cash equivalents and $30,244 of investments as of September 30, 2004. Investments consisted of $13,674 in corporate bonds, $2,850 in senior notes, $10,104 in government obligations, $2,615 in a certificate of deposit, and $1,001 in other investments as of September 30, 2004.

(2) Includes $20,444 related to stock options accounted for as a long-term liability in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* , which is expected to be reclassified to shareholders' equity upon completion of this offering.

Dilution

Our net tangible book value as of September 30, 2004 was approximately $47.4 million, or $1.23 per share, based on the number of shares of common stock outstanding as of September 30, 2004. Net tangible book value per share is equal to the amount of our total tangible assets less total liabilities, divided by the number of shares of common stock outstanding as of September 30, 2004. After giving effect to the sale of common stock offered by us pursuant to this prospectus at an assumed initial public offering price of $ per share (the midpoint of the range set forth on the cover of this prospectus), and after incorporating our receipt of the estimated net proceeds from this offering, our net tangible book value as of September 30, 2004 would have been approximately $ million, or $ per share. This represents an immediate increase in net tangible book value of $ per share to existing shareholders and an immediate dilution of $ per share to new investors. The following table illustrates this per share dilution:

Assumed initial public offering price per share		$
Net tangible book value per share before this offering	$ 1.23	
Increase per share attributable to new investors		
Net tangible book value per share after this offering		
Dilution per share to new investors		$

The following table summarizes the differences between existing shareholders and new investors with respect to the number of shares of common stock purchased from us, the total consideration paid, and the average price per share paid before deducting the underwriting discounts and commissions and our estimated offering expenses.

	Purchased		Total Consideration		
Existing and New Shareholders (in thousands except per share amounts)	**Number**	**Percent**	**Amount**	**Percent**	**Average Price Per Share**
Existing shareholders		%	$	%	$
New investors					
Total		%	$	%	

The discussion and table above assume no exercise of any stock options outstanding as of September 30, 2004. As of September 30, 2004, there were options to acquire 9,370,467 shares of common stock outstanding, 7,739,623 of which were exercisable at a weighted average exercise price of $9.79 per share. An additional 5,628,843 shares of common stock were reserved for issuance under our 2004 stock option plan.

If the underwriter exercises its over-allotment option in full, the following will occur:

- the number of shares of our common stock held by existing shareholders will decrease to approximately % of the total number of shares of our common stock outstanding after this offering;
- the number of shares of our common stock held by new investors will increase to , or approximately %, of the total number of shares of our common stock outstanding after this offering; and
- net tangible book value will increase to $ per share to existing shareholders, and there will be an immediate dilution in net tangible book value of $ per share to new investors.

Selected Historical Financial Data

The selected historical financial data shown below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our Consolidated Financial Statements and related notes included elsewhere in this prospectus. We have derived our Consolidated Statements of Operations Data and Other Consolidated Financial Data for the years ended December 31, 2001, 2002, and 2003 and Consolidated Balance Sheet Data as of December 31, 2002 and 2003 from our audited Consolidated Financial Statements included elsewhere in this prospectus. We have derived our Consolidated Statements of Operations Data and Other Consolidated Financial Data for the nine months ended September 30, 2003 and 2004 and Consolidated Balance Sheet Data as of September 30, 2004 from our unaudited Consolidated Financial Statements included elsewhere in this prospectus. The Consolidated Statements of Operations Data and Other Consolidated Financial Data for the years ended December 31, 1999 and 2000 and Consolidated Balance Sheet Data as of December 31, 1999, 2000, and 2001 were derived from our audited Consolidated Financial Statements that are not included in this prospectus. Historical results do not necessarily indicate the results you should expect for future periods.

	Year Ended December 31					Nine Months Ended September 30	
Consolidated Statements of Operations Data (in thousands except per share amounts)	**1999**	**2000**	**2001**	**2002**	**2003**	**2003**	
Revenue	$ 51,975	$ 74,973	$ 91,230	$ 109,619	$ 139,496	$ 102,393	$
Operating expense	94,900	137,047	107,621	117,959	150,250	109,528	
Operating income (loss)	(42,925)	(62,074)	(16,391)	(8,340)	(10,754)	(7,135)	
Non-operating income, net	1,945	20,728	676	4,463	1,110	304	
Income (loss) before income taxes, equity in net income of unconsolidated entities, minority interest in net loss of consolidated entities, and extraordinary gain	(40,980)	(41,346)	(15,715)	(3,877)	(9,644)	(6,831)	
Income tax expense (benefit)	(11,845)	(10,511)	(5,276)	(311)	2,950	3,732	
Equity in net income of unconsolidated entities	53	1,142	359	750	697	420	
Minority interest in net loss of consolidated entities	—	1,055	785	178	—	—	
Income (loss) before extraordinary gain	(29,082)	(28,638)	(9,295)	(2,638)	(11,897) $	(10,143) $	
Extraordinary gain—acquisition	—	—	—	3,084	—	—	
Net income (loss)	$ (29,082)	$ (28,638)	$ (9,295)	$ 446	$ (11,897)	$ (10,143)	$
Basic income (loss) per share:							
Income (loss) before extraordinary gain	$ (0.88)	$ (0.75)	$ (0.24)	$ (0.07)	$ (0.31)	$ (0.26)	$
Extraordinary gain—acquisition	—	—	—	0.08	—	—	
Basic income (loss) per share	$ (0.88)	$ (0.75)	$ (0.24)	$ 0.01	$ (0.31)	$ (0.26)	$
Weighted average common shares outstanding—basic	33,232	38,389	38,298	38,345	38,382	38,377	
Diluted income (loss) per share:							
Income (loss) before extraordinary gain	$ (0.88)	$ (0.75)	$ (0.32)	$ (0.17)	$ (0.31)	$ (0.26)	$
Extraordinary gain—acquisition	—	—	—	0.08	—	—	
Diluted income (loss) per share	$ (0.88)	$ (0.75)	$ (0.32)	$ (0.09)	$ (0.31)	$ (0.26)	$
Weighted average							

common shares outstanding—diluted	33,232	38,389	41,364	40,361	38,382	38,377

Other Consolidated Financial Data ($000)	Year Ended December 31 1999	2000	2001	2002	2003	Nine Months Ended September 30 2003	2004
Stock-based compensation expense (income) under the liability method	$ 29,129	$ 11,455	$ (3,336)	$ (3,283)	$ 17,796	$ 13,223	$ 3,099
Stock-based compensation expense under the equity method	—	4,396	9,003	10,575	11,233	8,373	5,670
Total stock-based compensation expense (1)	$ 29,129	$ 15,851	$ 5,667	$ 7,292	$ 29,029	$ 21,596	$ 8,769
Operating income (loss) before stock-based compensation expense (2)	$ (13,796)	$ (46,223)	$ (10,724)	$ (1,048)	$ 18,275	$ 14,461	$ 25,435
Sales tax expense (3)	$ —	$ 807	$ 2,294	$ 2,837	$ 3,079	$ 2,099	$ —
Cash provided by (used for) investing activities	$ (11,396)	$ (20,215)	$ 3,128	$ 1,435	$ (20,481)	$ (23,969)	$ (13,495)
Cash provided by (used for) financing activities	$ 1,385	$ 97,146	$ (1,049)	$ (1,952)	$ (26)	$ (7)	$ (6,401)
Cash provided by (used for) operating activities	$ (9,030)	$ (36,169)	$ (5,183)	$ 16,542	$ 29,705	$ 17,477	$ 19,085
Capital expenditures	(4,096)	(11,072)	(5,932)	(5,989)	(8,607)	(6,361)	(5,758)
Free cash flow (4)	$ (13,126)	$ (47,241)	$ (11,115)	$ 10,553	$ 21,098	$ 11,116	$ 13,327

Consolidated Balance Sheet Data ($000)	As of December 31 1999	2000	2001	2002	2003	As of September 30 2004
Cash, cash equivalents, and investments	$ 93,722	$ 59,454	$ 47,650	$ 64,796	$ 76,158	$ 82,741
Working capital (deficit) (5)	58,172	10,793	1,165	10,005	(5,910)	12,975
Total assets (6)	122,858	133,890	128,735	152,781	180,265	189,898
Long-term liabilities (7)	19,750	30,484	26,315	21,243	24,094	23,728
Total shareholders' equity (6)	52,460	38,048	35,970	48,132	44,821	63,227

(1) We have adopted SFAS No. 123, *Accounting for Stock-Based Compensation,* in all periods presented. SFAS No. 123 (Revised 2004), *Share-Based Payment,* which will require all public companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, will be effective for interim or annual periods beginning after June 15, 2005. We are in the process of reviewing the impact of SFAS No. 123 (Revised 2004), *Share-Based Payment,* on our current practice of voluntarily recognizing stock-based compensation expense.

The total expense for stock-based compensation is distributed with other employee compensation costs in the appropriate expense categories of our Consolidated Statements of Operations. In accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* , we use two accounting methods. For options granted under plans that may require us to settle the options in cash we use the liability method. Under this method we record a liability for a vested option equal to the difference between the option exercise price and the estimated fair market value of the shares of common stock underlying the option at the end of the reporting period. If this estimated fair market value increases over the reporting period we record an expense and, if it decreases, we record income.

For options granted under plans that do not require us to settle the options in cash, we use the equity method. Under this method we calculate expense based on fair value calculated using a Black-Scholes model at the time of grant and record expense as the options vest. In each year, our aggregate stock-based compensation expense reflects the impact of options granted in prior years. Following completion of this offering, we will no longer be required to settle any options for cash and anticipate that all of our options will be accounted for under the equity method of SFAS No. 123, *Accounting for Stock-Based Compensation* . See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Stock-Based Compensation."

(2) "Operating income (loss) before stock-based compensation expense" is defined as operating income (loss) before the effect of our stock-based compensation expense. Information concerning our stock-based compensation expense is described in note (1) above. We expect stock-based compensation expense to be a recurring cost. We have presented operating income (loss) before stock-based compensation expense solely as a supplemental disclosure to help our investors better understand the performance of our business, to enhance comparison of our performance from period to period, and to allow better comparison of our performance with that of our competitors. We use operating income (loss) before stock-based compensation expense to evaluate the performance of our business. Operating income (loss) before stock-based compensation should not be considered as an alternative to any measure of performance as promulgated under GAAP (such as operating income (loss)), nor should this data be considered as an indicator of our overall financial performance or liquidity. Also, the calculation of operating income (loss) before stock-based compensation expense used by us may not be comparable to similarly titled measures reported by other companies. The table below includes a reconciliation from our operating income (loss) to operating income (loss) before stock-based compensation expense:

	Year Ended December 31					**Nine Months Ended September 30**	
($000)	**1999**	**2000**	**2001**	**2002**	**2003**	**2003**	**2004**
Operating income (loss)	$ (42,925)	$ (62,074)	$ (16,391)	$ (8,340)	$ (10,754)	$ (7,135)	$ 16,666
Add back: Stock-based compensation expense	29,129	15,851	5,667	7,292	29,029	21,596	8,769
Operating income (loss) before stock-based compensation expense	$ (13,796)	$ (46,223)	$ (10,724)	$ (1,048)	$ 18,275	$ 14,461	$ 25,435

(3) During 2003, we participated in voluntary disclosure or similar programs related to state sales tax. Through these programs, we identified sales tax amounts due for prior years and negotiated or are in discussions with local tax authorities to settle these amounts. We have recorded expense in the four years to which the sales tax amounts apply. The estimated amounts of sales tax expense recorded in 2000, 2001, 2002, and 2003 were not materially different from actual sales tax expense for those periods based on the most current information available and negotiations of sales tax expense for those periods. We do not expect to record any expense related to these programs after 2003.

(4) "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. We use free cash flow to evaluate the performance of our business. This table includes a reconciliation from cash provided by (used for) operating activities to free cash flow. Free cash flow should not be considered as 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 as an indicator of our overall financial performance or liquidity. Also, the free cash flow definition used by us may not be comparable to similarly titled measures reported by other companies.

(5) We frequently collect cash in advance of providing services or fulfilling subscriptions for our customers. These amounts, which are recorded as current liabilities on our Consolidated Balance Sheets and classified as deferred revenue, totaled $56,398 as of September 30, 2004.

(6) 2002 and 2003 amounts have been restated. See Note 16 to our Consolidated Financial Statements.

(7) Includes $20,444 related to stock options accounted for as a long-term liability as of September 30, 2004 in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* , which is expected to be reclassified to shareholders' equity upon completion of this offering.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our Consolidated Financial Statements and related notes included elsewhere in this prospectus. It contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in or implied by these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this prospectus, particularly under the heading "Risk Factors." The following discussion gives effect to the restatement of our Investments in Unconsolidated Entities and Accumulated Other Comprehensive Income at December 31, 2002 and 2003 as discussed in Note 16 to our Consolidated Financial Statements. The restatement did not impact our Consolidated Statements of Operations or the Consolidated Statements of Cash Flows for the years ended December 31, 2002 or 2003.

What We Do

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. Our core business is providing independent research and analysis on individual stocks and mutual funds; we also provide information on variable annuities, closed-end funds, exchange-traded funds, separate accounts, hedge funds, and Section 529 college savings plans.

Our Company Values

We have established a set of principles that guide our company and that we expect our employees to follow:

- *Investors come first.* We believe that Morningstar's strength comes largely from the faith that investors place in us. Our independence, integrity, and advocacy for investors' interests are the foundation of our company. We strive to help investors achieve better results;

- *Great products.* We believe that Morningstar's products must exceed our customers' expectations and raise the standard over other existing products. To do this, our products must be not only innovative, but reliable and of the highest quality. They must be marked by exemplary content, design, and usability;

- *Entrepreneurial spirit.* We believe that companies should grow, but never grow old. The entrepreneurial spirit inspires independent thought, agile decision-making, and an acceptance of creative and unconventional solutions to business challenges;

- *Uncompromising ethics.* We require our employees to adhere to high ethical standards, regardless of the impact on our business. We believe that high ethical standards should be pursued for their own sake, and we expect every Morningstar employee to treat our customers and their fellow employees as we would wish to be treated ourselves;

- *Great people.* We believe that every person who works at Morningstar contributes to our success. We want to attract talented, hard-working, enthusiastic people, so we create an environment that encourages employees to learn throughout their careers, allows them to advance based on merit, and rewards them for helping Morningstar thrive; and

- *Financial success.* We believe that great products create value for our customers. This creates demand for our products and, in turn, generates financial success. Financial success strengthens our company and helps us continue to raise our standards and set more challenging goals.

How We Manage Our Business

We strive to manage Morningstar to maximize our long-term results, while staying focused on our mission of helping investors and adhering to our company values. We invest significantly in new product development and in enhancing our current offerings. It typically takes many years to recoup these investments, but we believe they are critical to building long-term value for our shareholders. We plan to continue this practice as a publicly held company.

We do not make public financial forecasts for our business. We are uneasy with management forecasts because they are, by their nature, subjective and could have an effect on a company's stock price. We prefer to avoid this potential conflict and let our results speak for themselves. We also want to avoid creating any incentive within our company to alter behavior to "make the numbers."

We will strive to communicate with candor and tell you the unvarnished truth about our business. You'll notice, for example, that we voluntarily chose to expense stock options in our financial statements. Although our results would have looked substantially better without this election, we believe it is the right thing to do. We'll also strive to communicate equally with all shareholders, without special treatment for large shareholders or research analysts.

How We're Organized

We emphasize a decentralized approach to running our business to empower our managers and to create a culture of responsibility and accountability. Our decentralized business structure includes three global business segments: Individual, Advisor, and Institutional. In all three of these segments, we believe our work helps individual investors make better investment decisions. Early in our history, our product lineup emphasized products for individual investors. As a result, the Individual segment contributed a majority of our revenue. In the early 1990s, our Advisor segment became a more important part of our business. More recently, we've begun serving more investors through our Institutional segment, which in terms of revenue became the largest of our three segments in 2003.

How We Evaluate Our Business

When our analysts evaluate a stock, they focus on assessing the company's estimated intrinsic value—the value of the company's future cash flows, discounted to their worth in today's dollars. Our approach to evaluating our own business works the same way. Our goal is to increase the intrinsic value of our business over time, which we believe is the best way to create value for our shareholders.

We provide three specific measures that can help you generate your own assessment of how our intrinsic value has changed over time:

- Revenue;
- Operating income (loss); and

- Free cash flow.

We define free cash flow 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. Our management uses 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, the free cash flow definition used by us may not be comparable to similarly titled measures reported by other companies.

Key Business Characteristics

We believe our business has the following characteristics:

Recurring Revenue

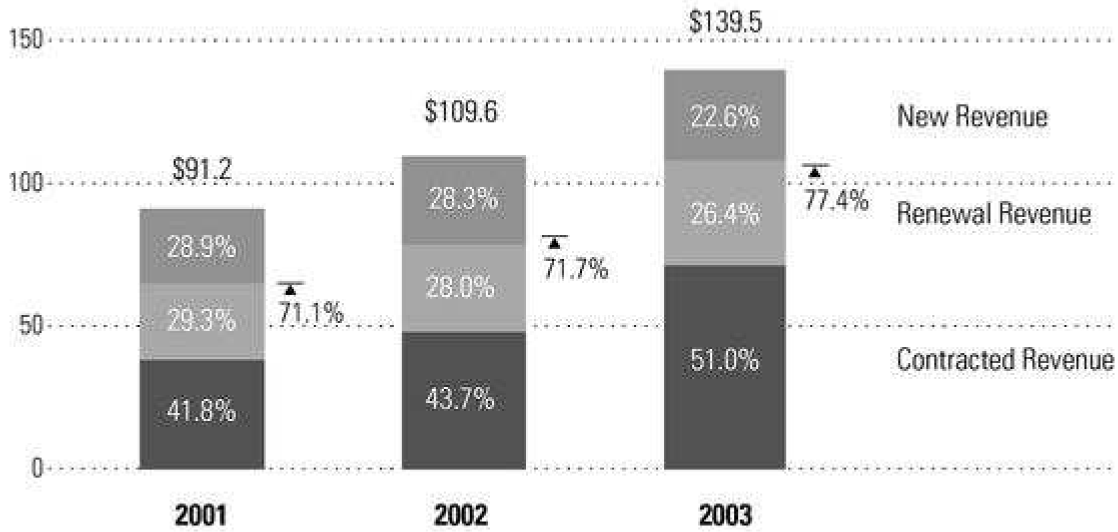
We have historically generated significant recurring revenue because many of our products are sold through subscriptions or license agreements. These subscriptions and licenses generally come up for renewal after one- to three-year terms. Many of our Advisor and Institutional customer agreements span multiple years. At the beginning of the year, we generally have contracts in place for a meaningful percentage of our total revenue for that year. For example, as of January 1, 2004, we had contracts in place that were expected to generate $93.1 million of revenue in 2004, assuming no cancellations. We can also estimate renewal revenue in a given year by applying historical renewal rates to the amount of revenue that will come up for renewal. A relatively smaller portion of our revenue typically comes from new sales completed during the year.

We separate our annual revenue into three categories, defined as follows:

- New revenue, which we define as revenue from selling additional products to current customers or from selling to new customers;
- Renewal revenue, which we define as revenue from renewals of subscriptions or licenses; and
- Contracted revenue, which we define as revenue from licenses or subscriptions that were in place at the beginning of the year.

The graph below shows the percentage of revenue from each of these three categories for the past three years.

Revenue Composition
Year Ended December 31 ($mil)



Significant Operating Leverage

Our business has relatively high fixed costs because of the investments required to create proprietary databases and content. We strive to leverage these fixed costs by selling a wide variety of products and services to multiple investor segments, through multiple media, and in many geographical markets. We believe that while the fixed costs of our business are relatively high, the variable cost of adding customers is considerably lower, particularly as our products and services focus more on Internet-based platforms. Historically, we have made substantial investments in building our databases and content that have adversely affected our short-term operating results. More recently, our free cash flow has improved because we've been able to increase revenue without a significant corresponding increase in expenses (excluding costs associated with stock-based compensation).

Deferred Revenue

We frequently collect cash in advance of providing services or fulfilling subscriptions for our customers. As a result, we can use some of that cash to fund our operations and invest in new product development. Although we may need to issue refunds for the unused portion of the subscription if a customer cancels, we generally have used deferred revenue to fund many of our other activities. These amounts, which are shown on our balance sheet as deferred revenue, totaled $55.6 million as of December 31, 2003 and $56.4 million as of September 30, 2004.

How Our Business Works: Revenue and Operating Expenses

We earn revenue by selling a variety of investment-related products and services. Many of our offerings, such as our newsletters, Principia software, and Premium service on Morningstar.com, are sold via subscriptions. These subscriptions are mainly offered for a one-year term. We also sell advertising on our Web sites. A variety of our products are sold through license agreements, including Advisor Workstation, Morningstar Direct (formerly Morningstar DataLab), Morningstar Retirement Manager, and Licensed Data. Our license agreements typically range from one to three years. For some of our other institutional services, mainly Investment Consulting, our fees are generally based on the scope of work and the level of service we provide. Finally, we collect fees relating to our Morningstar Managed Portfolios and managed retirement account services, which are calculated as a percentage of total assets under management.

We break our expenses into cost of goods sold, development, sales and marketing, general and administrative, and depreciation and amortization, as described below. We include stock-based compensation expense, as appropriate, in each of these categories.

- *Cost of goods sold.* This category includes the compensation expense for employees who produce the products we deliver to our customers. For example, this category covers the cost of production teams and analysts who write investment research reports. Cost of goods sold also includes other expenses such as postage, printing, and CD-ROM replication.

- *Development.* This category includes costs associated with enhancing our products on an ongoing basis. Development costs mainly include compensation costs for programmers, designers, and other employees who develop new products and make ongoing improvements to existing products. In some cases, we capitalize the compensation costs associated with certain development projects as required by GAAP. This reduces the expense that we would otherwise show here. We amortize these capitalized costs over three years.

- *Sales and marketing.* This category includes salaries, benefits, and commissions for our sales teams, product managers, and other marketing professionals. We also include the cost of advertising, direct mail campaigns, and other marketing programs to promote our products.

- *General and administrative.* This category consists mainly of compensation costs for each segment's management team, as well as human resources, finance, and support employees for each segment. The category also includes corporate overhead, including senior management, corporate systems, accounting, legal, and facilities expenses.

- *Depreciation and amortization.* Our capital expenditures consist mainly of computers, leasehold improvements, and capitalized product development costs related to certain software development projects. We recognize depreciation and amortization costs for these items over their appropriate lives, generally ranging from three to seven years. For more information about our policies on depreciation, amortization, and capitalized software development, see "—Application of Critical Accounting Policies and Estimates."

Joint Ventures and Minority Interests

We consolidate the results of our international operations, other than our ventures in Japan, Korea, Denmark, and Sweden. We used the equity method of accounting for Morningstar Asia (our subsidiary in China) until October 1, 2002, when we acquired the remaining 60.1% from our joint venture partners. We began consolidating the operations of Morningstar Asia into our financial statements at that time. Our operations in Japan, Korea, Denmark, and Sweden are accounted for using the equity method. The book value of these operations is shown on our balance sheet as investments in unconsolidated entities.

In June 2000, Morningstar Japan became a publicly traded company on the Osaka Stock Exchange "Hercules Market." Its ticker is 4765. The total market value of Morningstar Japan was $139.0 million as of December 31, 2001, $51.0 million as of December 31, 2002, $89.7 million as of December 31, 2003, and $124.0 million as of September 30, 2004. We own approximately a 35% stake in Morningstar Japan.

Stock-Based Compensation

We have historically granted options to our employees as a significant component of overall compensation. We believe that granting options encourages our employees to think like owners and gives them an incentive to help build our long-term value.

We use SFAS No. 123, *Accounting for Stock-Based Compensation* , to account for our stock option grants. SFAS No. 123 (Revised 2004), *Share-Based Payment* , which will require all public companies to measure compensation cost for all stock-based payments (including employee stock options) at fair value, will be effective for interim or annual periods beginning after June 15, 2005. We are in the process of reviewing the impact of the provisions of SFAS No. 123 (Revised 2004), *Share-Based Payment,* on our current practice of voluntarily recognizing stock-based compensation expense.

In accordance with SFAS No. 123, *Accounting for Stock-Based Compensation,* we use the following two accounting methods:

- For options granted under plans that may require us to settle the options in cash, we use the liability method. Under this method, we record a liability for vested options equal to the difference between the option exercise price and the estimated fair market value of the shares of common stock underlying the option. Substantially all of our options outstanding under these plans are fully vested. We calculate the expense for these options based on changes in the estimated fair market value of our stock, and we record this change by adjusting the amount of the liability at the end of each reporting period. If, as occurred in 2003 and in the nine months ended September 30, 2004, the estimated fair market value of our common stock increases, we record an expense reflecting the increased liability. If, as occurred in 2001 and 2002, the estimated fair market value of our common stock decreases, the liability declines and we record income.

- For options outstanding under plans that do not require us to settle the options in cash, we use the equity method. We calculate the expense under this method based on the Black-Scholes value of the option at the time of the grant. We record this expense as the options vest, typically in equal amounts over four years. This method requires that we make several estimates, including the volatility of our stock price, the expected option forfeiture rate, and the expected life of the option. In making these estimates, we have used historical data as well as management judgment to arrive at the data inputs.

The aggregate expense under the two methods is distributed with other employee compensation costs among various expense categories of our Consolidated Statements of Operations. In each year, this expense includes the impact of options granted in prior years. For example, the expense recorded in 2003 reflects the cost of options that were granted in 2000, 2001, 2002, and 2003 under the equity method, and the expense for all options granted between 1993 and 1999 under the liability method.

In 2000, we granted an unusually large number of options that vested ratably over four years and are accounted for under the equity method. The expense associated with these options in 2001, 2002, and 2003 was $6.6 million, $6.6 million, and $6.5 million, respectively. During 2004, we expect that our expense under the equity method for all options granted between 2000 and 2003 will be approximately $7.0 million.

Upon completion of this offering, we will no longer be required to settle any options in cash. We will record a final expense or income for options previously accounted for under the liability method by marking them to the initial public offering price. At an assumed initial public offering price of $ per share (the midpoint of the range set forth on the cover of this prospectus), this will result in expense or income in the quarter in which we complete this offering of approximately $. After being marked to the initial public offering price, these options will not have any further impact on our stock-based compensation expense. In the future, we anticipate that all of our options will be accounted for using the equity method. We expect that our stock-based compensation expense following the quarter in which this offering is completed will not be subject to the same level of fluctuation experienced in recent years because we will no longer record expense under the liability method. However, if our stock price increases, our expense under the equity method may also increase, even if we grant fewer options than we have granted in recent years.

In our Consolidated Statements of Operations we recognized stock-based compensation expense (income) under the liability and equity methods as follows:

	Year Ended December 31			Nine Months Ended September 30	
Stock-Based Compensation Expense Methods ($000)	**2001**	**2002**	**2003**	**2003**	**2004**
Stock-based compensation expense (income) under the liability method	$ (3,336)	$ (3,283)	$ 17,796	$ 13,223	$ 3,099
Stock-based compensation expense under the equity method	9,003	10,575	11,233	8,373	5,670
Total	$ 5,667	$ 7,292	$ 29,029	$ 21,596	$ 8,769

In 2003, the substantial increase in our stock-based compensation expense calculated under the liability method resulted from an increase in the estimated fair market value of our common stock.

We recorded stock-based compensation expense (income) in the following expense categories of our Consolidated Statements of Operations:

	Year Ended December 31			Nine Months Ended September 30	
Distribution of Stock-Based Compensation Expense (Income) ($000)	**2001**	**2002**	**2003**	**2003**	**2004**
Cost of goods sold	$ (379)	$ (89)	$ 3,091	$ 2,269	$ 1,120
Development	(31)	(59)	2,090	1,707	571
Sales and marketing	(115)	(64)	2,107	1,698	642
General and administrative	6,192	7,504	21,741	15,922	6,436
Total	$ 5,667	$ 7,292	$ 29,029	$ 21,596	$ 8,769

Stock-based compensation expense is not allocated among our segments and, therefore, is not reflected in our segment results.

Consolidated Business Results
Nine Months Ended September 30, 2004 vs. Nine Months Ended September 30, 2003

	Nine Months Ended September 30		
Key Metrics ($000)	**2003**	**2004**	**% Change**
Revenue	$ 102,393	$ 130,944	27.9%
Operating income (loss)	(7,135)	16,666	NMF
Operating margin (%)	NMF	12.7%	NMF
Stock-based compensation expense	21,596	8,769	(59.4)
Cash used for investing activities	(23,969)	(13,495)	(43.7)
Cash used for financing activities	(7)	(6,401)	NMF
Cash provided by operating activities	$ 17,477	$ 19,085	9.2%
Capital expenditures	(6,361)	(5,758)	(9.5)%
Free cash flow	$ 11,116	$ 13,327	19.9%

NMF—Not meaningful

Consolidated Revenue

In the nine months ended September 30, 2004, our revenue increased $28.5 million, or 27.9%, reflecting strong demand for the products and services in each of our business segments. Price adjustments had minimal impact on revenue growth. Currency translations contributed $1.5 million, and the July 2003 acquisition of mPower.com, Inc. (mPower) added $2.4 million to our revenue. Excluding the impact of currency translations and the mPower acquisition, our revenue increased approximately 24% in the first nine months of 2004 compared with the same period in 2003.

Revenue in our Individual segment increased $7.1 million; Advisor segment revenue increased $9.1 million; and Institutional segment revenue increased $13.6 million. The consolidated revenue increase was driven mainly by revenue associated with purchases of our independent research in connection with the Global Analyst Research Settlements; Morningstar.com Premium service; Internet advertising sales; Morningstar Advisor Workstation; Morningstar Managed Portfolios; Morningstar Retirement Manager (primarily resulting from the acquisition of mPower); and Investment Consulting. The revenue increase in these products and services was partially offset by lower revenue from some of our more mature products such as Reprints, *Morningstar Mutual Funds* , and *Morningstar FundInvestor* . Revenue from international operations increased $3.5 million, or 23.4%, to $18.4 million in the nine months ended September 30, 2004 compared with $14.9 million in the nine months ended September 30, 2003. Excluding the impact of currency translations, our international revenue increased approximately 14%.

Consolidated Operating Income (Loss)

Operating income increased $23.8 million during the period, reflecting the impact of our operating leverage (the relatively low level of variable cost of adding new customers) and lower stock-based compensation expense impacting all expense categories. The revenue increase of $28.5 million was partially offset by expense growth of approximately $4.7 million.

Cost of goods sold increased approximately $8.8 million, or 27.3%, to $41.0 million in the first nine months of 2004 from $32.2 million in the first nine months of 2003. The increase in cost of goods sold mainly reflects higher compensation costs relating to higher headcount across all of our business segments, increased incentive compensation related to operating and financial performance that exceeded internal estimates, and incentive compensation for our analyst team. These increases were partially offset by a reduction in stock-based compensation expense. As a percentage of revenue, cost of goods sold was 31.3% in the first nine months of 2004, compared with 31.5% in the first nine months of 2003.

Development expense decreased $0.1 million, or approximately 1%, to $11.1 million in the first nine months of 2004 from $11.2 million in the first nine months of 2003. The decrease mainly stems from lower stock-based compensation expense, partially offset by higher compensation (including incentive compensation). The amount of capitalized labor, primarily related to ongoing development of products such as Morningstar Direct, Morningstar Retirement Manager, and Morningstar Advisor Workstation was unchanged in the first nine months of 2004 compared with the same period in 2003. As a percentage of revenue, development expense was 8.5% in the first nine months of 2004, compared with 10.9% in the first nine months of 2003.

Sales and marketing costs increased $2.9 million, or 12.5%, to $26.0 million in the first nine months of 2004 from $23.1 million in the first nine months of 2003, largely because of higher compensation expense for our Advisor and Institutional businesses and increased marketing expense for our Individual business. As a percentage of revenue, sales and marketing expense was 19.9% in the first nine months of 2004, compared with 22.6% in the first nine months of 2003.

General and administrative expense decreased $7.3 million, or 19.1%, to $30.8 million in the first nine months of 2004 compared with $38.1 million in the first nine months of 2003. A $9.5 million reduction in stock-based compensation expense and lower sales tax expense in the first nine months of 2004 were partially offset by an increase in incentive compensation expense and corporate overhead. As a percentage of revenue, general and administrative expense was 23.5% in the first nine months of 2004, compared with 37.2% in the first nine months of 2003.

Stock-based compensation expense decreased $12.8 million, or 59.4%, to $8.8 million in the first nine months of 2004 from $21.6 million in the first nine months of 2003. The decrease reflects the fact that certain stock options granted in previous years are now fully vested and as a result no longer require recording additional expense. In addition, the $0.90 per share increase in the fair value of our common stock was significantly lower than the $5.55 per share increase in the fair value of our common stock in the comparable period of 2003. We did not grant any stock options in the first nine months of 2004.

Consolidated bonus expense increased approximately $8.5 million primarily because of our strong financial performance in 2004. The increase in bonus expense during the first nine months of 2004 also reflects accruals for a special bonus established for our analyst team. Costs for bonuses are reflected in each of the appropriate expense categories.

Depreciation and amortization costs increased approximately $0.5 million, or 9.0%, to $5.4 million in the first nine months of 2004 from $4.9 million in the first nine months of 2003. This increase was mainly driven by depreciation and amortization expense for computer equipment, leasehold improvements, and capitalized product development costs.

Consolidated Free Cash Flow

We generated approximately $13.3 million in free cash flow in the first nine months of 2004, reflecting cash provided by operating activities of $19.1 million and capital expenditures of $5.8 million. Free cash flow increased $2.2 million, due to the $1.6 million increase in cash provided by operations and the $0.6 million reduction in capital expenditures.

The increase in cash provided by operations reflects an increase in our net income adjusted for non-cash items, partially offset by an increase in working capital. Receivables from clients increased $3.9 million primarily as a result of increased billings. The increase in other assets of $1.7 million primarily reflects amounts that have been capitalized related to this offering. Accounts payable, accrued liabilities, and accrued compensation decreased $3.2 million, primarily due to payments related to bonuses and sales-tax related payments made in the first nine months of 2004.

Segment Business Results—Individual
Nine Months Ended September 30, 2004 vs. Nine Months Ended September 30, 2003

Our Individual segment provides products and services for the individual investor. The largest product in this segment is paid Premium service for our Web site, Morningstar.com. We also earn revenue from selling advertising on Morningstar.com. We offer various print publications on stocks and mutual funds, including our monthly newsletters, *Morningstar FundInvestor* and *Morningstar StockInvestor* , and our twice-monthly publication, *Morningstar Mutual Funds* . This business segment also produces independent research on stocks and funds. All of our Individual revenue is currently generated in the United States.

Revenue we generate from providing independent equity research associated with the Global Analyst Research Settlements, as discussed in "Business—Industry Overview," is included in our Individual segment. We expect that this new independent equity research business will have a material effect on the revenue, expense, and operating income of the Individual segment in the future. Under the terms of these settlements, which were made to resolve allegations of undue influence of investment banking interests on securities research, 10 leading Wall Street brokerage firms agreed to allocate approximately $432.5 million to pay for independent research. This amount will be paid through the engagement of numerous research providers under annual contracts over a five-year period. Each firm involved in the settlements is required to provide research from at least three providers of independent research that do not have ties to investment banking interests. We have entered into agreements with five major brokerage firms to provide independent equity research. Under the terms of the settlements, these agreements, together with the agreements entered into by all other research providers, expire in the second and third quarters of 2005.

Key Metrics ($000)	Nine Months Ended September 30 2003	2004	% Change
Revenue	$ 26,030	$ 33,096	27.1%
Operating income	$ 4,505	$ 3,414	(24.2)%
Operating margin (%)	17.3%	10.3%	NMF

NMF—Not meaningful

Revenue for the Individual segment increased $7.1 million in the first nine months of 2004 compared with the same period in 2003. The increase primarily reflects revenue relating to the Global Analyst Research Settlements. While we are confident in the quality and value of our equity research, we cannot guarantee that we will retain the business under our current agreements. We are pursuing opportunities to sell our stock research to firms that entered into agreements with other providers which are up for renewal. Additionally, we are marketing our equity research to financial service and brokerage firms not involved in the settlements. The remainder of the increase was driven by Morningstar.com, partially offset by lower revenue from some of our more mature products such as Reprints, *Morningstar Mutual Funds* , and *Morningstar FundInvestor*.

Operating income for the Individual segment decreased $1.1 million in the first nine months of 2004 compared with the same period in 2003, as expenses related to the expansion of our stock research capabilities, including the hiring of additional stock analysts, preceded revenue from the services we are providing under the Global Analyst Research Settlements. Cost of goods sold accounted for most of the expense increase and was driven by higher compensation costs, including special incentive compensation for our analyst team. Sales and marketing expense increased primarily as a result of marketing efforts for Morningstar.com Premium service. General and administrative costs increased due to higher corporate overhead. Depreciation and amortization costs increased slightly, reflecting refurbishment costs and network equipment additions.

Segment Business Results—Advisor
Nine Months Ended September 30, 2004 vs. Nine Months Ended September 30, 2003

Our Advisor segment focuses on products and services for financial advisors. Our key products in this segment are Advisor Workstation and Principia. Advisor Workstation is a Web-based investment planning system that provides financial advisors with a comprehensive set of tools for investment research, planning, and client presentations. Advisor Workstation is available in two editions: the Office Edition for independent financial advisors and the Enterprise Edition for financial advisors affiliated with larger firms. Principia is our CD-ROM-based investment research software. In addition, we offer Morningstar Managed Portfolios, a fee-based discretionary investment management program made up of mutual fund portfolios that financial advisors can use for their clients' taxable and tax-deferred accounts.

Key Metrics ($000)	Nine Months Ended September 30 2003	2004	% Change
Revenue	$ 36,209	$ 45,287	25.1%
Operating income	$ 6,729	$ 10,812	60.7%
Operating margin (%)	18.6%	23.9%	NMF

NMF—Not meaningful

Advisor Workstation and Morningstar Managed Portfolios made the largest contribution to the Advisor segment's revenue growth of $9.1 million in the first nine months of 2004. The increase in Advisor Workstation revenue is mainly from sales of the Enterprise Edition. The increase in revenue for Morningstar Managed Portfolios was driven by an increase in the amount of assets under management compared to the same period in 2003.

Operating income increased $4.1 million to $10.8 million in the first nine months of 2004, compared with operating income of $6.7 million in the same period in 2003. The $9.1 million increase in revenue was partially offset by a $5.0 million increase in operating expense. Cost of goods sold increased primarily as a result of higher compensation-related expense, including higher incentive compensation expense associated with favorable segment performance. Development expense increased primarily due to higher incentive compensation expense. Sales and marketing expense increased primarily due to higher sales commissions expense for products such as Advisor Workstation. General and administrative costs increased primarily because of higher corporate overhead.

Segment Business Results—Institutional
Nine Months Ended September 30, 2004 vs. Nine Months Ended September 30, 2003

Our Institutional products focus on Web-based investment software and electronic data feeds. We also offer print products and consulting services. Key products in this segment are Morningstar Direct, Morningstar Retirement Manager, Licensed Data, and Investment Consulting. For the nine months ended September 30, 2004, this segment represented, before intersegment eliminations, 43.9% of our consolidated revenue. We expect that the Institutional segment will continue to account for the largest portion of our consolidated revenue for the forseeable future.

	Nine Months Ended September 30		
Key Metrics	**2003**	**2004**	**% Change**
Revenue	$ 43,860	$ 57,534	31.2%
Operating income	$ 4,047	$ 10,693	164.2%
Operating margin (%)	9.2%	18.6%	NMF

NMF—Not meaningful

Revenue increased $13.6 million in the first nine months of 2004 compared with the same period in 2003, driven primarily by Investment Consulting, Licensed Data, Morningstar Direct, and Licensed Tools and Content. Morningstar Retirement Manager was another major contributor to revenue growth, partly due to our acquisition of mPower in July 2003, which represented $2.4 million of the Institutional segment revenue in the first nine months of 2004.

Operating income increased $6.7 million in the first nine months of 2004 compared with the same period in 2003. The increase was primarily due to revenue growth of $13.6 million. Operating expense increased approximately $6.9 million, or 17.7%, primarily reflecting increases in cost of goods sold, sales and marketing expense, and general and administrative expense. The increase in these categories was mainly driven by compensation-related expense, including incentive compensation and sales commissions, increased operating expense in our international operations, primarily in Europe, and our acquisition of mPower in July 2003.

Consolidated Business Results
2003 vs. 2002

Key Metrics ($000)	Year Ended December 31 2002	2003	% Change
Revenue	$ 109,619	$ 139,496	27.3%
Operating loss	(8,340)	(10,754)	28.9
Operating margin (%)	NMF	NMF	NMF
Stock-based compensation expense	7,292	29,029	298.1
Cash provided by (used for) investing activities	1,435	(20,481)	NMF
Cash used for financing activities	(1,952)	(26)	(98.7)
Cash provided by operating activities	$ 16,542	$ 29,705	79.6%
Capital expenditures	(5,989)	(8,607)	43.7
Free cash flow	$ 10,553	$ 21,098	99.9%

NMF—Not meaningful

Consolidated Revenue

In 2003, our revenue increased $29.9 million, reflecting strong demand for the products and services in each of our business segments. Price adjustments had minimal impact on revenue growth. Revenue in our Institutional segment increased $18.9 million; revenue in our Advisor segment increased $8.2 million; and revenue in our Individual segment increased $3.4 million. The consolidated revenue increase was driven mainly by increased sales of Advisor Workstation, Morningstar Retirement Manager, Licensed Data, Morningstar.com, and Morningstar Direct, partially offset by lower sales for some of our more mature products such as *Morningstar FundInvestor* and *Morningstar Mutual Funds* . Revenue from our largest-selling product, Principia, decreased less than 1% in 2003.

Top Five Products (Segment) 2002	Revenue ($000)	% Revenue	Top Five Products (Segment) 2003	Revenue ($000)
Principia (Advisor)	$ 29,056	26.5%	Principia (Advisor)	$ 28,856
Morningstar.com (Individual)	14,728	13.4	Licensed Data (Institutional)	22,453
Licensed Data (Institutional)	13,462	12.3	Morningstar.com (Individual)	16,312
Licensed Tools and Content (Institutional)	7,765	7.1	Advisor Workstation (Advisor)	10,799
Investment Profiles and Guides (Institutional)	5,828	5.3	Licensed Tools and Content (Institutional)	9,222

Our revenue from international operations increased $6.2 million, or 45.3%, to $20.1 million in 2003 from $13.9 million in 2002 and accounted for 14.4% of our 2003 total revenue. Licensed Tools and Content, Licensed Data, and Advisor Workstation were the biggest drivers of this international revenue growth. Currency translations contributed an additional $1.7 million, and the mPower acquisition added $2.1 million, to our 2003 revenue. Without the impact of currency translations and the mPower acquisition, our year-over-year revenue growth would have been approximately 24%.

Consolidated Operating Loss

Our operating loss increased $2.5 million, or 28.9%, to $10.8 million in 2003 from $8.3 million in 2002, reflecting an increase in operating expense of approximately $32.4 million, partially offset by the $29.9 million increase in revenue. The increase in operating expense was driven largely by stock-based compensation expense, which increased by $21.7 million, or 298.1%, from $7.3 million in 2002. $21.1 million of this increase was due to the increase in our estimated fair market value for options expensed under the liability method. See "—Stock-Based Compensation."

Cost of goods sold increased $4.5 million, or 11.5%, to $43.5 million in 2003 from $39.0 million in 2002. The increase in cost of goods sold mainly reflects a $3.2 million increase in stock-based compensation expense, as well as a $1.3 million increase in other compensation related expenses, primarily due to increased headcount and an increase in bonus expense. As a percentage of revenue, cost of goods sold was 31.2% in 2003, compared with 35.6% in 2002.

Development costs increased $2.8 million, or 23.4%, to $14.7 million in 2003 from $11.9 million in 2002. This increase mainly reflects approximately a $2.2 million increase in stock-based compensation expense. To a lesser degree, it reflects an increase in costs associated with continued development of products such as Morningstar Direct, Morningstar Retirement Manager, and Morningstar.com. As a percentage of revenue, development costs were 10.5% in 2003, compared with 10.8% in 2002.

Sales and marketing costs increased $5.8 million, or 23.2%, to $30.8 million in 2003 from $25.0 million in 2002, largely because of a $2.2 million increase in stock-based compensation expense. The remaining increase of $3.6 million in sales and marketing costs was due to higher commissions and larger sales teams for our institutional businesses. As a percentage of revenue, sales and marketing costs were 22.1% in 2003, compared with 22.8% in 2002.

General and administrative costs increased $17.6 million, or 48.3%, to $54.1 million in 2003 from $36.5 million in 2002. This change was mainly driven by a $14.2 million increase in stock-based compensation expense. We also recorded a $0.9 million reserve in conjunction with the Australian legal proceeding discussed in Note 15 of our Notes to Consolidated Financial Statements. As a percentage of revenue, general and administrative expenses increased to 38.8% in 2003 from 33.3% in 2002 primarily because of higher stock-based compensation expense.

Our bonus expense increased to $12.6 million in 2003 from $10.4 million in 2002 primarily because of strong performance in our Institutional segment. Costs for bonuses are reflected in each of the appropriate expense categories.

Depreciation and amortization costs increased $1.6 million, or 28.4%, to $7.1 million in 2003 from $5.5 million in 2002. This increase was mainly driven by depreciation and amortization charges for computer equipment, leasehold improvements, and capitalized product development for Advisor Workstation. Depreciation and amortization expenses accounted for 5.1% of revenue in both 2002 and 2003.

Consolidated Free Cash Flow

We generated $21.1 million in free cash flow in 2003, reflecting cash provided by operating activities of $29.7 million and capital expenditures of $8.6 million. Our capital expenditures in 2003 largely reflect refurbishment costs for our main office space in Chicago, capitalized labor for software development, and purchases of computer equipment. Our free cash flow in 2003 almost doubled from the previous year primarily due to a $13.2 million increase in cash provided by operations.

Segment Business Results—Individual
2003 vs. 2002

Key Metrics ($000)	Year Ended December 31 2002	2003	% Change
Revenue	$ 31,998	$ 35,406	10.7%
Operating income	$ 4,342	$ 7,391	70.2%
Operating margin (%)	13.6%	20.9%	NMF

NMF—Not meaningful

Revenue growth of $3.4 million for the Individual segment primarily reflects an increase in subscribers for our Morningstar.com Premium service, slightly offset by a decrease in revenue from *Morningstar Mutual Funds* . Subscriptions for Morningstar.com Premium service increased increased to 114,140 as of December 31, 2003, compared with 103,700 as of December 31, 2002. Four products contributed approximately 85% of revenue for the Individual segment during 2003: Morningstar.com, *Morningstar Mutual Funds* , *Morningstar StockInvestor* , and *Morningstar FundInvestor* .

Operating income for the Individual segment showed substantial improvement in 2003, as revenue growth far exceeded growth in operating expenses. Cost of goods sold decreased due to lower compensation expense, slightly offset by increased fulfillment costs due to higher numbers of subscribers. Development costs grew slightly, reflecting higher compensation expense. Sales and marketing expense increased 8.2% due to marketing programs for Morningstar.com and *Morningstar StockInvestor* . General and administrative costs decreased slightly, mainly because of lower corporate overhead costs. Depreciation and amortization costs increased $0.2 million, or 30.2%, reflecting refurbishment costs and network equipment additions. The improvement in operating margin to 20.9% in 2003 from 13.6% in 2002 is due primarily to the impact of our operating leverage (the relatively low level of variable cost of adding new customers). Most expense categories decreased as a percentage of revenue in 2003 compared with 2002.

Segment Business Results—Advisor
2003 vs. 2002

Key Metrics ($000)	Year Ended December 31 2002	2003	% Change
Revenue	$ 40,972	$ 49,161	20.0%
Operating income (loss)	$ (575)	$ 9,521	NMF
Operating margin (%)	NMF	19.4%	NMF

NMF—Not meaningful

The Advisor segment's revenue increased $8.2 million during the period. Advisor Workstation made the largest contribution to revenue growth in 2003. Both the Enterprise Edition and the Office Edition posted significant growth, primarily driven by an increase in the number of licenses. Morningstar Managed Portfolios also contributed to revenue growth due to an increase in the level of assets under management. Principia revenue was essentially unchanged as the number of subscriptions did not change significantly. The number of licenses and subscriptions for Advisor Workstation and Principia combined increased to approximately 101,000 as of December 31, 2003, compared with approximately 74,000 as of December 31, 2002.

The Advisor segment's operating results improved $10.1 million to operating income of $9.5 million in 2003 from an operating loss of $0.6 million in 2002. The improvement reflects an $8.2 million increase in revenue and a $1.9 million reduction in operating expense, primarily cost of goods sold. Production and fulfillment costs were lower because we switched to a less costly shipping vendor for Principia. Development costs also decreased due to lower new product development costs. For both sales and marketing and general and administrative costs, expense levels were approximately in line with the previous year.

Segment Business Results—Institutional
2003 vs. 2002

	Year Ended December 31		
Key Metrics ($000)	**2002**	**2003**	**% Change**
Revenue	$ 40,825	$ 59,745	46.3%
Operating income (loss)	$ (6,398)	$ 4,160	NMF
Operating margin (%)	NMF	7.0%	NMF

NMF—Not meaningful

Revenue grew $18.9 million driven by Licensed Data and Investment Consulting. Morningstar Retirement Manager was another major contributor to growth, partly due to our acquisition of mPower in July 2003, which accounted for $2.1 million of our 2003 revenue. Morningstar Direct, which we introduced in 2001, also contributed to sales growth.

With revenue growth far exceeding the increase in operating expense, Institutional segment operating income turned positive in 2003. Operating expense increased $8.4 million, or 17.7%.

Cost of goods sold increased because we hired more employees in Europe. Development cost also increased due to increased staffing. Sales and marketing cost increased due to an expansion of our sales force and higher commissions. General and administrative costs grew modestly.

Consolidated Business Results
2002 vs. 2001

Key Metrics ($000)	Year Ended December 31 2001	2002	% Change
Revenue	$ 91,230	$ 109,619	20.2%
Operating loss	(16,391)	(8,340)	(49.1)
Operating margin (%)	NMF	NMF	NMF
Stock-based compensation expense	5,667	7,292	28.7
Cash provided by investing activities	3,128	1,435	(54.1)
Cash used for financing activities	(1,049)	(1,952)	86.1
Cash provided by (used for) operating activities	$ (5,183)	$ 16,542	NMF
Capital expenditures	(5,932)	(5,989)	1.0%
Free cash flow	$ (11,115)	$ 10,553	NMF

NMF—Not meaningful

Consolidated Revenue

Our revenue growth in 2002 compared with 2001 was $18.4 million, reflecting strong demand for products and services in each of our business segments. Price adjustments had minimal impact on revenue growth. Revenue in our Institutional segment increased $8.3 million; revenue in our Advisor segment increased $6.2 million; and Individual segment revenue increased $4.4 million. On a product level, the consolidated revenue increase was driven by higher sales of Morningstar.com, Advisor Workstation, and Principia. This growth was partially offset by declining sales on some of our more mature print products, such as *Morningstar Mutual Funds* and *Morningstar FundInvestor* .

Top Five Products (Segment) 2001	Revenue ($000)	% Revenue	Top Five Products (Segment) 2002	Revenue ($000)
Principia (Advisor)	$ 25,979	28.5%	Principia (Advisor)	$ 29,056
Licensed Data (Institutional)	14,380	15.8	Morningstar.com (Individual)	14,728
Morningstar.com (Individual)	10,608	11.6	Licensed Data (Institutional)	13,462
Morningstar Mutual Funds (Individual)	6,337	6.9	Licensed Tools and Content (Institutional)	7,765
Investment Profiles and Guides (Institutional)	5,369	5.9	Investment Profiles and Guides (Institutional)	5,828

Our international operations contributed $13.9 million in revenue in 2002, an increase of $6.5 million, or 87.1%, compared with $7.4 million in 2001. International revenue made up 12.6% of total revenue in 2002, compared with 8.1% in 2001. Licensed Tools and Content was the biggest driver of revenue growth overseas.

Consolidated Operating Loss

We reduced our operating loss by $8.1 million, or 49.1%, to $8.3 million in 2002 from $16.4 million in 2001. We achieved this primarily through revenue growth of $18.4 million, which outpaced the $10.3 million increase in operating expense.

Cost of goods sold decreased $0.5 million, or 1.3%, to $39.0 million in 2002 from $39.5 million in 2001. The decrease was driven largely by reductions in staffing and fulfillment expense, partially offset by costs associated with our international operations. Cost of goods sold, as a percentage of revenue, decreased to 35.6% in 2002 from 43.3% in 2001, reflecting the impact of our operating leverage (the relatively low level of variable cost of adding new customers).

Development costs increased $4.2 million, or 54.6%, to $11.9 million in 2002 from $7.7 million in 2001. The increase was primarily due to higher compensation expense relating to Advisor Workstation, Morningstar Direct, and Morningstar Retirement Manager. As a percentage of revenue, development costs were 10.8% in 2002, compared with 8.4% in 2001.

Sales and marketing costs increased $4.3 million, or 21.0%, to $25.0 million in 2002 from $20.7 million in 2001. The increase mainly reflects higher compensation expense associated with additional sales staff for our Institutional and Advisor segments. As a percentage of revenue, sales and marketing expense was 22.8% in 2002, compared with 22.6% in 2001.

General and administrative costs increased $2.3 million, or 6.8%, to $36.5 million in 2002 from $34.2 million in 2001. The increase was driven in part by stock-based compensation expense, which increased $1.3 million, or 21.2%, to $7.5 million in 2002 from $6.2 million in 2001. Other contributors to higher general and administrative costs were a $0.5 million increase in sales tax expense and additional general and administrative staff for our international operations, partially offset by a $0.5 million reduction in corporate overhead. The increase in the sales tax expense is explained in "—Sales Tax Expense." As a percentage of revenue, general and administrative expense was 33.3% in 2002, compared with 37.5% in 2001.

In 2002 we incurred costs of $10.4 million, associated with our bonus program, compared with $8.7 million in 2001. The growth in bonus expense was primarily driven by strong results in our Individual segment. This bonus expense is reflected in each of the appropriate operating expense categories.

Depreciation and amortization costs were essentially unchanged in 2002 compared with 2001. These costs for both years mainly consisted of charges for computer equipment and capitalized labor. As a percentage of revenue, depreciation and amortization expense was 5.1% in 2002, compared with 6.1% in 2001.

Consolidated Free Cash Flow

Our free cash flow substantially improved in 2002, increasing $21.7 million to free cash flow of $10.6 million in 2002 from a cash burn of $11.1 million in 2001. This significant growth was mainly due to the improvement in cash provided by operating activities, which totaled $16.5 million in 2002, compared with a cash burn of $5.2 million in 2001. Capital expenditures, meanwhile, showed modest growth of 1.0% for the year, mainly due to computer equipment and capitalized software development costs. The change in deferred revenue contributed $14.6 million to cash provided by operating activities. This growth in deferred revenue resulted primarily from higher sales of our Institutional products, particularly Licensed Data.

Segment Business Results—Individual
2002 vs. 2001

Key Metrics ($000)	Year Ended December 31 2001	2002	% Change
Revenue	$ 27,642	$ 31,998	15.8%
Operating income (loss)	$ (1,508)	$ 4,342	NMF
Operating margin (%)	NMF	13.6%	NMF

NMF—Not meaningful

The $4.4 million increase in revenue was primarily due to an increase in subscribers for our Morningstar.com Premium service to 103,700 from 84,283. This increase was slightly offset by a decline in revenue in our more mature print products, *Morningstar Mutual Funds* and *Morningstar FundInvestor* .

Operating results improved $5.8 million to income of $4.3 million in 2002 from a loss of $1.5 million in 2001 due to the $4.4 million revenue increase and approximately a $1.4 million reduction in operating expense.

The decrease in operating expense was primarily driven by lower cost of goods sold, reflecting lower compensation expense as a result of reduced staffing and decreases in production and fulfillment costs. We achieved these savings by negotiating better terms with vendors, primarily for our print products. Development costs increased slightly, reflecting the cost of continued enhancements on Morningstar.com. This was partially offset by lower expense for technical infrastructure services as a result of switching vendors. Sales and marketing costs, as well as general and administrative expense, were essentially unchanged for the year. As a percentage of revenue, the cost of goods sold, sales and marketing, and general and administrative expense categories decreased in 2002 compared with 2001.

Segment Business Results—Advisor
2002 vs. 2001

Key Metrics ($000)	Year Ended December 31 2001	2002	% Change
Revenue	$ 34,823	$ 40,972	17.7%
Operating loss	$ (1,811)	$ (575)	(68.3)%
Operating margin (%)	NMF	NMF	NMF

NMF—Not meaningful

Revenue for this segment increased by $6.2 million largely driven by sales of Principia. The introduction of Advisor Workstation also contributed to revenue growth during 2002. The number of licenses for these products increased to approximately 74,000 subscriptions as of December 31, 2002 from approximately 52,000 subscriptions as of December 31, 2001.

The Advisor segment's operating loss decreased $1.2 million to $0.6 million in 2002 from $1.8 million in 2001, reflecting a $6.2 million increase in revenue and approximately a $5.0 million, or 13.4%, increase in operating expense.

Cost of goods sold increased mainly due to higher compensation costs because we hired more people to develop Advisor Workstation and to support Morningstar Managed Portfolios. This was partially offset by lower fulfillment costs for Principia. Sales and marketing costs also increased due to increased staffing for our sales force for Advisor Workstation and Morningstar Managed Portfolios. General and administrative costs decreased in 2002 because 2001 included costs associated with launching Morningstar Managed Portfolios.

Segment Business Results—Institutional
2002 vs. 2001

Key Metrics ($000)	Year Ended December 31 2001	2002	% Change
Revenue	$ 32,542	$ 40,825	25.5%
Operating loss	$ (7,780)	$ (6,398)	(17.8)%
Operating margin (%)	NMF	NMF	NMF

NMF—Not meaningful

Revenue increased $8.3 million, driven mainly by higher sales of Investment Consulting and Licensed Tools and Content.

Despite strong revenue growth, operating results improved only moderately. We had losses in both years mainly because of our international operations.

The Institutional segment's operating expense increased $6.9 million, driven largely by higher general and administrative, sales and marketing, and development expense. Cost of goods sold increased slightly, as higher production expense was offset by decreases in compensation and fulfillment costs. Sales and marketing costs increased because we expanded our sales force. General and administrative costs grew primarily due to increases in staff for our European operations. In addition, we incurred costs to develop and produce a new corporate marketing catalog. Depreciation and amortization costs increased slightly, mainly due to purchases of computer equipment in the latter part of the year.

Selected Quarterly Financial Data

(in thousands except per share amounts)	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Restated (1) Q1	2003 Restated (1) Q2	2003 Restated (1) Q3	2003 Restated (1) Q4	2004 Q1	2004 Q2	2004 Q3
Revenue	$ 25,222	$ 27,115	$ 27,528	$ 29,754	$ 32,138	$ 34,315	$ 35,940	$ 37,103	$ 41,127	$ 43,244	$46,573
Operating expense:											
Cost of goods sold	8,856	10,043	9,859	10,277	10,744	10,657	10,826	11,294	12,266	14,908	13,858
Development	2,977	2,892	2,880	3,132	3,989	3,855	3,334	3,485	3,361	3,664	4,057
Sales and marketing	5,969	7,028	6,845	5,150	8,334	7,358	7,436	7,670	8,365	8,284	9,367
General and administrative	9,477	10,426	10,583	6,018	13,136	12,837	12,111	16,061	8,688	11,176	10,930
Depreciation and amortization	1,418	1,327	1,433	1,369	1,340	1,646	1,925	2,212	1,811	1,788	1,755
Total operating expense	28,697	31,716	31,600	25,946	37,543	36,353	35,632	40,722	34,491	39,820	39,967
Operating income (loss)	(3,475)	(4,601)	(4,072)	3,808	(5,405)	(2,038)	308	(3,619)	6,636	3,424	6,606
Non-operating income (expense):											
Gain on sale of investment in unconsolidated entity	—	—	3,398	—	—	—	—	510	—	—	—
Interest income, net	236	186	242	378	59	115	62	43	224	210	260
Other income (expense), net	31	19	16	(43)	6	29	33	253	38	58	250
Non-operating income, net	267	205	3,656	335	65	144	95	806	262	268	510
Income (loss) before income taxes, equity in net income (loss) of unconsolidated entities, minority interest in net loss (income) of consolidated entities, and extraordinary gain	(3,208)	(4,396)	(416)	4,143	(5,340)	(1,894)	403	(2,813)	6,898	3,692	7,116
Income tax expense (benefit)	(915)	(682)	(616)	1,902	501	1,459	1,772	(782)	2,674	2,440	3,235
Equity in net income (loss) of unconsolidated entities	(379)	946	154	29	116	351	(47)	277	282	97	212
Minority interest in net loss (income) of consolidated subsidiaries	72	84	58	(36)	—	—	—	—	—	—	—
Income (loss) before extraordinary gain	(2,600)	(2,684)	412	2,234	(5,725)	(3,002)	(1,416)	(1,754)	4,506	1,349	4,093
Extraordinary gain—acquisition	—	—	—	3,084	—	—	—	—	—	—	—
Net income (loss)	$ (2,600)	$ (2,684)	$ 412	$ 5,318	$ (5,725)	$ (3,002)	$ (1,416)	$ (1,754)	$ 4,506	$ 1,349	$ 4,093
Basic income (loss) per share	$ (0.07)	$ (0.07)	$ 0.01	$ 0.14	$ (0.15)	$ (0.08)	$ (0.04)	$ (0.05)	$ 0.12	$ 0.04	$ 0.11
Weighted average common shares outstanding—basic	38,337	38,343	38,348	38,352	38,366	38,373	38,391	38,395	38,395	38,397	38,438
Diluted income (loss) per share	$ (0.07)	$ (0.07)	$ 0.01	$ 0.02	$ (0.15)	$ (0.08)	$ (0.04)	$ (0.05)	$ 0.11	$ 0.03	$ 0.10
Weighted average common shares outstanding—diluted	40,558	40,686	40,536	40,321	38,366	38,373	38,391	38,395	41,546	41,528	41,819

(1) The 2003 quarterly financial data has been restated to properly allocate the change in stock-based compensation expense based on the fair value per share of our common stock for each interim quarterly period. We previously recorded the increase in stock-based compensation expense attributed to the change in the fair value of our common stock for the period January 1, 2003 to December 31, 2003, in the fourth quarter of 2003. In addition, an adjustment to interest income, net, which was originally recorded during the fourth quarter of 2003 has been properly allocated to each interim quarterly period. The following table reflects the originally reported amounts:

	2003 (as originally reported) Q1	Q2	Q3	Q4
Cost of goods sold	$ 10,175	$ 10,143	$ 10,574	$ 12,629
Development	3,514	3,484	3,124	4,541
Sales and marketing	7,861	6,987	7,234	8,716
General and administrative	9,222	9,617	10,006	25,300
Depreciation and amortization	1,340	1,646	1,925	2,212
Total operating expense	$ 32,112	$ 31,877	$ 32,863	$ 53,398
Operating income (loss)	$ 26	$ 2,438	$ 3,077	$ (16,295)
Interest income, net	$ 116	$ 173	$ 119	$ (129)
Non-operating income, net	$ 122	$ 202	$ 152	$ 634
Income (loss) before income taxes, equity in net income (loss) of unconsolidated entities, minority interest in net loss (income) of consolidated entities, and extraordinary gain	$ 148	$ 2,640	$ 3,229	$ (15,661)
Income (loss) before extraordinary gain	$ (237)	$ 1,532	$ 1,410	$ (14,602)

Net income (loss)	$ (237)	$ 1,532	$ 1,410	$ (14,602)
Basic income (loss) per share	$ (0.01)	$ 0.04	$ 0.04	$ (0.38)
Diluted income (loss) per share	$ (0.01)	$ 0.04	$ 0.03	$ (0.38)
Weighted average common shares outstanding—diluted	40,228	40,233	40,207	38,395

Sales Tax Expense

During 2003, we participated in voluntary disclosure or similar programs related to state sales tax. Through these programs we identified sales tax amounts due for prior years and have negotiated or are in discussions with local tax authorities to settle these amounts. We have recorded expense in the four years in which the sales tax amounts apply, as follows:

	Year Ended December 31			
($000)	**2000**	**2001**	**2002**	**2003**
Sales Tax Expense	$ 807	$ 2,294	$ 2,837	$ 3,079

We made cash payments in conjunction with these voluntary disclosure programs of $1.6 million in 2003. We anticipate that most of the remaining $7.4 million expected to be due in connection with state sales tax for periods ended on or before December 31, 2003 will be paid in 2004. We do not expect to record any expenses related to these programs after 2003. We have now put in place procedures to collect applicable sales tax from our customers.

Non-Operating Income

The following table presents the components of our non-operating income for the following periods:

	Year Ended December 31			Nine Months Ended September 30	
Non-Operating Income ($000)	**2001**	**2002**	**2003**	**2003**	**2004**
Gain on sale of investment in unconsolidated subsidiary	$ —	$ 3,398	$ 510	$ —	$ —
Interest income, net	1,559	1,042	279	236	694
Other income (expense), net	(883)	23	321	68	346
Non-operating income	$ 676	$ 4,463	$ 1,110	$ 304	$ 1,040

In 2002, we sold our investment in Techfi Corporation, a provider of portfolio management and accounting software, resulting in a pre-tax gain of $3.4 million. In 2003, we also recorded a pre-tax gain of $0.5 million related to this transaction when funds were released from escrow.

Net interest income primarily reflects interest from our investment portfolio. The decline in interest income in 2003 compared to 2002 is due to lower returns on invested cash balances. We also paid interest expense of $0.4 million, $0.2 million, and $0.2 million in 2001, 2002, and 2003 respectively, related to the note payable to Joe Mansueto. This note was repaid on March 30, 2004.

Other income (expense) primarily represents royalty income from Morningstar Japan, realized gains and losses on our investment portfolio, and settlement of foreign currency exchange gains and losses arising from the ordinary course of business in our international operations.

Income Tax Expense (Benefit)

Following our conversion from an S Corporation to a C Corporation on September 1, 1999, we have generated net operating losses (NOLs). These losses created a future tax benefit, recorded on our balance sheet as a deferred tax asset, because we are allowed to use them to offset future taxable net income. Because of these NOLs, we have paid nominal corporate income tax through the end of 2003. We used $14.4 million of these NOLs in 2003. Additionally, we acquired NOLs through our acquisition of mPower that we do not expect to have a material impact on our tax situation. Based on planned operating results, excluding NOLs acquired in the mPower acquisition, we anticipate using substantially all of our NOLs in 2004. We have recorded a valuation allowance related to the portion of our NOLs from the mPower acquisition as use of these NOLs is limited to approximately $200,000 per year by the U.S. Internal Revenue Service. For more information, see Note 14 of our Notes to the Consolidated Financial Statements.

Our stock-based compensation related to non-qualified options generates a deferred tax asset. While we deduct this expense to calculate our operating income, it is not deductible for tax purposes until employees exercise their options. This timing difference creates an asset, which we may use over the remaining life of the outstanding options as the options are exercised.

For the nine months ended September 30, 2004, our income before income taxes and equity in net income of unconsolidated entities was $17.7 million, and our income tax expense was $8.3 million. Our effective tax rate for the nine months ended September 30, 2004 was 47.2%. For the nine months ended September 30, 2003, our loss before income taxes and equity in net income of unconsolidated entities was $6.8 million and our income tax expense was $3.7 million. For both periods, the tax provision reflects the impact of expense related to incentive stock options for which no tax benefit is recorded and the fact that we are not recording a tax benefit related to losses recorded by our non-U.S. operations.

In 2003 and 2002, our effective tax rates were higher than the federal statutory tax rate of 35.0% in part because the losses generated by our foreign entities are not included in our consolidated operations for U.S. tax purposes. Because these losses are excluded from our taxable income, our tax expense is higher. However, these losses lower our reported net income. The net effect increases our tax expense as a percentage of total pretax net income. These foreign NOLs should become deductible in international tax jurisdictions to the extent our international operations become profitable.

Extraordinary Gain

In 2002, we recorded an extraordinary gain of $3.1 million related to our acquisition of an interest in Morningstar Asia. The fair value of Morningstar Asia's net assets exceeded the purchase price. For more information, see Note 6 of our Notes to the Consolidated Financial Statements.

Liquidity and Capital Resources

General. We believe that our available cash balances and investments, along with any cash generated from operations and the net proceeds from this offering, will be sufficient to meet our operating and cash needs for the foreseeable future. We expect this offering to add $ million to our cash, cash equivalents, and investments, using an assumed initial public offering price of $ (the midpoint of the range set forth on the cover of this prospectus). We invest our cash reserves in cash, cash equivalents, and fixed-income securities.

These investments have a weighted average maturity of six months, and no single security has a maturity greater than two years.

Cash and cash equivalents. At September 30, 2004 we had cash and cash equivalents of $52.5 million, a decrease of $1.0 million compared with December 31, 2003. The decrease reflects bonus payments made in the first nine months of 2004 which related to 2003 performance, an initial installment of incentive compensation for the analyst team, transfers from cash and cash equivalents into our portfolio of investments in fixed income and debt securities, and repayment of our note payable to Joe Mansueto, chairman, chief executive officer, and controlling shareholder. These items were partially offset by an increase in cash provided by operating activities. In addition to the $52.5 million of cash and cash equivalents at September 30, 2004, we had $30.2 million of investments, consisting primarily of fixed income and debt securities.

Cash provided by (used for) operating activities. Our main source of capital is cash generated from operating activities. Cash flows generated by operating activities increased $1.6 million in the first nine months of 2004 compared to the first nine months of 2003. The increase mainly reflects improvement in our operating results partially offset by an increase in working capital. Receivables from clients increased $3.9 million in the first nine months of 2004 primarily as a result of increased billings. The increase in other assets of $1.7 million primarily reflects amounts that have been capitalized related to this offering. Accounts payable, accrued liabilities, and accrued compensation decreased $3.2 million, primarily due to payments related to bonuses and sales-tax related payments made in the first nine months of 2004.

Net cash provided by operating activities was $29.7 million in 2003, compared with $16.5 million in 2002. This increase of 79.6% was primarily driven by improvement in our operating results adjusted for non-cash items and a reduction in working capital.

Because we frequently collect cash in advance of providing services or fulfilling subscriptions for our customers and use some of that cash to fund other activities, we often have significant deferred revenue, which is shown as a liability on our balance sheet. This means that our working capital may at times be negative. At December 31, 2003, 2002, and 2001 our deferred revenue was $55.6 million, $47.7 million, and $33.7 million, respectively. At September 30, 2004 our deferred revenue was $56.4 million.

Cash used for investing activities. Cash flows used for investing activities were $13.5 million in the first nine months of 2004 and $24.0 million in the first nine months of 2003. The decrease is attributed primarily to lower levels of cash used for acquisitions. In the nine months ended September 30, 2004, cash used for acquisitions was $0.2 million related to our purchase of the remaining 51% of Morningstar Norge AS (Morningstar Norway). In the first nine months of 2003, cash used for acquisitions, net of cash acquired, was $10.4 million, related to our acquisitions of Morningstar Research Inc. (Morningstar Canada) and mPower. Our capital expenditures were $5.8 million in the first nine months of 2004 compared to $6.4 million in the first nine months of 2003. At September 30, 2004 our investments, consisting primarily of fixed income and debt securities, were $30.2 million, an increase of $7.6 million compared to December 31, 2003.

Capital expenditures were $8.6 million, $6.0 million, and $5.9 million in 2003, 2002, and 2001, respectively. Capital expenditures are primarily for computer hardware and capitalized product development costs.

Proceeds from the sale of investments in an unconsolidated entity were $0.5 million in 2003 and $4.8 million in 2002. These proceeds relate to cash received upon the sale of our investment in Techfi Corporation and the subsequent release of funds from escrow.

In 2003, cash used for acquisitions, net of cash acquired, was $10.8 million related to our acquisitions of mPower and the remaining interest in Morningstar Canada. Cash provided from acquisitions was $3.5 million in 2002 related to our acquisition of an interest in Morningstar Asia.

Cash used for financing activities. Cash used for financing activities consists primarily of payments of long-term debt and capital lease obligations and cash paid for purchases of our stock.

The current portion of long-term debt was approximately $6.6 million at December 31, 2003, which primarily represented a promissory note payable to Joe Mansueto, chairman, chief executive officer, and controlling shareholder. The obligation and related interest were paid in full on March 30, 2004. See Note 9 of our Notes to the Consolidated Financial Statements and "Certain Relationships and Related Party Transactions—Transactions Involving Joe Mansueto."

There were no proceeds from issuances of notes payable in the nine months ended September 30, 2004 or in the years 2003 and 2002. In 2001, proceeds from issuing notes payable were $0.6 million, reflecting proceeds from a promissory note we issued to the minority shareholder of Morningstar Canada. This note was repaid during 2002.

Under the 1993 Morningstar Stock Option Plan, subject to certain conditions, holders of vested options are permitted to exercise their options and immediately resell to us the shares of common stock obtained from such exercise at a price equal to the fair market value of such shares, as determined by our board of directors. We have the right to pay this purchase price in equal installments over a period of five years, with the deferred purchase price accruing interest at a floating rate based on 13-week U.S. Treasury securities. As of September 30, 2004, we recorded among our long-term liabilities $1.2 million of deferred obligations relating to such repurchases. We expect to satisfy these obligations in full by 2007, with approximately $0.9 million coming due in the next twelve months. Upon completion of this offering, holders of the options issued under our 1993 Option Plan will no longer have the right to require us to repurchase any shares obtained upon exercise of such options and the long-term liability associated with these options will be reclassified to shareholders' equity.

Acquisitions

Variable Annuity Research and Data Service

In January 2005, we acquired Finetre Corporation's Variable Annuity Research and Data Service (VARDS) unit for $9 million in cash, subject to an adjustment for working capital. Founded in 1988, VARDS provides research and data on variable annuity products and is used by many firms that offer variable annuities. The service is also used by many brokerage firms for research, due diligence, and suitability determination. We believe this acquisition strengthens our investment database and should help provide investors with the information they need to make well-informed decisions when investing in variable annuities.

Morningstar Norway

In February 2004, we purchased the remaining 51% of Morningstar Norway that we did not previously own. The purchase price consisted of $0.2 million in cash and approximately $0.1 million of other consideration. Prior to this transaction, our investment in Morningstar Norway was accounted for by the equity method.

mPower

In July 2003, we acquired all of the outstanding stock of mPower. For 2003, mPower contributed $2.1 million to our revenue. This transaction is accounted for as a "bargain purchase" because the purchase price was less than the total fair value of the assets acquired. Therefore, certain long-term assets were allocated values that were lower than their fair value at the date of acquisition. In Note 6 of our Notes to the Consolidated Financial Statements included elsewhere in this prospectus, we show our summary pro forma consolidated results as if we had owned mPower for the full year. Also included in this prospectus are Unaudited Pro Forma Consolidated Statement of Operations for 2003 that gives effect to our acquisition of mPower as if it had occurred on January 1, 2003 and mPower's consolidated financial statements for the years ended December 31, 2001 and 2002.

Morningstar Canada

In January 2003, we purchased the remaining half of Morningstar Canada that we did not previously own. We have always consolidated the results of Morningstar Canada for all periods presented in the financial statements because we have always controlled its day-to-day operations.

Morningstar Asia

In October 2002, we purchased the 60.1% of Morningstar Asia owned by Advanced Internet Visions Limited (a joint venture between Pacific Century Cyberworks Limited and Pacific Century Insurance Company Limited) and various Softbank entities, our partners in the joint venture created in April 2000. Through this transaction we obtained 100% ownership of Morningstar Asia. Because the purchase price was lower than the value of the net assets acquired, we recognized an extraordinary gain of $3.1 million in 2002. Following this increase of our ownership, we began consolidating the results of Morningstar Asia's operations in our own financial statements. The impact on our 2003 results was not significant.

Application of Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our Consolidated Financial Statements, which have been prepared in accordance with GAAP. Our significant accounting policies are discussed in Note 2 of our Notes to the Consolidated Financial Statements. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities (including the recoverability of tangible and intangible assets and disclosure of contingent assets and liabilities as of the date of the financial statements). Management estimates and assumptions also affect the reported amounts of revenue and expense during the reported period.

We evaluate our estimates on an ongoing basis. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results of these assumptions form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could vary from the estimates and assumptions used in the preparation of our

Consolidated Financial Statements. If actual amounts are ultimately different from previous estimates, the revisions are included in our results of operations for the period in which the actual amounts become known.

We believe the following critical accounting policies reflect the significant judgments and estimates used in the preparation of our Consolidated Financial Statements:

Revenue Recognition. Much of our revenue comes from the sale of subscriptions or licenses for printed publications and software. We recognize this revenue in equal amounts over the term of the subscription or license, which generally ranges from one to three years. We also provide analysis, consulting, retirement advice, and other services. We recognize this revenue when the service is provided or during the service obligation period defined in the contract. Deferred revenue is the amount paid in advance for subscriptions, licenses or services that has not yet been recognized as revenue. At December 31, 2002 and 2003 and at September 30, 2004 our deferred revenue was $47.7 million, $55.6 million, and $56.4 million, respectively. This deferred revenue is expected to be recognized in future periods as we fulfill our service obligations. The amount of deferred revenue may increase or decrease primarily based on the mix of contracted product and services, and the volume of new and renewal subscriptions. We believe that the estimate related to revenue recognition is a critical accounting estimate because to the extent that there are material differences between our determination of deferred revenue and actual results, our financial condition or results of operations may be affected.

Computer Software and Development. We capitalize certain costs associated with computer software and software development according to Statement of Position 98-1 , *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, and Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.* Product development costs consist primarily of the compensation costs associated with developing new Web-based products and certain enhancements of existing products. We also develop software that enables users to access information on our Web site through subscription services. We amortize these development costs on a straight-line basis over their estimated remaining economic life, which is generally three years.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* , we review long-lived assets, such as property, equipment, and purchased intangibles subject to amortization for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We measure recoverability of assets to be held and used by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, we recognize an impairment charge equal to the amount by which the carrying amount of the asset exceeds the fair value of the asset.

We believe that the estimate related to accounting for the impairment or disposal of long-lived assets is a critical accounting estimate because the assumptions used are highly susceptible to changes in the operating results and cash flows of our operations. Historically, the estimated amounts of undiscounted cash flows generated by the assets have not differed materially from the actual cash flows generated from those assets in subsequent periods. Additionally, we have not recorded an impairment of long-lived assets during any period between 2001 and 2003, or in the first nine months of 2004. We had recorded net property equipment and capitalized software of $15.3 million, $17.6 million and $18.2 million as of December 31, 2002 and 2003 and September 30, 2004, respectively, which are subject to testing for impairment.

Goodwill and Other Intangible Assets. We adopted SFAS No. 142, *Goodwill and Other Intangible Assets,* on January 1, 2002. Under this standard, goodwill and intangible assets with indefinite lives are no longer amortized. Instead, they are subject to an annual test for impairment based on a discounted cash flow model. The approach that we use to estimate the fair value of components of our segments is dependent on a number of factors, including estimates of future market growth and trends, forecasted revenue and costs, capital investments, appropriate discount rates, certain assumptions to allocate shared assets and liabilities, and other variables which can significantly affect the value of the intangible asset. We base our fair value estimates on assumptions we believe to be reasonable, but these assumptions are unpredictable and inherently uncertain. Actual future results may differ from those estimates. These assumptions are updated annually, at a minimum, to reflect information concerning components of our segments.

We believe that the accounting estimate related to goodwill and other intangible asset impairment is a critical accounting estimate because the assumptions used are highly susceptible to changes in the operating results and cash flows of components of our segments. Historically, the estimated results of our discounted cash flow models have not differed materially from the actual results of operations in subsequent periods. Based on current estimates, we do not expect to make significant changes to the assumptions used in our discounted cash flow model during 2004. Additionally, we have not recorded an impairment of goodwill or any other intangible asset during any period between 2001 and 2003, or in the nine months ended September 30, 2004. We had recorded total goodwill and net intangible assets of $6.0 million, $15.9 million, and $15.8 million as of December 31, 2002 and 2003 and September 30, 2004, respectively, which are subject to testing for impairment.

Stock-Based Compensation. We have adopted SFAS No. 123, *Accounting for Stock-Based Compensation* , to account for stock option grants made to employees and non-employee directors. SFAS No. 123, (Revised 2004) *Share-Based Payment* , which will require all public companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, will be effective for interim or annual periods beginning after June 15, 2005. We are in the process of reviewing the impact of the provisions of SFAS No. 123 (Revised 2004), *Share-Based Payment* , on our current practice of voluntarily recognizing stock-based compensation expense.

In accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* , we use the following two accounting methods:

For options granted under plans that may require us to settle the options in cash, we use the liability method. The liability is valued using a fair value price of our common shares. This method requires that we make several estimates concerning the future cash flows, including estimates of future market growth and trends, forecasted revenue and costs, capital investments, appropriate discount rates, certain assumptions to allocate shared assets and liabilities, and other variables. We base our fair value estimates on assumptions we believe to be reasonable, but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates. In both 2001 and 2002 we recorded stock-based compensation income of $3.3 million based on the liability method. In 2003, we recorded stock-based compensation expense of $17.8 million based on the liability method. A $1 increase/decrease in the valuation of our common stock at December 31, 2003 would have resulted in an increase/decrease of approximately $3.0 million in stock-based compensation expense for options using the liability method for the year ended December 31, 2003.

For options outstanding under plans that do not require us to settle the options in cash, we use the equity method. We calculate the expense under this method based on the Black-Scholes value of the option at the time of the grant. We record this expense as the options vest, typically in equal amounts over four years. This method requires that we make several estimates, including the volatility of our stock price, the expected option forfeiture rate, and the expected life of the option. In making these estimates, we have used historical data as well as management judgment to arrive at the data inputs. In 2001, 2002 and 2003 the stock-based compensation expense recorded under the equity method was $9.0 million, $10.6 million, and $11.2 million, respectively. A 1% increase/decrease in the Black-Scholes value of the option would have resulted in an increase/decrease of $0.1 million stock-based compensation expense for options accounted for using the equity method for the year ended December 31, 2003.

We believe that the accounting estimates related to stock-based compensation expense are critical accounting estimates because the assumptions used are highly susceptible to changes in our operating results and cash flows.

Quantitative and Qualitative Disclosures about Market Risk

We may be subject to risk from fluctuating interest rates. As of September 30, 2004, our portfolio of cash, cash equivalents, and investments had a weighted average maturity of less than six months, and no single investment in the portfolio had a maturity greater than two years. Our investment portfolio is actively managed and may suffer losses due to fluctuating interest rates, market prices, or adverse security selection. At September 30, 2004, our investments, consisting primarily of fixed-income and debt securities, were $30.2 million. Based on our estimates, a 100 basis point change in interest rates would have increased or decreased the fair value of our investment portfolio by approximately $0.2 million.

As our non-U.S. revenue increases as a percentage of revenue, fluctuation in foreign currencies is an increasing 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.

Contractual Obligations

The following table presents our known contractual obligations as of December 31, 2003 and the expected timing of cash payments related to these contractual obligations:

	Year Ending December 31						
Contractual Obligations ($000)	**2004**	**2005**	**2006**	**2007**	**2008**	**Thereafter**	**Total**
Capital lease obligations	$ 44	$ 12	$ —	$ —	$ —	$ —	$ 56
Bank loans	33	—	—	—	—	—	33
Note payable (1)	6,500	—	—	—	—	—	6,500
Minimum commitments on non-cancelable lease obligations (2)	1,788	1,454	1,347	1,024	844	70	6,527
Obligations related to stock options (3)	958	909	105	57	—	—	2,029
Obligations related to previous purchases of common stock (3)	411	388	5	—	—	—	804
Total	$ 9,734	$ 2,763	$ 1,457	$ 1,081	$ 844	$ 70	$ 15,949

(1) The note payable represents borrowings from Joe Mansueto. The note was repaid on March 30, 2004.

(2) The non-cancelable lease obligations relate primarily to lease commitments on office space.

(3) These obligations relate to stock option exercises and common stock purchases. See Note 12 of our Notes to the Consolidated Financial Statements.

In addition, we have an obligation to pay up to $2.3 million under a deferred compensation agreement with Don Phillips, discussed in Note 11 of our Notes to the Consolidated Financial Statements. On our 2003 Consolidated Balance Sheet, $1.9 million is classified as current and $0.4 million is classified as long-term. We are required to make these payments as he exercises certain stock options granted to him under the 1999 Stock Option Plan. As the timing of these payments is uncertain, we have not included this obligation in the above table.

There are no purchase commitments as of December 31, 2003 that we believe would have a significant impact on our Consolidated Balance Sheet or Consolidated Statement of Cash Flows.

Recently Issued Financial Accounting Standards

In December 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. This Interpretation replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, which was issued in January 2003. We will be required to apply Interpretation No. 46 (revised December 2003) to variable interests in variable interest entities created after December 31, 2003. We currently do not have any controlling financial interests that meet the requirements of this interpretation.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* . This statement establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. The statement also includes required disclosures for certain financial instruments within its scope. The statement was effective for instruments entered into or modified after May 31, 2003 and otherwise became effective as of January 1, 2004, except for mandatorily redeemable financial instruments. For certain mandatorily redeemable financial instruments, SFAS No. 150 became effective on January 1, 2005. The effective date has been deferred indefinitely for certain other types of mandatorily redeemable financial instruments. We currently do not have any financial instruments that are within the scope of SFAS No. 150.

In December 2003, the FASB revised SFAS No. 132 *, Employers' Disclosures about Pensions and Other Postretirement Benefits* . The disclosure requirements of SFAS No. 132 were revised to require more complete information in both annual and interim financial statements about pension and postretirement benefits as well as to increase the transparency of the financial reporting related to those plans and benefits. Except as noted, the revised disclosure requirements are effective for financial statements with fiscal years ending after December 15, 2003. The interim-period disclosures required by the revised statement are effective for periods beginning after December 15, 2003. The additional disclosure of information about foreign plans required by the revised statement is effective for fiscal years ending after June 15, 2004. We currently do not have any pension or other postretirement benefit obligations that are within the scope of SFAS No. 132.

In October 2004, the FASB concluded that SFAS No. 123 (Revised 2004), *Share-Based Payment* , which will require all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, will be effective for public companies (except small business issuers as defined in SEC Regulation S-B) for interim or annual periods beginning after June 15, 2005. We are in the process of reviewing the impact of the provisions of SFAS No. 123 (Revised 2004), *Share-Based Payment* , on our current practice of voluntarily recognizing stock-based compensation expense.

Business

Industry Overview

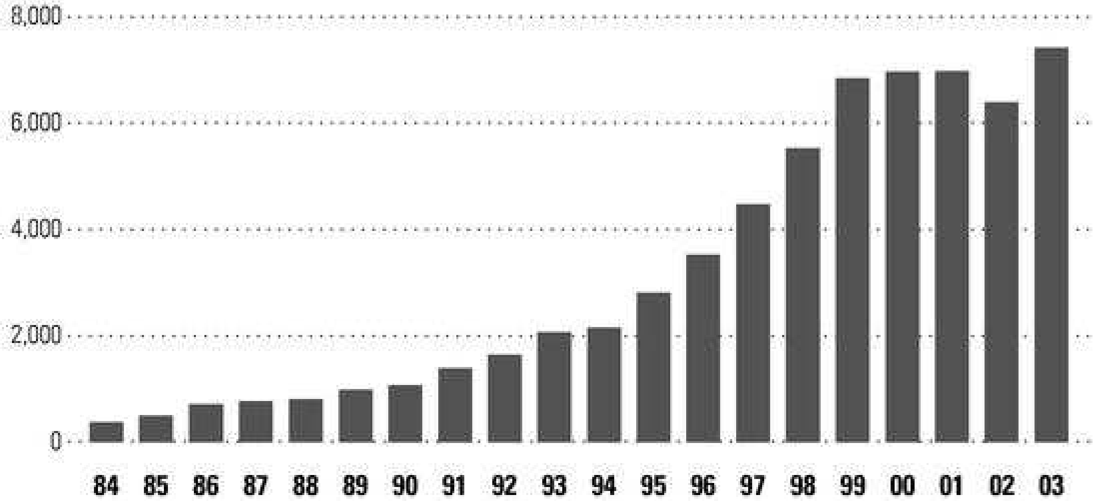
We operate in the economic and financial segment of the business information industry. With a total market size of approximately $15.7 billion in 2002, this segment represents the largest component of the business information market. A report published by Veronis Suhler Stevenson in July 2004 projects that spending on economic and financial data will increase by an average of 7.2% per year from 2004 to 2008, with industry sales reaching $23.7 billion by 2008.

We divide our market into three segments: individual investors; financial advisors; and institutions such as banks, insurance companies, mutual fund companies, brokerage firms, and retirement plan providers and sponsors. The individual investor market consists of approximately 84.3 million investors in the United States, according to the Equity Ownership in America report published by the Investment Company Institute (ICI) and the Securities Industry Association in 2002 (the EOA report), and an equal or greater number in major international markets. We estimate that there are approximately 285,000 financial advisors in the United States and an additional 410,000 in major international markets. In the institutional segment, we estimate that there are approximately 4,000 financial institutions in the United States, and an additional 5,000 in major international markets.

We believe a number of trends should support continued demand for economic and financial data. At the broadest level, the U.S. financial services industry has experienced significant growth over the past 30 years. Fueling this growth have been rising equity markets and a shift away from traditional bank savings accounts to investment-related assets, such as stocks, bonds, and mutual funds. The total value of assets in these securities, according to Federal Reserve data, increased from $765 billion (45% of total household liquid financial assets) in 1975 to $11.2 trillion (73% of total household liquid financial assets) in mid-2003.

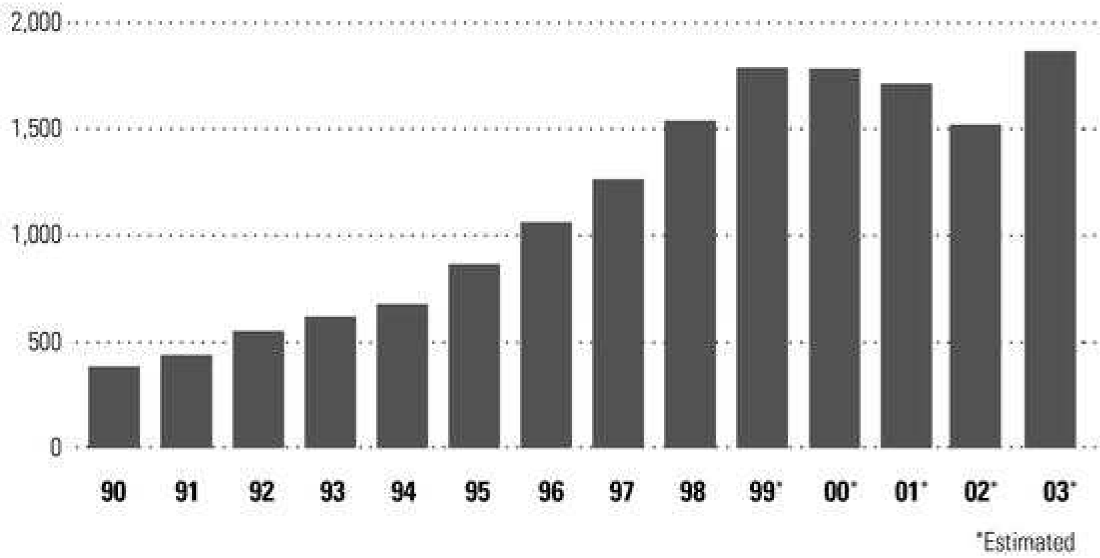
Household ownership of equity securities has also increased dramatically, with 49.5% of U.S. households owning stocks or stock mutual funds as of December 2002 compared with 19.0% in 1983, according to the EOA report. Based on ICI data, total assets in U.S.-based mutual funds have grown from $370.7 billion in 1984 to $7.4 trillion as of December 2003, representing a compound annual growth rate of 17.1%. Meanwhile, the total number of mutual funds (not including money-market funds or multiple share classes) has increased from 818 in 1984 to 7,150 as of December 2003. The total number of households investing in mutual funds has grown by an average of 9.1% per year since 1984, reaching 53.3 million households in 2003, according to an October 2003 report by the ICI. We believe the increased participation of individual investors in the equity markets—both directly via stock ownership and indirectly via mutual funds—has led to a greater need for information about investing.

Assets in U.S.-Based Mutual Funds, 1984–2003 ($bil) (Source: ICI)



In the retirement market, millions of investors are now charged with planning for their own retirement, as more companies have shifted from traditional pension plans to self-directed retirement plans such as 401(k)s. As a result, many employers, as plan sponsors, have set up tax-advantaged retirement plans in which their employees may invest. Retirement plan providers—typically third party asset management companies or companies that offer administrative services—often supply investment offerings to these plans and their participants. Total assets in 401(k) plans have increased from $385 billion in 1990 to an estimated $1.9 trillion at the end of 2003, according to the ICI Mutual Fund Fact Book. Based on data from the U.S. Census Bureau, the total number of individuals in the prime retirement planning years of age 45 to 64 is projected to increase to 26.2% of the total U.S. population by 2010, from 22.1% in 2000. Meanwhile, the percentage of U.S. residents over the age of 65 is expected to increase from 12.4% of the total U.S. population (totaling approximately 35.0 million people) in 2000 to 13.0% of the total U.S. population by 2010 (totaling approximately 40.2 million people) and 16.3% of the total population by 2020 (totaling approximately 54.6 million people). As more investors approach retirement age, we believe the demand for information and advice on retirement planning and investing will increase.

Assets in 401(k) Plans, 1990–2003 ($bil) (Source: ICI)



In recent years, investable assets have also dramatically increased outside the United States. In many countries, government-sponsored pension funds are increasingly transferring responsibility for retirement benefits to the individual, leading to a growing need for investment information and advice. More than half of the world's investable assets are located outside the United States, and the portion of non-U.S. investable assets has been increasing. As of June 2004, non-U.S. mutual fund assets totaled approximately $6.8 trillion, according to ICI data. A total of 14 countries each had mutual fund assets of more than $100 billion as of June 2004. Major markets include France ($1.2 trillion), Luxembourg ($1.2 trillion), Australia ($531 billion), Italy ($450 billion), and the United Kingdom ($416 billion), according to ICI data. As barriers on global capital flows continue to fall, we believe that equity markets will expand over time, leading to a need for information and advice on investing by investors around the world.

We believe ongoing growth in the financial services industry both in the United States and elsewhere will continue to support demand for economic and financial information. Within this industry, we believe there are two primary trends that will impact demand for specific products and services:

- *Investors are overwhelmed with data and are looking for more interpretation and advice to help them make intelligent decisions.* Although the amount of available information about investing has increased dramatically, we believe investors are interested not just in data, but also in insight and understanding. Based on a Harris Interactive poll prepared for the Securities Industry Association in November 2003 (the Harris Interactive Poll), 67% of investors feel they know just some or very few of the things necessary to make good investment decisions. While the universe of investors is significantly larger than it was 10 years ago, many investors learned firsthand the difficulties of investing on their own when equity valuations dropped beginning in early 2000.

  Currently, more than half of investors rely on the advice of a financial professional when making decisions about buying or selling a security. The percentage of investors who purchase stocks and stock mutual funds through full-service brokerage firms has increased from 44% and 33%, respectively, in 1999 to 47% and 45%, respectively, in 2002, according to the EOA report. The percentage of total sales of mutual funds (excluding money-market funds) made through third parties increased from 77% in 1990 to 87% in 2003, according to the ICI Mutual Fund Fact Book. We believe that the increased need for interpretation and advice will lead to an increase in demand for value-added information and tools in the financial advisor market, as well as demand for integrated portfolio solutions in the institutional market. While more investors now work with a financial professional as opposed to making decisions on their own, we believe that many of these investors seek out third-party sources of information to validate the advice they receive; and

- *Investors are looking for trusted, independent sources for investment help.* While the demand for investment information and advice has increased, there's often a gap between this demand and the level of trust investors feel they can place in the companies and mutual funds they invest in. Many investors have expressed serious levels of concern about company management teams and accounting practices, according to the Harris Interactive Poll. The mutual fund industry has faced scrutiny following allegations of lapses in fiduciary duty by several major fund companies. As regulators and industry leaders work toward solutions to these problems, we believe that investors will continue to seek out trusted sources of independent research.

In addition, investors and government regulators have been placing more emphasis on independent equity research. In 2003, 10 leading Wall Street brokerage firms agreed to a $1.4 billion settlement (the Global Analyst Research Settlements) with the SEC, New York Attorney General, and other securities regulators to resolve allegations of undue influence of investment banking interests on securities research. Approximately $432.5 million of the $1.4 billion in fines which the brokerage firms agreed to pay in the settlements has been designated for independent research over a period of five years, with such independent research to be provided by companies that don't have ties to investment banking interests.

Business Overview

We are a leading provider of independent investment research in the United States and in major international markets. 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. As of December 31, 2003, we provided extensive data on more than 15,700 mutual fund share classes in the United States, 39,000 mutual funds and similar vehicles in international markets, 6,500 stocks, 2,800 separate accounts, 480 closed-end funds, 36,000 variable annuity/life subaccounts, 100 exchange-traded funds, and 80 state-sponsored college savings plans (commonly known as Section 529 College Savings Plans). We serve nearly 4 million individual investors, 100,000 financial advisors, and 500 institutional clients, with operations in 16 countries around the world. In addition to our U.S.-based products and services, we have local versions of our products designed for investors in Australia, Canada, Denmark, France, Holland, Germany, Italy, Japan, Korea, New Zealand, Norway, People's Republic of China (both Hong Kong and the mainland), Spain, Sweden, and the United Kingdom.

We believe our reputation for excellence stems from our innovative contributions to the investment industry over the past 20 years, particularly in bringing relevant investment information to a broad audience. We were among the first firms to:

- provide information on mutual fund portfolio managers;
- calculate the overall price/earnings and price/book ratios for fund portfolios;
- perform fundamental analysis based on mutual funds' underlying holdings;
- conduct in-depth interviews with mutual fund portfolio managers;
- classify funds according to what they actually hold as opposed to their stated investment styles;
- apply the concepts of margin of safety and economic moats to a broad universe of stocks; and
- develop a stock rating system that incorporates margins of safety, business risk assessments, analyst-generated fair value estimates, and the stock's current market price.

Our data and proprietary analytical tools such as the Morningstar Rating, which brings both performance and risk together into one evaluation, and the Morningstar Style Box, which provides a visual summary of a fund's underlying investment style, have become important tools that millions of investors and advisors use in making investment decisions. We've also developed in-depth advice on security selection and portfolio building to meet the needs of investors looking for integrated portfolio solutions. These tools are employed by many investors because they offer a useful framework for comparing potential investments and making decisions.

We believe Morningstar is one of the most recognized and trusted names in the investment industry and our "investors come first" approach to our business has led to a reputation for independence and objectivity. We believe our position in the industry also results from high-quality products and services, a history of product innovation, and widespread recognition of our brand.

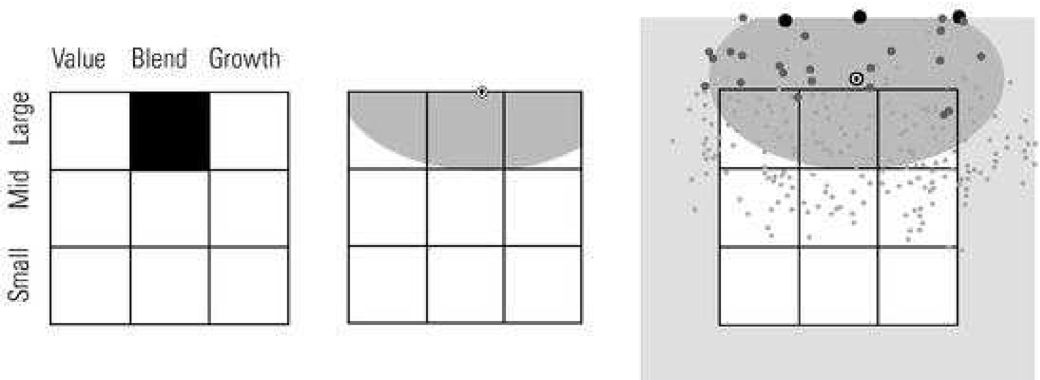
From 1999 to 2003, our revenue increased by a compound annual growth rate of 28.0% largely because of strong internally generated growth. During this period, our lowest annual growth rate was 20.2% in 2002, and our highest annual growth rate was 44.2% in 2000. In 2003, our revenue was $139.5 million, an increase of 27.3% over 2002. In the nine months ended September 30, 2004, we generated revenue of $130.9 million and net income of $9.9 million. As of September 30, 2004, we had an accumulated deficit of $80.6 million.

The Morningstar Rating

★ ★★ ★★★ ★★★★ ★★★★★

We provide Morningstar Ratings on mutual funds, stocks, separate accounts, closed-end funds, as well as variable annuity/life portfolios and subaccounts. For managed investment products, the Morningstar Rating brings performance and risk together into one evaluation, with the top 10% of rated offerings receiving 5 stars and the bottom 10% receiving 1 star. We believe that the Morningstar Rating is an industry standard for helping individual investors and financial advisors evaluate mutual funds.

The Morningstar Style Box



We provide three levels of detail for the Morningstar Style Box: a basic grid illustrating the overall style of a stock or fund, a basic Ownership Zone illustrating the area of the Style Box in which most of the fund's holdings tend to fall, and a detailed Ownership Zone that plots precisely where the fund's holdings fall within the Style Box. For the hypothetical mutual fund shown here, the first illustration shows that the fund's overall style emphasizes large-capitalization stocks with a blend of value and growth characteristics.

The second illustration shows that most of the fund's investments fall into the large-capitalization range and that the fund puts slightly more emphasis on growth stocks than value-oriented stocks.

The third illustration shows the complete distribution of the fund's holdings. Because some individual holdings have extremely large market capitalizations, they land outside the traditional Style Box range.

Our business operations are divided into three segments:

- Individual, which focuses on products for the individual investor;
- Advisor, which focuses on products for financial advisors; and
- Institutional, which focuses on products for institutional clients, including banks, brokerage firms, insurance companies, mutual fund companies, and retirement plan providers and sponsors.

For individual investors, our largest product is our U.S.-based Web site, Morningstar.com. Morningstar.com is a leader in broad-based, innovative investment research, and it consistently ranks among the best investment sites on the Web. Morningstar.com has consistently been highly rated by *Barron's* since the launch of its annual investment Web site review in 1997, which rates investment Web sites based on ease of use, depth and usefulness of data, quality of editorial content, tools and interactivity, and timeliness. Our site has also been named by *Forbes* as "Best of the Web" for the fund selection category in each of the past five years. With approximately 3.5 million registered users and an additional 126,000 paid subscribers, we believe that Morningstar.com is one of the largest investment-related subscription services on the Internet. We also offer numerous investor Web sites in international markets, as well as a variety of print publications for individual investors. Our Web sites and individual investor publications reach nearly 4 million investors worldwide. Our Individual business segment also offers independent equity research to individual investors. Our independent equity research is currently distributed to five major brokerage firms to meet the requirements for independent equity research under the Global Analyst Research Settlements.

For financial advisors, our largest products are Morningstar Advisor Workstation, a comprehensive, Web-based investment planning system, and Principia, a CD-ROM-based investment research product. We also offer Morningstar Managed Portfolios, an asset management service consisting of portfolios of mutual funds in which advisors can invest their clients' assets. We sell our advisor-related products both directly to independent financial advisors and through enterprise licenses, which allow financial advisors associated with the licensing enterprise to use our products. For example, we have enterprise license agreements in place with American Express and UBS, which allow their associated financial advisors to use Morningstar Advisor Workstation. According to a report published in June 2003 by the research-based consulting firm Tiburon Strategic Advisors, Morningstar was ranked as the leading provider of investment research and data, financial planning software, and asset allocation software among 1,476 independent financial advisors surveyed.

For institutional clients, our key products and services include Morningstar Direct (formerly Morningstar DataLab), a set of Web-based research tools that combines advanced performance and holdings-based analysis with access to our proprietary statistics; Licensed Data, a complete set of investment data spanning all eight of our core databases, available as an electronic data feed; Investment Consulting, which draws on our extensive industry knowledge to help clients create and maintain investment products; and Morningstar Retirement Manager, a broad-based suite of services for retirement plan participants, including education, guidance, advice, and managed retirement accounts.

History

In the early 1980s, the mutual fund industry was experiencing dramatic growth. However, comprehensive information about fund performance was not readily available to individual investors. Most individuals—the very audience for whom mutual funds were created—lacked the tools they needed to track, analyze, and make intelligent decisions about mutual funds. Morningstar founder Joe Mansueto believed this fundamental information should be widely available and created our company in 1984 to provide individual investors with useful and informative mutual fund analysis and commentary.

In 1984, we published our first product, *The Mutual Fund Sourcebook* , a quarterly publication containing performance data, portfolio holdings, and other information on approximately 400 mutual funds. This product was a comprehensive collection of mutual fund data, priced to be affordable for individual investors.

In 1986, we launched *Morningstar Mutual Funds* , a biweekly publication that included in-depth data and analyst commentary on more than 700 mutual funds. This publication quickly became our largest product and drove our growth over the following several years. In 1991, we launched Morningstar Principia, one of the first software programs that financial advisors could use to analyze mutual funds. This CD-ROM-based software is currently our largest-selling product and was a leading source of the company's growth in the 1990s.

We launched Morningstar.com in 1997, the first of our major Internet-based platform products, with content on both stocks and mutual funds. We launched the *Morningstar StockInvestor* newsletter in 1998, and have continued to expand our stock coverage through Morningstar.com's Premium service since that time.

In 1998, we established a joint venture in Japan with Softbank, the first of numerous international ventures. To help accelerate development of our Internet-based products, Softbank invested $91 million in Morningstar in 1999, purchasing 20% of our then-outstanding shares. We established ventures in Australia and New Zealand in 1999, expanded into Canada in 1999, and created ventures in several other Asian markets in 2000. We launched seven ventures in Europe in 2001.

In July 2003, we acquired mPower, a San Francisco-based investment advisory firm that specialized in serving retirement plans sponsored by large employers.

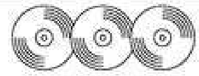
In early 2004, we began creating a hedge fund database to help make the hedge fund industry more transparent to investors. In July 2004, we began providing independent stock research to five major brokerage firms to meet the terms of the Global Analyst Research Settlements.

1984
- Joe Mansueto establishes Morningstar in his Chicago apartment

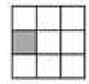
1985
- Morningstar Rating for mutual funds debuts

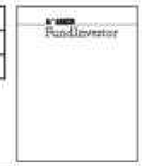
1986
- *Morningstar Mutual Funds* launches

1991
- CD-ROM-based Principia software for advisors launches
- Paul Rand designs a new logo for Morningstar



1992
- Morningstar creates the nine-square Morningstar Style Box
- *Morningstar FundInvestor* monthly newsletter debuts
- Revenue exceeds $10 million



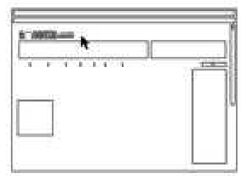


1994
- I.D. (International Design) Magazine names *Morningstar Mutual Funds* binder best package of the year

1996
- Morningstar category system for mutual funds debuts

1997
- Morningstar.com launches

1998
- Tokyo-based Softbank and Morningstar establish a joint venture in Japan
- *Morningstar StockInvestor* monthly newsletter debuts

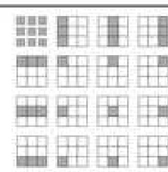


1999
- Morningstar offices open in Australia and New Zealand
- Softbank acquires 20% stake in Morningstar
- Morningstar expands operations into Canada
- Revenue exceeds $50 million

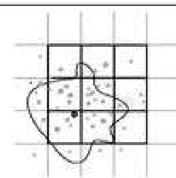
2000
- Morningstar launches online retirement advice
- Morningstar Europe, Morningstar Asia, and Morningstar Korea open
- Morningstar Japan completes initial public offering on NASDAQ-Japan

2001
- Morningstar Direct (formerly Morningstar DataLab) debuts
- Morningstar Advisor Workstation launches
- Morningstar Managed Portfolios launches
- Morningstar Rating for stocks debuts

2002
- Morningstar Indexes debut
- Morningstar.com surpasses 100,000 Premium members
- Revenue exceeds $100 million



2003
- Morningstar managed retirement accounts launch
- Style Box "Ownership Zones" debut
- Morningstar acquires mPower
- Morningstar Rating for separate accounts debuts



2004
- Morningstar begins creating a hedge fund database
- Morningstar Advisor Workstation Office Edition launches
- Morningstar begins providing independent equity research to five investment banks under Global Analyst Research Settlements

Competitive Strengths

We believe we have the following competitive strengths:

Strong Reputation and Brand.

We have built a trusted name among individual investors, financial advisors, and institutions. We believe that our reputation for quality and independence is a key reason why our clients feel comfortable choosing our products. Because we resell our content through many different platforms, our data and information appear in many outside sources, including many large media outlets and software providers. Our investment analysts are frequently quoted in various media for their opinions about investing in stocks and mutual funds, which also helps us reach a wider audience.

Investor Focus.

Because investors depend on our information to help them make well-informed investment decisions, we design our products to provide the pertinent facts. We also maintain an independent view. If we think an investment vehicle doesn't meet the needs of investors, we won't hesitate to express that opinion. We've advocated better disclosure practices for mutual funds and stocks, and we've contributed Congressional testimony and numerous speeches and articles addressing corporate governance issues in the mutual fund industry. We have a history of advocating clear disclosure of mutual fund manager names, complete and timely disclosure of mutual fund portfolio holdings, lower expenses and fees for mutual fund shareholders, and candid discussions of portfolio strategy and performance in mutual fund shareholder reports.

Depth, Breadth, and Accuracy of Data.

We maintain what we believe is one of the largest, most accurate, and most complete databases in the industry, with data on more than 100,000 investment offerings. As of December 31, 2003, we provided extensive data on more than 15,700 mutual fund share classes in the United States, 39,000 mutual funds and similar vehicles in international markets, 6,500 stocks, 2,800 separate accounts, 480 closed-end funds, 36,000 variable annuity/life subaccounts, 100 exchange-traded funds, and 80 Section 529 College Savings Plans. Our historical performance data on mutual funds goes back to 1976. In addition to raw performance statistics, we also provide data on portfolio holdings for the mutual funds and other managed investment products in our database. We believe that this information helps investors look "under the hood" and better understand what drives a fund's performance, as well as how to use individual funds more intelligently within a portfolio.

Innovative, Proprietary Research Tools.

We have developed a number of proprietary research and analytical tools that support our fundamental approach to investing, which we believe give us an edge over our competitors. Examples include the Morningstar Rating, which helped popularize the concept of risk-adjusted returns among the general investing public; the Morningstar Style Box, which classifies investment offerings based on their underlying size and investment style; and the Morningstar Ownership Zone, a graphical tool that plots each stock in a fund's portfolio within the Morningstar Style Box. We have continued to innovate by developing a proprietary sector classification system for stocks, a tool for viewing the geographical exposure of a portfolio, a set of proprietary market indexes based on the Morningstar Style Box, and a set of comprehensive asset-allocation tools for the retirement planning market.

Expertise in Research, Technology, and Design.

Over the past 20 years, we've focused on building our expertise in three core skill areas of research, technology, and design. As of December 31, 2003, we employed 107 investment analysts in our U.S. and international operations. Our approach to analysis emphasizes fundamental research. We analyze mutual funds down to the individual security level, and use a consistent set of research tools across our seven core investment databases. For stocks, we focus on determining the underlying value of the business, instead of trying to predict short-term price movements or momentum.

Morningstar strives to rapidly adopt new technology that can improve the products we deliver to our customers. We have also built a flexible technology platform that allows our products to work together across a full range of investment databases, delivery formats, and market segments. We develop most of our own software and technology tools, enabling us to leverage our expertise and tailor our products to the needs of our customers. As of December 31, 2003, our technology team consisted of 165 programmers and 43 technology and infrastructure professionals.

Because we believe that making complex financial data accessible and easy to use empowers people to make more intelligent investment decisions, we view design as an integral part of the product development process. Our design team, which consisted of 24 designers as of December 31, 2003, has won several awards and recognitions over the past 20 years. Our designs for *Morningstar FundInvestor* and *Morningstar StockInvestor* received a certificate of excellence in the American Institute of Graphic Arts (AIGA) annual design competition in 2002. Morningstar was also nominated for a Corporate Achievement Award of the Smithsonian Cooper-Hewitt National Design Museum's National Design Awards program in both 2002 and 2004.

Large and Loyal Customer Base.

Our individual investor Web sites have nearly 3.8 million registered users worldwide, and our print publications reach more than 80,000 additional individuals. In the Advisor market, we reach more than 100,000 financial advisors. We work with approximately 500 institutional clients, including many leading banks, mutual fund companies, insurance companies, and brokerage firms. We believe our work reaches millions of other investors who access Morningstar's data and analysis through their financial advisors or other channels, such as newspapers, magazines, or other investment Web sites.

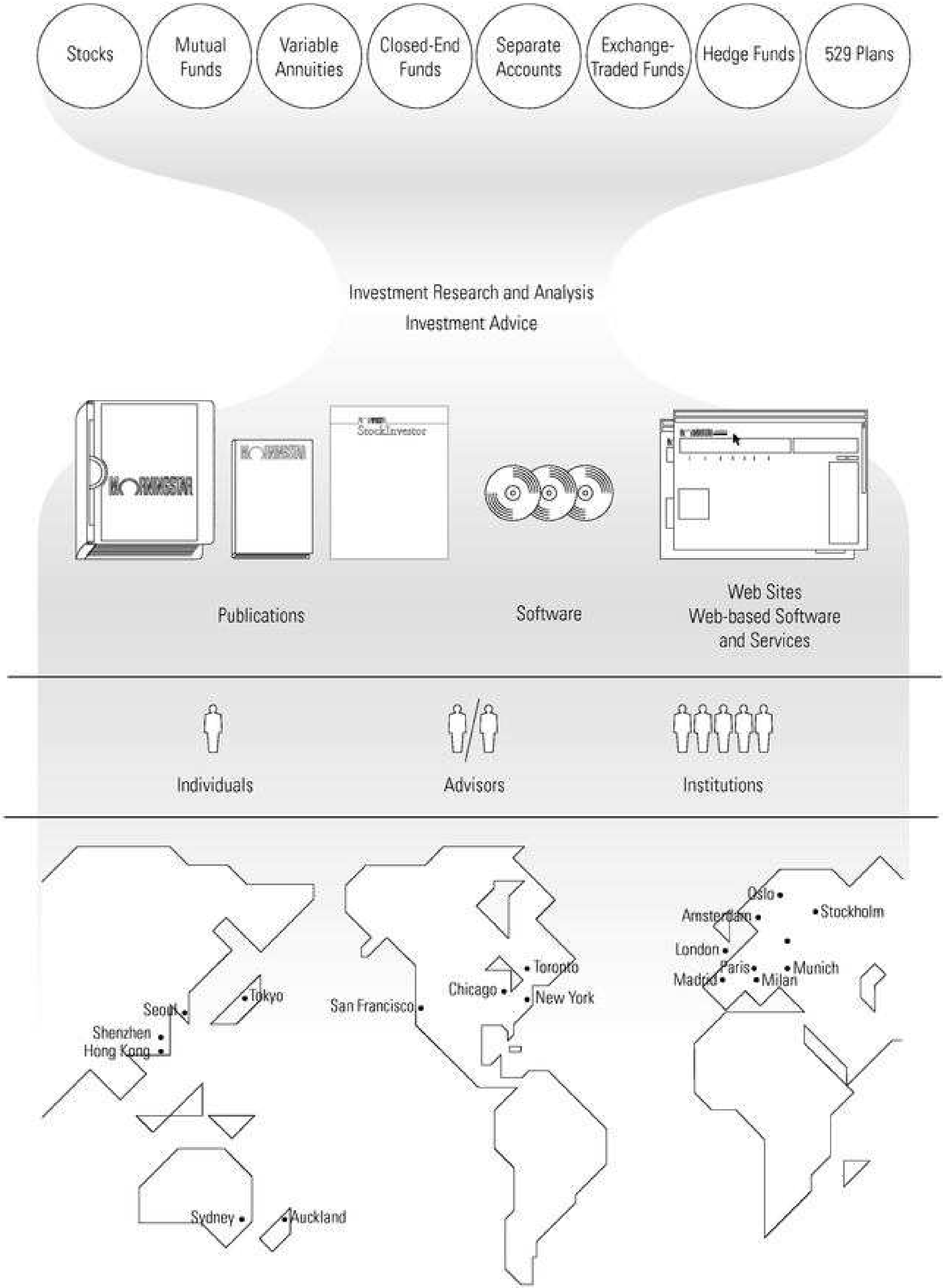
We sell many of our products through annual subscriptions and multi-year contracts. As a result, a large percentage of our revenue base has historically consisted of recurring revenue. In 2003, contracts and license and subscription renewals accounted for 77.4% of our revenue. We believe that the widespread acceptance of our proprietary tools creates an incentive for clients to continue to renew our products and services. In addition, our data is often integrated in our clients' operations, which we believe creates an additional incentive for ongoing contract renewals. We also strive to retain customers by emphasizing high levels of product support, which entails both helping our customers use our products effectively and listening to customer feedback. We believe that this two-way communication helps build customer loyalty over time.

Diversified Revenue Base and Broad Reach Within Multiple Segments.

In 2003, our three segments each contributed significantly to our revenue, with Institutional, Advisor, and Individual accounting for revenue (before eliminations) of \$59.7 million, \$49.2 million, and \$35.4 million, respectively. Our business also is broadly diversified by client, with our largest customer accounting for less than 3% of our revenue in 2003. We believe our broad product lineup and extensive reach across multiple investor segments enhance our appeal across our business segments. For example, widespread usage of our products by individual investors helps reinforce demand from financial advisors and institutional clients because their end users have a high level of familiarity with our proprietary tools.

Entrepreneurial Culture and Experienced Management Team.

Morningstar has built a strong entrepreneurial culture over the past 20 years. We believe that our ability to empower and motivate employees is a key competitive strength and one of the primary reasons for our history of internally generated growth. Our philosophy is that people can and will do their best work when they have the freedom and tools to make their own decisions. Our managers value trust and honest communication. We provide a dynamic, open environment that is governed by a set of values that stress investor advocacy, entrepreneurial spirit, and teamwork. We also emphasize innovation and reward people for delivering results. Our executive officers have an average tenure with Morningstar of more than 12 years.



We leverage our eight core investment databases by selling a wide variety of products via multiple media, to three key investor segments, across many geographical markets.

Growth Strategies

Our mission is to create great products that help investors reach their financial goals. This mission guides our operations, in the United States and internationally, and our product offerings, whether designed for individual investors, financial advisors or institutions. In keeping with this mission, we are pursuing four growth strategies:

Enhance our position in each of our three market segments by building on the strength of existing products.

We believe our existing products offer a strong base upon which to build our future growth. We offer integrated research and portfolio tools, allowing investors to use our proprietary information and advice across multiple security types. We believe that individual investors, financial advisors, and institutional clients increasingly want integrated solutions as opposed to having to use different research tools for different parts of their portfolios. To help meet this need, one of our key strategies is to focus our product offerings on four of our major Web-based investor platforms:

- Morningstar.com for individual investors;
- Morningstar Advisor Workstation for financial advisors;
- Morningstar Direct for institutional investment research professionals; and
- Morningstar Retirement Manager for the retirement planning market.

Expand the range of services we offer investors, financial advisors, and institutional clients.

We plan to expand our product offerings to better meet the needs of investors. We plan to introduce new databases for additional types of investment offerings, including hedge funds, various types of managed investment pools in international markets, and other widely used investment products. We also expect to continue expanding our product offerings in three primary areas:

- *Expand our stock-research capabilities.* Our equity research builds on our approach to mutual fund analysis, which has historically focused on analyzing the individual stocks that make up each fund's portfolio. In 2004, we increased the number of stocks that include in-depth written analyst coverage from approximately 700 to 1,500. We plan to sell this research through multiple channels, including to several institutional clients to fulfill their obligations to purchase independent research under the terms of the Global Analyst Research Settlements. We have entered into agreements with five of the firms named in the Global Analyst Research Settlements to provide independent stock research to their customers. In addition, we are continuing to pursue additional opportunities to distribute our equity research in the United States and in major international markets. We expect to benefit as a provider of some of the independent research required under the terms of the settlements, and we also believe that investors' increasing awareness of the value of independent research will strengthen our business over the long term;

- *Selectively develop our investment management business, primarily through Morningstar Managed Portfolios and Morningstar Retirement Manager*. Our investment management programs combine managed investment products—typically mutual funds—in portfolios designed to help investors and financial advisors meet their specific financial goals. Morningstar Managed Portfolios (which we introduced in 2001) is a fee-based discretionary investment management program distributed exclusively through financial advisors. Morningstar Retirement Manager (which we introduced in 2003) is offered to retirement plan participants through retirement plan providers and employers. Retirement Manager includes a managed account service designed for plan participants who choose to delegate management of their portfolios to Morningstar's investment professionals who select investment options (typically mutual funds) and make retirement planning choices for the participant; and

- *Develop a comprehensive hedge fund database.* We have created a hedge fund database to help investors analyze this alternative asset class, with the goal of making the hedge fund industry more transparent to investors. Hedge funds in the United States now represent more than $1 trillion in investor assets, according to the June 2004 AFSR/Correct Net Hedge Fund Administrator survey. Offering data on hedge funds is a natural extension of our work on other managed investment vehicles. We plan to introduce this hedge fund database in early 2005.

Continue to expand our international brand presence, products, and services.

Over the past several years, international markets have accounted for an increasing percentage of our revenue, expanding from 8.1% of revenue in 2001 to 14.4% in 2003. We plan to continue expanding our international operations to meet the increasing demand for wide-ranging, independent investment insight by investors around the globe. Because more than half of the world's investable assets are located outside of the United States, we believe there are significant opportunities for us in non-U.S. markets.

Seek growth through strategic acquisitions.

Historically, we have focused primarily on organic growth by developing and expanding our products and services. However, we have made, and may in the future consider making, selective acquisitions that promote our key business objectives. For example, in July 2003 we acquired mPower, which specialized in providing advisory services to retirement plans sponsored by large employers, and in January 2005 we acquired VARDS to enhance our variable annuity data. In reviewing potential acquisitions, we plan to focus on transactions that:

- offer a good strategic fit with our mission of creating great products that help investors reach their financial goals;

- help us build our proprietary investment databases, research capabilities, technical and marketing expertise, or customer base faster and more cost effectively than we could if we built them ourselves; and

- offer a good cultural fit with our entrepreneurial spirit and brand leadership.

Business Segments, Products and Services

The table below shows our revenue by business segment for each of the past three years and for the nine months ended September 30, 2004:

	For the Year Ended December 31						Nine Months Ended September 30	
	2001		2002		2003		2004	
Revenue by Segment	$000	%	$000	%	$000	%	$000	%
Individual	$ 27,642	30.3 %	$ 31,998	29.2 %	$ 35,406	25.4 %	$ 33,096	25.3 %
Advisor	34,823	38.2	40,972	37.4	49,161	35.2	45,287	34.6
Institutional	32,542	35.7	40,825	37.2	59,745	42.8	57,534	43.9
Elimination of intersegment revenue	(3,777)	(4.2)	(4,176)	(3.8)	(4,816)	(3.4)	(4,973)	(3.8)
Consolidated revenue	$ 91,230	100.0 %	$ 109,619	100.0 %	$ 139,496	100.0 %	$ 130,944	100.0 %

Individual

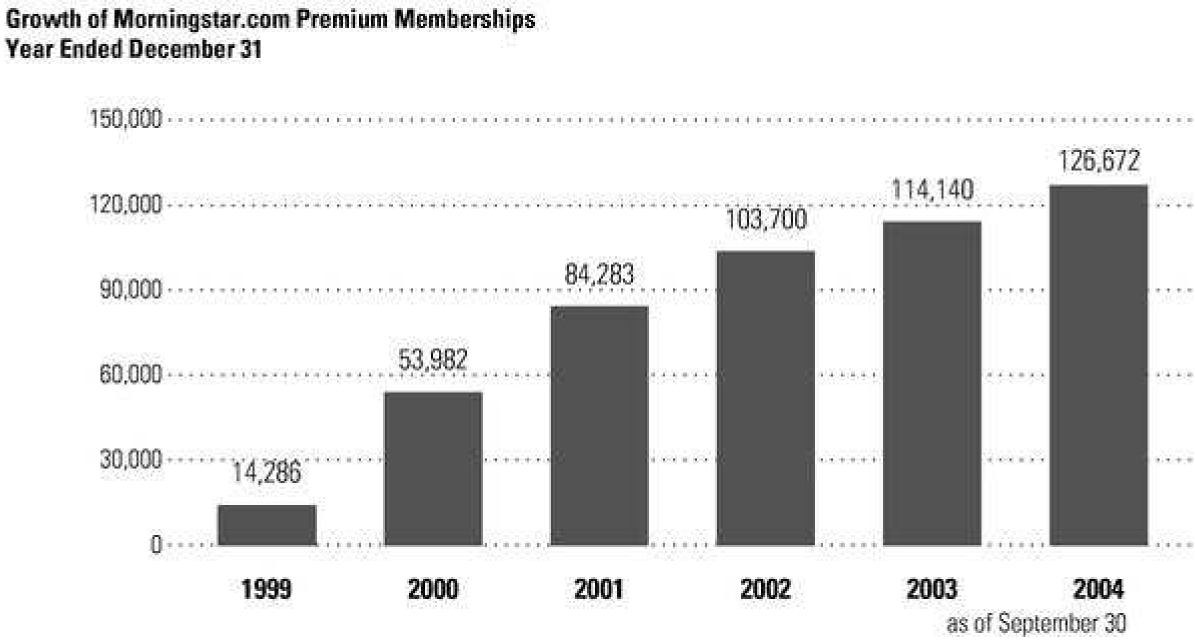
Within the Individual business segment, our Web sites reach millions of individual investors both in the United States and abroad. As of September 30, 2004, Morningstar.com had approximately 3.5 million registered users in the United States, and our 15 country-specific international sites reach an additional 285,000 investors in 12 languages. Most of our products target either experienced investors who are engaged in the investing process or those who want to learn more about investing. Based on surveys of our customers, we believe our products reach a mix of "do-it-yourself" investors who want to take charge of their own investment decisions and investors who seek out third-party sources to validate the advice they receive from brokers or financial planners.

Our client base in this segment consists of more than 200,000 paying customers, with the majority consisting of Premium members of Morningstar.com. We also sell advertising space on Morningstar.com. We reach 80,000 subscribers through several investment newsletters designed for individual investors. In addition to this customer base, approximately 4,000 public and private libraries in the United States subscribe to our services. We also offer books and PDF reports on individual securities.

Morningstar.com (Web site)

As of September 30, 2004, our free membership services had nearly 3.8 million registered users worldwide, and include exclusive Morningstar commentaries, proprietary portfolio tools, and educational content to help investors of all levels learn and improve their investment skills. We use our free content as a gateway into Premium membership, which includes access to written analyst reports on more than 1,500 stocks and 2,000 mutual funds, Analyst Picks and Pans, and Premium Stock and Fund Screeners. Morningstar.com also includes Portfolio X-Ray, which helps investors evaluate their portfolios at the individual security level, and a variety of other portfolio tools.

As of September 30, 2004, we had more than 126,000 paying customers on Morningstar.com. We charge $13.95 for a monthly subscription, $125 for an annual subscription, and $209 for a two-year subscription for Morningstar.com's Premium service.



Morningstar Mutual Funds (publication)

Morningstar Mutual Funds (commonly known as the "mutual fund binder"), features our signature one-page reports on approximately 1,600 mutual funds. These reports contain historical performance data, portfolio statistics, and proprietary measurement tools. Twice a month, subscribers receive updated reports for 160 of the covered funds, along with news, commentary, industry research, and summary performance data for all 1,600 funds. Subscribers can also access a Web-based version for the most current information. We charge $549 for a one-year subscription to *Morningstar Mutual Funds* .

Morningstar FundInvestor (newsletter)

Morningstar FundInvestor is a monthly newsletter that includes data on 500 of the most popular mutual funds, ideas on building better portfolios, proprietary research, model portfolios, and news on changes within the fund industry. We charge $89 for a one-year subscription to *Morningstar FundInvestor* .

Morningstar StockInvestor (newsletter)

Morningstar StockInvestor is a monthly newsletter that includes updates on our two model portfolios (a "Tortoise" portfolio designed for conservative investors and a "Hare" portfolio designed for more risk-tolerant investors), a "Red Flags" column that highlights stocks to avoid, and a watch list of "The Morningstar Bellwether 50," which features large-capitalization stocks investors may want to consider. Each issue also offers commentaries about how investors can improve their stock selection and learn from leading portfolio managers. We charge $99 for a one-year subscription to *Morningstar StockInvestor* .

In addition to the products mentioned above, we offer several other investment newsletters and a series of books, which are available directly from us and in bookstores.

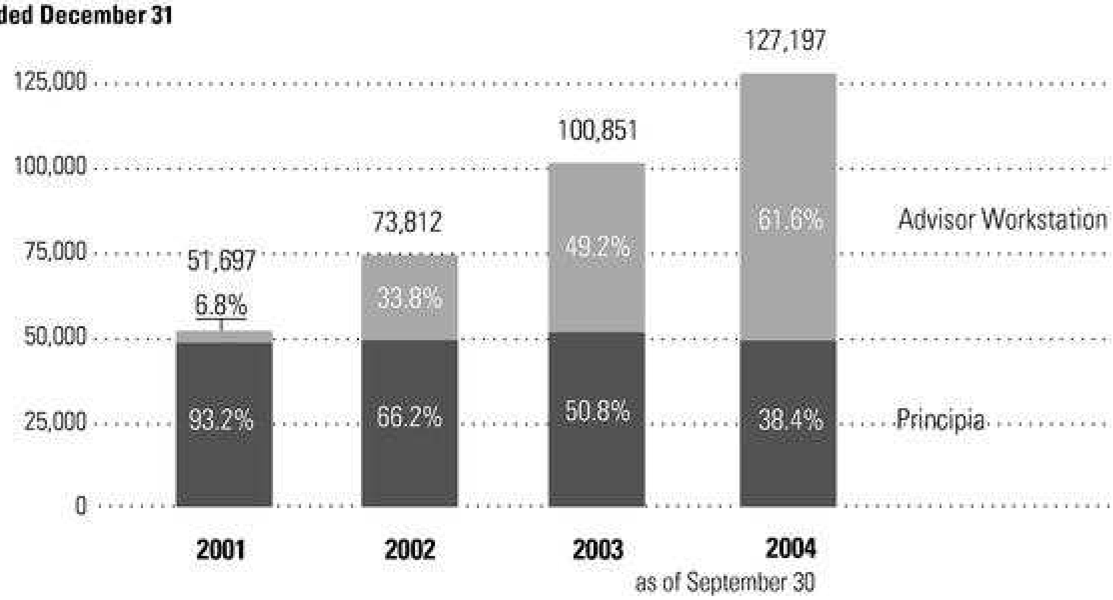
Independent Equity Research (Web-based service)

As of September 30, 2004, we offered independent equity research on more than 1,500 companies. Our approach to stock analysis focuses on long-term fundamentals. Our analysts evaluate companies by assessing each company's competitive advantage, analyzing the level of business risk, and completing an in-depth projection of the company's future cash flows. For companies we cover, we create an analyst-generated fair value estimate, a Morningstar Rating for stocks, a rating for business risk, and an assessment of the economic moat (a concept designed to describe the degree of a company's competitive advantage versus its competitors). For the remaining companies, we offer quantitatively generated grades for growth, profitability, and financial health, as well as descriptive text that explains the company's business operations. We currently deliver independent equity research primarily to individual investors as part of our Premium service on Morningstar.com and through the Global Analyst Research Settlements. We significantly expanded the number of stocks covered by our analyst team in 2004.

Advisor

We believe our Web-based content and CD-ROM software is integrated into the daily operations and research processes of many financial advisors who use our research and tools to help individual investors reach their financial goals. We license our advisor products both directly to independent financial advisors and through enterprise agreements for financial advisors affiliated with larger firms. For example, our enterprise licensing agreements with American Express and UBS allow financial advisors associated with those companies to use Advisor Workstation. Most of our license agreements have terms ranging from one to three years. As of September 30, 2004 we had established relationships with more than 100,000 financial advisors in the United States and approximately 35,000 financial advisors in international markets.

Principia Subscriptions and Advisor Workstation Licenses
Year Ended December 31



Morningstar Principia (software)

Principia is a leading investment planning software for the financial advisor industry and currently has approximately 48,000 subscriptions. As of December 31, 2003, Principia featured modules that provide timely data on more than 15,700 mutual fund share classes, 6,500 stocks, 2,800 separate accounts, 480 closed-end funds, and 36,000 variable annuity/life subaccounts. Each module is available separately or together in a CD-ROM format and features searching, screening, and ranking tools. Principia allows advisors to create integrated portfolios for clients and offers three-page Portfolio Snapshot reports that provide a comprehensive picture of a portfolio. The Snapshot report shows overall style and sector weightings as well as the cumulative exposure to individual stocks.

The Snapshot report is among those approved by the National Association of Securities Dealers for financial advisors to distribute and review with their clients. Principia prices generally range from approximately $615 per year for a subscription to one investment database to $2,695 for a subscription package spanning multiple investment universes. Pricing for enterprise licenses varies based on the number of users.

Morningstar Advisor Workstation (Web-based product)

Advisor Workstation, a Web-based investment planning product, provides financial advisors with a comprehensive set of tools for conducting their core business—including investment research, planning, and presentation tools. It also allows advisors to build and maintain a client portfolio database that can be fully integrated with the firm's back-office technology and resources. Moreover, it helps advisors create customized reports for any combination of variable annuity/life subaccounts, separate accounts, mutual funds, stocks, exchange-traded funds, closed-end funds, and individual stocks. As of September 30, 2004, more than 70,000 advisors used Advisor Workstation, which is available in two editions: the Office Edition for independent financial advisors and the Enterprise Edition for financial advisors affiliated with larger firms. We generally charge $5,000 per year for the Office Edition. Pricing for the Enterprise Edition varies primarily based on the number of users.

Morningstar Managed Portfolios (service)

Morningstar Managed Portfolios is a fee-based discretionary investment management program distributed exclusively through financial advisors. Our team of investment professionals selects portfolios of mutual funds, monitors the asset classes and funds chosen for each portfolio, and makes adjustments as needed. We complement these services with online client-management functions such as risk profiling and access to client statements, transaction capabilities, and performance reports.

The Morningstar Managed Portfolios program was introduced in 2001 and had more than $750 million in assets under management as of September 30, 2004. We charge asset-based fees for Morningstar Managed Portfolios.

Institutional

Through our Institutional segment, as of September 30, 2004, we served approximately 500 clients, including mutual fund companies, brokerage firms, insurance companies, banks, and retirement plan sponsors and providers. We believe our institutional clients value our independence, breadth of information, and customized services; in addition, we believe our research, tools, and advice reach many individual investors through this channel. Across the Institutional segment, we've established client relationships with many of the largest companies in the financial services industry, including American Express, Nationwide Financial, Prudential, MetLife, and Fidelity Investments. Approximately 20% of our institutional sales are to clients located outside of the United States—primarily in Australia, Canada, and various countries in Europe. We typically sell our institutional products based on a contract term of one to three years.

Morningstar Direct (formerly Morningstar DataLab) (Web-based product)

Morningstar Direct is an Internet-based research platform that provides in-depth performance and holdings-based analysis of investment data. This service is the exclusive source for the underlying details on our proprietary statistics. It is integrated across multiple investment types and includes mutual funds, variable annuity/life subaccounts, and separate accounts. Morningstar Direct allows investment professionals to conduct advanced performance comparisons and in-depth analyses of a portfolio's underlying investment style. Pricing for

Morningstar Direct is based on the number of securities covered, the amount of information we provide, and the level of distribution.

Licensed Data (service)

We believe our investment databases are among the most comprehensive in the industry. Nearly all of the information in our databases comes from primary sources and can be packaged as a stand-alone option or in combination with other information. We can deliver the information through up-to-date technologies for rapid transmission and ease of use. Our Licensed Data service offers an extensive set of data focusing on investment performance, operations, portfolio statistics, and fees and expenses. Pricing for Licensed Data is based on the number of funds or other securities covered, the amount of information provided for each security, and the level of distribution.

Licensed Tools and Content (Web-based service)

We offer an extensive set of online tools and editorial content for other investment Web sites to license. Our online tools and content can be customized to meet the needs of international audiences. We also offer a fully integrated set of tools and applications to provide portfolio answers and analysis in context.

Investment Profiles & Guides (publications)

Our Investment Profiles are single-page reports that combine key elements from our data, design, and editorial content to clearly present relevant information about an investment. They cover mutual funds, stocks, variable annuity/life subaccounts, separate accounts, custom funds, and Section 529 College Savings Plans. Investment Profiles are designed for use when communicating with clients, as well as for employers to communicate with retirement plan participants. We also offer Investment Guides, which are a collection of Investment Profiles, summary information, and educational articles. Pricing for Investment Profiles and Investment Guides is based on the number of securities covered, the amount of information we provide, and the level of distribution.

Morningstar Indexes (service)

Based on the same methodology as the Morningstar Style Box, our 16 real-time indexes track the U.S. equity market by capitalization and investment style. They include a broad market index, three capitalization-based indexes, three composite style indexes, and nine indexes based on both investment style and market capitalization. The Morningstar Indexes cover approximately 97% of the U.S. equity market based on market capitalization. We charge licensing fees for the Morningstar Indexes, with fee levels generally customized by client. Barclays Global Investors is licensing our 16 style-based indexes and has introduced nine exchange-traded funds (ETFs) based on the Morningstar Indexes.

Morningstar Retirement Manager (service)

Morningstar Retirement Manager is a suite of services that helps retirement plan participants plan and invest for their retirements. It gives clear guidance explaining whether participants' suggested plans are on target to meet their retirement goals. As part of this service, we also offer specific suggestions for contribution rates, asset mix, investment style, and sector exposure to help participants maximize their retirement portfolios, as well as specific recommendations for funds to invest in. Morningstar Retirement Manager includes a managed account service designed for plan participants who choose to delegate management of their portfolio to Morningstar's investment professionals. We offer these services primarily to retirement plan providers—typically third party asset management companies or companies that offer administrative services. These providers often supply investment offerings to retirement plan sponsors and their participants. As of September 30, 2004, more than 11 million plan participants had access to our advice and guidance services through approximately 65,000 plan sponsors and 29 plan providers. We believe we have a broader reach in the retirement market than our competitors. Pricing for Morningstar Retirement Manager depends on the number of participants, as well as the level of service we provide.

Investment Consulting (service)

Our team of investment professionals works with institutions to improve their investment offerings and the level of service they provide to clients. Our consultants evaluate portfolios, recommend strategies, help set investment policies, design asset allocations, and monitor ongoing performance. Pricing for our consulting services is based on the scope of work and the level of service required.

Marketing and Sales

We promoted our print, software, and Web-based products and services with a staff of approximately 130 sales and marketing professionals as of December 31, 2003. Our marketing staff includes both product specialists and a corporate marketing group that manages company initiatives. As part of this group, we have several strategic account managers who oversee all aspects of our largest institutional client relationships. We also have a sales operations staff, which focuses on tracking revenue, forecasting sales, and other tasks to support our sales team. Across all three of our segments, we emphasize high levels of product support to help our customers use our products effectively and listen to customer feedback. Providing helpful, consistent product support is a core aspect of our sales and marketing strategy.

Individual

We promote our individual investor products primarily through traditional direct mail, e-mail, promotions on our 16 investor Web sites worldwide, public relations, and advertising on related Web sites. We had 29 sales and marketing professionals in our Individual segment as of December 31, 2003.

Our strategy is to increase the number of investors who sign up for Morningstar.com Premium membership by continuing to develop and promote Premium content such as analyst reports, Fund Analyst Picks and Pans, and value-added portfolio tools, which we will market to registered users and other investors. As a core marketing strategy for Morningstar.com, we purchase advertisements on third-party sites such as Yahoo! and Google based on certain investment-related key words that can bring interested investors to relevant content on Morningstar.com.

We believe that equity research is a key growth opportunity in the individual investor market. Our marketing strategy for this area is to emphasize our proprietary and independent approach to stock analysis, which focuses on bottom-up analysis of company fundamentals.

Advisor

Our products for advisors, which include Advisor Workstation, Principia, and Morningstar Managed Portfolios, are sold primarily through our sales force and direct mail, with promotional support from online and print advertising and conference exhibits. We also use the annual Morningstar Investment Conference to promote our offerings for advisors. As of December 31, 2003, we had 26 sales team members dedicated to selling Advisor-related products. We believe that there are substantial opportunities to increase Advisor Workstation sales by attracting additional brokerage firms and investment advisors to sign up as clients. We also expect to expand our offerings to financial advisors in international markets.

Institutional

We market our products for institutional clients, including Morningstar Direct, Licensed Data, Investment Consulting, and Morningstar Retirement Manager for the retirement market, almost exclusively through our sales team. As of December 31, 2003, we had 75 sales and marketing professionals in our Institutional segment. We provide marketing support for our sales team in the form of online and print advertising, direct mail, and conference exhibits. We also have data reselling agreements with third-party providers of investment tools and applications, allowing us to increase the distribution of our data with minimal additional cost.

International Operations

We conduct our business operations outside of the United States through a variety of subsidiaries and joint venture operating companies. We have wholly-owned or majority-owned operating companies doing business in each of the following markets: Australia, Canada, France, Holland, Germany, Italy, New Zealand, Norway, People's Republic of China (both Hong Kong and the mainland), Spain, and the United Kingdom. See Note 15 of our Notes to Consolidated Financial Statements for information on a legal proceeding that may, if decided adversely to us, affect our ownership of our Australian and New Zealand subsidiaries.

In addition, we hold minority ownership positions in operating companies based in Denmark, Japan, Korea, and Sweden. Our ownership in these companies is either held directly by us or indirectly through separate foreign subsidiaries that we control. The joint venture in Japan, Morningstar Japan, is publicly traded under ticker 4765 on the Osaka Stock Exchange "Hercules Market." As of September 30, 2004, we held approximately a 35% stake in Morningstar Japan; our share had a market value of approximately $43.5 million.

To enable these companies to do business in their designated territories, we provide them with the rights to the Morningstar name and logo and with access to certain of our products and technology. Each company operating within a particular country is responsible for developing or obtaining (through third-party licensing arrangements) databases of securities information for that country and for creating new products or modifying our existing products to suit the needs of clients within that country.

Competitive Landscape

The economic and financial information market has been marked by increased consolidation over the past five years, with the strongest players generally gaining market share at the expense of smaller competitors. Our largest competitors are Standard & Poor's (a division of The McGraw-Hill Companies), Thomson Financial Services (a division of Thomson Corporation), and Lipper (a division of Reuters). These companies have financial resources that are significantly greater than ours. We also have a number of smaller competitors in one or more of our three business segments. Most of our competitors compete with individual products or segments of our business; we are not aware of any company that offers substantially similar product solutions in all three of our market segments.

We believe the most important competitive factors in our industry are brand and reputation, data quality and comprehensiveness, quality of investment analysis and analytics, design, reliability, product support capabilities, and price.

- *Individual.* In our Individual business segment, we compete with the personal finance Web sites of Yahoo!, America Online, a division of Time Warner, Microsoft, CBS MarketWatch, TheStreet.com, The Motley Fool, SmartMoney.com, Intuit, and *The Wall Street Journal* . Our print publications compete most directly with Value Line, The Motley Fool, Phillips Investment Resources (a division of Phillips International), KCI Communications, Horizon Publishing Company, and the Association of Mutual Fund Investors.

- *Advisor.* Our primary competitors in this business segment include Thomson Financial Services, SEI Investments, Ibbotson Associates, Standard & Poor's, SunGard, and Mobius Services provided by CheckFree Investment Services.

- *Institutional.* In the retirement advice market, we compete primarily with Financial Engines, Inc. and Ibbotson Associates. For Licensed Data and Investment Profiles & Guides, our primary competitors are Lipper, Standard & Poor's, Factset Research Systems, and Bowne & Co. For Morningstar Direct, our primary competitors are Lipper, Zephyr Management, Markov, Strategic Insight Mutual Fund Research and Consulting, Informa Investment Solutions and Mobius Management Systems. Our Investment Consulting business competes primarily with Ibbotson Associates and Lipper, as well as some smaller competitors in the retirement consulting business.

Our international operations compete with a variety of other companies not named above, including Brain Power, MoneyMate, ASSIRT, vanEyk Research, and IWL.

Integrity and Quality

Research Independence

Our independence, integrity, and advocacy for investors' interests are the foundation of our company. We have established specific policies and procedures to help ensure that our research remains independent and objective. All Morningstar employees are required to adhere to our Employee Code of Ethics and our Securities Trading Policy. In addition, we maintain a strict line of separation between Morningstar's fund and stock analysts and the company's sales teams. Sales personnel are prohibited from setting up meetings between analysts and clients or potential clients. If a sales person wishes to contact someone on the analyst staff, he or she must channel all requests through the director of the analyst staff. Sales personnel may not contact analysts directly.

In addition, our analysts may not disclose the content of their reports to any outside parties before publication. We prohibit all Morningstar employees from owning shares in mutual-fund management companies (defined as any firm that earns at least 20% of its revenue from mutual funds). Our equity analysts may not own shares in the companies they cover or in key competitors of the companies they cover.

Quality Controls and Procedures

Our data is the bedrock of the products and services we've created to help investors make better decisions. Throughout our history, we have invested in people and technology with the objective of maintaining accurate, high-quality data. For example, the data collection process for our mutual fund database includes more than 200 business rules designed to identify and correct errors.

We also strive to continuously improve our procedures to enhance the quality and integrity of our data. In addition, we have established programs to help our employees better understand the value we place on quality and the importance of promptly addressing any question about the accuracy of our data.

Intellectual Property and Other Proprietary Rights

We treat our brand, product names and logos, software, technology, databases, and other products as proprietary. We try to protect this property by using trademark, copyright, patent and trade secrets laws, licensing and nondisclosure arrangements, and other security measures. For example, in the normal course of business, we only provide our intellectual property to third parties through standard licensing agreements. The purposes of these agreements are to both define the extent and duration of any third party usage rights and to provide for our continued ownership in any intellectual property furnished.

Because of the value of our brand name and logo, we have tried to register one or both of them in all of the relevant international classes under the trademark laws of most of the jurisdictions in which we do business. As we move into new markets, we are continuing to effect these registrations and, in some jurisdictions, the registration of certain product identifiers as well. To date, we have registered our name and/or logo in 14 countries and the European Union and have applied for registrations in six other countries.

We currently hold three U.S. patents, one U.K. patent, and one Canadian patent. We do not rely on our patents and do not believe patents are important to our business.

We have encountered jurisdictions in which a third party has a pre-existing trademark in certain relevant international classes. In Australia, a third party has a pre-existing trademark registration that incorporates the name "Morningstar." We have not yet proceeded with a registration of our brand name or logo in Australia and, to date, have not been actively challenged by the third party registrant. In addition, we were not able to successfully register the "Morningstar" name and logo in Germany with respect to certain products because another party holds a pre-existing registration on the name. It is possible that our continued ability to use the "Morningstar" name or logo, either on a stand-alone basis or in association with certain products or services, could be compromised in these jurisdictions because of the pre-existing registrations.

In addition to licensing and non-disclosure agreements, a number of practical considerations help to protect our intellectual property:

- Two decades of data collection have enabled us to create one of the largest proprietary databases of historical investment information in the industry.
- Access to this proprietary database is necessary to enable most of our products to function properly.

- We continue to update and enhance our products so that newer versions contain more features and functions than their older counterparts.

Government Regulation

United States

Our investment advisory and broker-dealer businesses are subject to extensive regulation in the United States at both the federal and state level, as well as by self-regulatory organizations. Financial services businesses are among the nation's most extensively regulated. The SEC is responsible for enforcing the federal securities laws and serves as a supervisory body for all federally registered investment advisors and broker-dealers.

Three of our subsidiaries, Morningstar Investment Services, Inc., Morningstar Associates, LLC, and mPower Advisors, LLC are registered as investment advisors with the SEC under the Investment Advisers Act of 1940 (Advisers Act). As registered investment advisors, these companies are subject to the requirements and regulations of the Advisers Act. Such requirements relate to, among other things, record-keeping and reporting requirements, disclosure requirements, and limitations on principal transactions between an advisor and advisory clients, as well as general anti-fraud prohibitions.

We provide each of our investment advisor companies with financial and operational support. However, each of them operates independently from other areas of Morningstar, using separate personnel and making independent investment decisions.

Morningstar Investment Services is a broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act) and a member of the NASD. The regulation of broker-dealers has, to a large extent, been delegated by the federal securities laws to self-regulatory organizations, including the NASD. Subject to approval by the SEC, the NASD adopts rules that govern its members. The NASD conducts periodic examinations of the operations of Morningstar Investment Services. Broker-dealers are subject to regulations that cover all aspects of the securities business, including sales practices, market making and trading among broker-dealers, use and safekeeping of clients' funds and securities, capital structure, record-keeping, and the conduct of directors, officers, and employees. Violation of applicable regulations can result in the revocation of a broker-dealer license, the imposition of censures or fines, and the suspension or expulsion of a firm, its officers, or employees. Morningstar Investment Services is subject to certain net capital requirements under the Exchange Act. The net capital requirements, which specify minimum net capital levels for registered broker-dealers, are designed to measure the financial soundness and liquidity of broker-dealers.

Additional legislation and regulations, including those relating to the activities of investment advisors and broker-dealers, changes in rules imposed by the SEC or other U.S. or foreign regulatory authorities and self regulatory organizations or changes in the interpretation or enforcement of existing laws and rules may adversely affect our business and profitability. Our businesses may be materially affected not only by regulations applicable to it as an investment advisor or broker-dealer, but also by regulations of general application.

Australia

In order to provide financial information services in Australia, our Australian subsidiary, Morningstar Research Pty Limited (Morningstar Australia), must hold an Australian Financial Services License and submit to the jurisdiction of the Australian Securities and Investments Commission (ASIC). This license requires Morningstar Australia to maintain positive net asset levels and sufficient cash resources to cover three months of expenses and to comply with the audit requirements of the ASIC. The availability of this license may be adversely affected by the legal proceeding described in Note 15 of the Notes to our Consolidated Financial Statements.

Licensing Agreements

Agreements with Customers

In the majority of our licensing agreements, we license our products and/or other intellectual property to our customers for a fee. We generally use our own form of standard agreements, whether in paper or electronic form, and we do not provide our products and services to customers or other users without having an agreement in place.

Other Licensing Agreements

We also maintain licensing agreements with each of our joint venture companies. We put these agreements in place so these companies can use our intellectual property, such as our products and trademarks, to develop and market similar products under our name. If we dissolve a subsidiary or terminate a joint venture, all licensed rights granted by us terminate. The only exception is our joint venture in Japan (Morningstar Japan). It has the right to continue to use our intellectual property for up to one year after the termination of its joint venture agreement if that termination is not caused by Morningstar Japan's breach. In all cases, we retain ownership of all information licensed and own or have the right to acquire any works that are created from that information.

As well as acting as a licensor of intellectual property, we also license certain intellectual property from third parties. In the ordinary course of our business, we incorporate and use intellectual property from a variety of third-party sources.

Properties and Facilities

Our headquarters are located in Chicago, Illinois, and consist of approximately 133,000 square feet of leased space. Our lease on this space expires in January 2009. We lease an additional 60,500 square feet in 19 offices located around the world. We believe that our headquarters and other offices are adequate for our immediate needs and that additional or substitute space is available if needed to accommodate growth and expansion.

Employees

We had approximately 830 employees as of December 31, 2003. Our employees are not represented by any collective bargaining organization and we have never experienced a work stoppage.

Legal Proceedings

In March 2002 Mr. Graham Rich, a former managing director, chief executive officer, and beneficial shareholder of Morningstar Australia, and two companies controlled by Mr. Rich named us and several of our employees in a proceeding brought in the Equity Division of the Supreme Court of New South Wales, Australia. In the proceeding, Mr. Rich and his affiliates are pursuing monetary and equitable remedies, including an order setting aside our purchase of certain of Mr. Rich's shares in Morningstar Australia. In February 2004, we offered to settle all claims for Australian $1.25 million, which then approximated U.S. $942,000, and we recorded a reserve of this amount for these claims in the fourth quarter of 2003. While we are vigorously contesting the claims against us, this proceeding is not yet in the documentary discovery stage and its likely outcome cannot be determined at this time. In 2003 and in the nine months ended September 30, 2004, Morningstar Australia generated total revenue of U.S. $3.7 million and U.S. $3.2 million, respectively. For more information on this matter, see Note 15 of the Notes to our Consolidated Financial Statements.

The staff of the Securities and Exchange Commission is conducting an investigation related to incorrect total return data that we published from March 12, 2004 to March 23, 2004 with respect to a single mutual fund, the Rock Canyon Top Flight Fund, that overstated the fund's returns. In May 2004, we received a "Wells Notice" from the staff of the Division of Enforcement of the SEC indicating that it intended to recommend that the SEC take legal action against us alleging that we violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)-5 promulgated thereunder. We have been fully cooperating with the staff of the SEC in its investigation and continue to be in discussions with the SEC regarding this matter. We cannot predict the scope, timing, or outcome of the investigation, 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, these matters may have on our business, financial condition, results of operations, and cash flow.

At our initiative in response to the investigation described in the paragraph above and as part of our ongoing effort to continually improve our processes, we have taken numerous steps to strengthen our quality-control procedures, including increasing our communication efforts, centralizing lines of reporting for data questions or errors, augmenting the stringent business rules we have in place, and improving our data analyst training. See " — Integrity and Quality" for additional information.

In December 2004, Morningstar Associates, LLC, a wholly owned subsidiary of Morningstar, Inc., received a request in the form of a subpoena from the New York Attorney General's office, seeking information and documents from Morningstar Associates, LLC related to an investigation the New York Attorney General's office is conducting. While the subpoena is very broad, it specifically asks for information and documents about the investment consulting services Morningstar Associates, LLC offers to retirement plan providers, including fund lineup recommendations for retirement plan sponsors. We have been fully cooperating with the New York Attorney General's office. Shortly after the New York Attorney General's office issued the subpoena, the SEC notified Morningstar Associates, LLC that it had begun an examination of the investment consulting services Morningstar Associates, LLC offers to retirement plan providers. We cannot predict the scope, timing, or outcome of the investigation or examination 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, these matters may have on our business, financial condition, results of operations, and cash flow.

In addition to these proceedings, from time to time, we are involved in legal proceedings and litigation that arise in the normal course of our business.

Management

Executive Officers and Directors

The name, age, position, and a brief account of the business experience of each of our executive officers and directors are set forth below.

Name	Age	Position
Joe Mansueto	48	Chairman, Chief Executive Officer and Director
Tim Armour	56	Managing Director
Chris Boruff	39	President, Advisor Business
Bevin Desmond	38	President, International Business
Martha Dustin Boudos	38	Chief Financial Officer and Secretary
Catherine Gillis Odelbo	42	President, Individual Business
Tao Huang	42	Chief Operating Officer
Elizabeth Kirscher	40	President, Data Services Business
Art Lutschaunig	46	President and Chief Investment Officer, Morningstar Investment Services
Don Phillips	42	Managing Director and Director
Patrick Reinkemeyer	39	President, Morningstar Associates
John Rekenthaler	43	Vice President, New Product Development
David W. Williams	44	Managing Director, Design
Cheryl Francis	51	Director
Steve Kaplan	45	Director
Jack Noonan	57	Director
Paul Sturm	58	Director

Joe Mansueto

Joe Mansueto founded Morningstar in 1984. He has served as our chairman since our inception, and as our chief executive officer from inception to 1996 and from 2000 to the present. He holds a bachelor's degree in business administration from The University of Chicago and a master's degree in business administration from The University of Chicago Graduate School of Business.

Tim Armour

Tim Armour has been one of our managing directors since 2000. He is responsible for strategic relationships and business development. He joined us in 1998 as our chief operating officer and from 1999 to 2000 served as our president. He holds a bachelor's degree in business administration from Gettysburg College and a master's degree in business administration from the Columbia Business School at Columbia University.

Chris Boruff

Chris Boruff has been the president of our advisor business since 2000. He is responsible for overseeing strategy, development, and marketing associated with our products for financial advisors. He joined us in 1996 as product manager for Principia, and from 1997 to 1998, he served as senior product manager of advisor products. From 1999 to 2000, he served as vice president of advisor products, where he was responsible for all marketing related to financial advisors. He holds a bachelor's degree in economics and psychology from Northwestern University.

Bevin Desmond

Bevin Desmond has been president of our international business since 2000. She is responsible for identifying and developing new markets, managing and directing operations, and launching new products. She joined us in 1993 and was one of three employees who started our international business. From 1998 to 2000, she served as manager of all international ventures. She holds a bachelor's degree in psychology from St. Mary's College.

Martha Dustin Boudos

Martha Dustin Boudos has been our chief financial officer since 2001 and our secretary since April 2004. She is responsible for finance, human resources, legal, and compliance. She joined us in 1992 as a marketing manager. She also played a key role in the creation of our Web site, Morningstar.com. From 2000 to 2001, she was responsible for our retirement advice service. During 2001, she served as our vice president of human resources. She holds a bachelor's degree in political science from Wellesley College and a master's degree in business administration from the Kellogg School of Management at Northwestern University.

Catherine Gillis Odelbo

Catherine Gillis Odelbo has been president of our Individual segment since 2000. She joined us in 1988 as a mutual fund analyst and from 1999 to 2000 served as senior vice president of content development for the company, as well as publisher and editor of our stock and closed-end fund research. She holds a bachelor's degree in American history from The University of Chicago and a master's degree in business administration from The University of Chicago Graduate School of Business.

Tao Huang

Tao Huang has been our chief operating officer since 2000. He is responsible for corporate strategy, oversight of all business units, and directing our day-to-day operations. He joined us in 1990 as a software developer and from 1996 to 1998 served as chief technology officer. During 1998, he served as president of international operations, where he was responsible for increasing our presence worldwide. From 1998 to 2000, he served as senior vice president of business development and head of Internet operations. He holds a bachelor's degree in computer science from Hunan University in China, a master's degree in computer science from Marquette University, and a master's degree in business administration from The University of Chicago Graduate School of Business.

Elizabeth Kirscher

Elizabeth Kirscher has been president of our data services business since 2000. She is responsible for managing our investment databases and related products. She joined us in 1995 as a major accounts manager in our institutional sales area. From 1998 to 1999, she served as international product manager and worked on the launch of Morningstar Japan. From 1999 to 2000, she was director of sales and business development for Morningstar.com and marketed Morningstar.com data and tools to other Web sites. She holds a bachelor's degree from Vassar College and a master's degree in business administration from the Columbia Business School at Columbia University.

Art Lutschaunig

Art Lutschaunig has been president and chief investment officer for Morningstar Investment Services since August 2001. He is responsible for managing the investment services business, including oversight of the group's investment research and portfolio management. Before joining us in May 2001, he was an independent consultant. From 2000 to 2001, he served as president of Giving Capital, Inc. He holds a bachelor's degree in marketing from Villanova University.

Don Phillips

Don Phillips has been one of our managing directors since 2000. He is responsible for corporate strategy, research, and corporate communications. He joined us in 1986 as our first analyst. He served as our vice president and publisher from 1991 to 1996, as our president from 1996 to 1998, and as our chief executive officer from 1998 to 2000. He also serves on the board of directors for Morningstar Japan. He has served on our board of directors since August 1999. He holds a bachelor's degree in English from the University of Texas and a master's degree in American literature from The University of Chicago.

Patrick Reinkemeyer

Patrick Reinkemeyer has been president of Morningstar Associates since October 2004. He is responsible for Morningstar's investment consulting and retirement businesses. From 2001 until October 2004, Reinkemeyer served as president of Morningstar's institutional investment consulting business. He joined us in 1996. From 1996 to 1997, he directed our print and software variable annuity/life products. He holds a bachelor's degree in history from Middlebury College and a master's degree in business administration from The University of Chicago Graduate School of Business.

John Rekenthaler

John Rekenthaler has been vice president of new product development since October 2004 and is responsible for leading product development throughout our global organization. From 2001 until October 2004, he served as president of Morningstar Associates and head of the company's retirement advice business. He joined us in 1988 as an assistant editor and from 1998 to 2000 served as our director of research. From 1991 to 1995, he served as editor of *Morningstar Mutual Funds* and *Morningstar FundInvestor* . He holds a bachelor's degree in English from the University of Pennsylvania and a master's degree in business administration from The University of Chicago Graduate School of Business.

David W. Williams

David W. Williams has been one of our managing directors since 2000. He is in charge of design and its application to brand identity, products, communications, and the workplace. He joined us in 1993 and has been instrumental in establishing design as one of our recognized core capabilities. He holds a bachelor's degree in industrial design from The Ohio State University and a master's degree in fine arts from the Yale University School of Art.

Cheryl Francis

Cheryl Francis was elected to our board of directors in July 2002. She has been vice chairman, Corporate Leadership Center, since 2002 and an independent business and financial advisor since 2000. From 1995 to 2000, she served as executive vice president and chief financial officer of R.R. Donnelley & Sons Company, a print media company. She currently serves as a member of the board of directors of HNI Corporation and Hewitt Associates, as well as a trustee for Cornell University. She holds a bachelor's degree from Cornell University and a master's degree in business administration from The University of Chicago Graduate School of Business.

Steve Kaplan

Steve Kaplan served as a member of our advisory board beginning in 1998 and was elected to our board of directors in August 1999. Since 1988, he has been a professor at The University of Chicago Graduate School of Business where he currently is the Neubauer Family Professor of Entrepreneurship and Finance. He holds a bachelor's degree in applied mathematics and economics from Harvard College and a Ph.D. in business economics from Harvard University. He also serves on the board of trustees of the Columbia Acorn Funds where he serves as a member of the governance and compliance committees.

Jack Noonan

Jack Noonan served as a member of our advisory board beginning in 1998 and was elected to our board of directors in August 1999. Since 1992, he has served as president and chief executive officer of SPSS Inc., a software company specializing in predictive analytics, where he also currently serves on the board of directors.

Paul Sturm

Paul Sturm served as a member of our advisory board beginning in 1998 and was elected to our board in August 1999. Since 1992, he has worked at *Smart Money* Magazine where he currently writes a monthly column on investing. From 1985 to 1989, he was assistant managing editor at *Business Week* . From 1980 until 1985, he held a similar position at *Forbes* . Prior to that, he worked as a business writer for a variety of publications based in New York, Washington, and London. He holds a bachelor's degree in economics from Oberlin College and a master's degree in journalism from Columbia University. He received a law degree from Georgetown University Law Center.

Board of Directors

Our board consists of six directors, four of whom our board has determined satisfy the independence criteria set forth in the NASDAQ Marketplace Rules. Each member is subject to election at each annual meeting of shareholders. The authorized number of directors may be changed only by resolution of the board of directors or a vote of the shareholders.

We do not intend to rely on the "controlled company" exception to the NASDAQ Marketplace Rules. Accordingly, we intend to comply with the rules generally requiring that companies listed on NASDAQ have a majority of independent directors and maintain a compensation committee and a nominating and corporate governance committee composed entirely of independent directors. Following completion of this offering, a majority of our directors will be independent and all of the directors on our compensation and nominating and corporate governance committees will be independent.

Committees of the Board of Directors

Audit Committee

We have established an audit committee made up solely of independent directors consisting of Cheryl Francis, Steve Kaplan, and Paul Sturm. Cheryl Francis serves as the chair of our audit committee. We believe that each of the members of our audit committee is financially sophisticated and able to read and understand our financial statements, and our board has determined that Cheryl Francis is an audit committee financial expert within the meaning of the Sarbanes-Oxley Act of 2002. The audit committee's duties include:

- reviewing and recommending to the board internal accounting and financial controls and accounting principles and auditing practices to be employed in the preparation and review of our financial statements;
- making recommendations to the board concerning the engagement of an independent auditor to audit our annual financial statements and the scope of the audit to be undertaken by such auditors; and
- approving in advance all audit services to be provided to us and all non-audit services to be provided to us by our independent auditor.

Compensation Committee

We have established a compensation committee made up solely of independent directors consisting of Steve Kaplan, Jack Noonan, and Paul Sturm. Steve Kaplan serves as chairman of our compensation committee. The compensation committee is appointed by the board to assist in establishing annual and long-term performance goals and compensation for senior management. The compensation committee ensures that executive compensation remains competitive in order to retain and attract talent to Morningstar and is closely linked to both individual and company performance. The compensation committee's duties include:

- reviewing at least annually the performance of senior management in meeting our goals and objectives and recommending actions to the board regarding base salaries, incentive plans, and equity-based plans for senior management;
- overseeing the administration of our option plans and other compensation plans, approving plan amendments, overseeing compliance, and interpreting plan guidelines;
- approving annual award grants to employees and changes in share price; and
- providing an annual summary report on executive compensation to the board of directors.

Nominating and Corporate Governance Committee

Effective upon the completion of this offering, we will establish a nominating and corporate governance committee composed solely of independent directors. The nominating and corporate governance committee will assist the board with its responsibilities regarding:

- the identification of individuals qualified to become board members;
- the selection of director nominees for the next annual meeting of shareholders; and
- the selection of director candidates to fill any vacancies on the board of directors.

We have adopted charters and corporate governance guidelines for our audit committee and compensation committee. We will adopt a charter for our nominating and corporate governance committee prior to the completion of this offering. We will make each of these documents available on our Web site at www.morningstar.com.

Director Compensation

Each non-employee director is entitled to receive a fee of $1,000 per board meeting and $500 per committee meeting attended, plus travel expenses in connection with attendance at meetings. As chair of the audit committee, Cheryl Francis will receive an annual retainer of $5,000 beginning in 2005. Upon election to the board, non-employee directors receive a grant of options to purchase 60,000 shares of our common stock at an exercise price equal to the fair market value of such stock at the date of grant. Non-employee directors are also entitled to receive an annual grant of options to purchase 12,000 shares of our common stock. Options granted to our non-employee directors vest over three years. The option grants to our non-employee directors for 2004 have an initial exercise price equal to $14.70 per share, with the exercise price increasing over the term of the options at a rate equal to the 10-year Treasury yield rate as of the date of grant. Subject to the discretion of our board and our compensation committee, we intend to continue the practice of granting options with similar exercise price features to non-employee directors for the foreseeable future. See "—Executive Compensation." Directors who are also our employees do not receive any additional compensation for serving on the board of directors or attending board meetings.

Compensation Committee Interlocks and Insider Participation

None of our executive officers serves as a member of the board of directors or the compensation committee of any other company that has one or more executive officers serving as a member of our board of directors or compensation committee. Prior to the formation of the compensation committee in 2003, the board of directors as a whole made decisions relating to compensation of our executive officers. Our compensation committee currently consists of Steve Kaplan, Jack Noonan, and Paul Sturm. Prior to April 30, 2004, our compensation committee consisted of Steve Kaplan, Jack Noonan, and our chief executive officer, Joe Mansueto. On August 31, 1999, Joe Mansueto loaned us $6.5 million that we repaid on March 30, 2004. Additionally, a corporation wholly-owned by him provided sales services to us between 1995 and 2003 that we discontinued effective December 31, 2003. For more information on these transactions, see "Certain Relationships and Related Party Transactions—Transactions Involving Joe Mansueto."

Executive Compensation

Our compensation philosophy is to pay senior management competitive base salaries and provide them the opportunity to earn meaningful incentive compensation, ranging from 50% to 120% of base compensation, through the Morningstar Incentive Plan. Equity awards that vest over time are also an important component of how we reward employees. We believe equity awards can help align the economic interests of our management with those of our shareholders. To better ensure that the benefits of these awards are tied to meaningful appreciation in shareholder value, we granted options in 2004 with an initial exercise price equal to $14.70 per share, with the exercise price increasing over the term of the options at a rate equal to the 10-year Treasury yield rate as of the date of grant. Subject to the discretion of our board and our compensation committee, we intend to continue the practice of granting options with similar exercise price features for the foreseeable future.

Our board has adopted share ownership requirements for our senior management. Our managing directors and presidents are required to own shares of our common stock with a value equal to at least two times and one times their annual base salaries, respectively. The policy also requires that senior management retain a meaningful portion of the after-tax value they realize through equity awards, such as options, for so long as they remain employed with us. Our senior management must retain at least 80% of such value before they satisfy applicable share ownership requirements and 40% of such value after they satisfy those requirements.

CEO Compensation

In consideration of his status as our principal shareholder, Joe Mansueto believes that his compensation as our chief executive officer should be realized primarily through appreciation in the long-term value of our common stock. Accordingly, at his request, he does not participate in our equity or cash-based incentive programs. In addition, since resuming his role as our chief executive officer in 2000, his annual salary has been fixed at $100,000. While our compensation committee will continue to have the discretion to review and make recommendations concerning his compensation, we expect that his salary will remain at $100,000 per year for the foreseeable future.

Compensation of Executive Officers

The following table shows all compensation earned or received during the year ended December 31, 2003 by our chief executive officer and our five other senior executive officers (the named executive officers), the first four of whom qualify as our most highly compensated executive officers, for the year ended December 31, 2003.

	Annual			**Long Term**	
Summary Compensation	**Salary**	**Bonus (1)**	**Shares Underlying Option Awards**	**LTIP Payouts (2)**	**All Other (3)**
Joe Mansueto Chairman and Chief Executive Officer	$ 100,000	$ —	—	$ —	$ 8,304
Tim Armour Managing Director	275,000	157,500	10,000	17,684	12,276
Martha Dustin Boudos Chief Financial Officer and Secretary	200,000	189,283	100,000	20,716	12,204
Tao Huang Chief Operating Officer	250,000	311,071	50,000	28,295	12,252
Don Phillips Managing Director	300,000	136,250	10,000	20,716	12,300
David W. Williams Managing Director, Design	160,000	110,000	10,000	13,251	11,766

(1) This table does not include deferred cash bonus amounts that may be payable to certain of our named executive officers if we meet certain performance targets in the year ending December 31, 2004. If the performance targets are met, all of the deferred cash bonus amounts will be paid. If the performance targets are not met, none of the deferred cash bonus amounts will be paid. For a more detailed description of our Incentive Plan, see "—Morningstar Incentive Plan." These deferred cash bonus amounts are as follows: Tim Armour $7,500; Martha Dustin Boudos $14,283; Tao Huang $11,070; Don Phillips $11,250; and David W. Williams $10,000.

(2) "LTIP Payouts" consist of deferred cash bonus amounts under our Incentive Plan that were paid to certain of our named executive officers for meeting certain performance targets for the year ended December 31, 2003.

(3) "All Other" includes matching contributions to our 401(k) plan for the year ended December 31, 2003 for our named executive officers in the following amounts: Joe Mansueto $8,272; Tim Armour $12,000; Martha Dustin Boudos $12,000; Tao Huang $12,000; Don Phillips $12,000; and David W. Williams $11,600; and also includes the amounts paid for basic life insurance and accidental death and dismemberment insurance on behalf of our named executive officers as follows: Joe Mansueto $32; Tim Armour $276; Martha Dustin Boudos $204; Tao Huang $252; Don Phillips $300; and David W. Williams $166.

Option Grants

The following table shows certain information concerning grants of common stock options to each of our named executive officers for the year ended December 31, 2003.

					Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
Option Grants in 2003	**Number of Securities Underlying Options (2)**	**Percent of Total Options Granted to Employees**	**Exercise Price Per Share**	**Expiration Date**	**5% (3)**	**10% (3)**
Joe Mansueto (1)	—	—%$	—	—	$ —	$ —
Tim Armour	10,000	1.3	8.57	5/1/2013	51,912	126,326
Martha Dustin Boudos	100,000	12.6	8.57	5/1/2013	519,121	1,263,265
Tao Huang	50,000	6.3	8.57	5/1/2013	259,560	631,632
Don Phillips	10,000	1.3	8.57	5/1/2013	51,912	126,326
David W. Williams	10,000	1.3	8.57	5/1/2013	51,912	126,326

(1) Joe Mansueto does not receive options under our stock option plans.

(2) These options have a term of 10 years and vest in equal annual amounts over four years.

(3) The potential realizable values represented in the table assume stock price appreciation of 5% and 10%, compounded annually over the life of the option from the date of grant. The appreciation values are disclosed in keeping with SEC requirements and are not meant to represent our forecast of future share price appreciation.

Aggregate Option Exercises in 2003 and Year-End Option Values

The following table shows information concerning the exercise of stock options during the year ended December 31, 2003 by our named executive officers and the value of unexercised options as of December 31, 2003. None of our named executive officers exercised any options in 2003.

	Number of Securities Underlying Unexercised Options		Value of Unexercised In-the-Money Options (1)	
Aggregate Option Exercises	**Exercisable**	**Unexercisable**	**Exercisable**	**Unexercisable**
Joe Mansueto	—	—	$ —	$ —
Tim Armour	478,561	84,363		
Martha Dustin Boudos	94,174	204,546		
Tao Huang	890,869	525,777		
Don Phillips	1,305,772	389,228		
David W. Williams	100,725	43,539		

(1) We determined the value of unexercised in-the-money options at December 31, 2003 by calculating the difference between an assumed initial public offering price of $ per share (the midpoint of the range set forth on the cover of

this prospectus) and the option exercise price of each applicable in-the-money option multiplied by the number of shares underlying such option.

Employment Agreements and Change in Control Arrangements

We do not have any employment agreements, termination agreements, or change-in-control agreements with any of our named executive officers.

Morningstar Incentive Plan

We have adopted the Morningstar Incentive Plan (Incentive Plan), formerly known as the Morningstar Bonus Program, that rewards employees for meeting and exceeding annual performance goals established by the compensation committee that we expect to be based on operating income before stock-based compensation expense.

Eligibility to participate in the Incentive Plan is limited to all regular full-time and part-time employees who

- are employed when the payments are made during the first quarter of the following year; and
- are not be eligible to participate in any other annual bonus or incentive plan.

Employees are eligible to receive bonuses based on meeting financial goals that are set for both specific businesses and the company as a whole. Employees who work at the corporate level (including our executive officers and managing directors) receive bonuses based solely on the profitability of the company.

Goals for the Incentive Plan are established by our compensation committee at the beginning of the year. If a business or the company misses its financial goals in a given year, the bonus is reduced and if the shortfall is substantial enough, eliminated.

The company retains a portion of each annual bonus pool for one year to encourage continued positive results in the following year. This deferred amount is payable to employees only if performance in the business or company meets the minimum financial goals set for the following year.

Bonus payouts are determined at year-end once financial results are final and audited and are paid in cash. Each individual's bonus is based upon the individual's contribution to the success of the specific business measured or the company.

In addition, commissioned sales employees, temporary employees, and any independent contractors are not eligible to participate in the Incentive Plan.

The compensation committee administers the Incentive Plan and has the authority to construe, interpret, and implement the Incentive Plan and prescribe, amend, and rescind rules and regulations relating to the Incentive Plan. The determination of the compensation committee on all matters relating to the Incentive Plan or any award agreement is final, binding, and conclusive.

Morningstar 1999 Incentive Stock Option Plan

We maintain the Morningstar 1999 Incentive Stock Option Plan (the 1999 Option Plan). A copy of the 1999 Plan is filed as an exhibit to this registration statement of which this prospectus is a part.

As of September 30, 2004, options to purchase 869,174 shares were outstanding under the terms of the 1999 Option Plan, of which options to purchase 724,598 shares of common stock were exercisable. No additional options may be granted under the 1999 Option Plan. All outstanding options under the 1999 Option Plan will continue to be governed by their existing terms.

Morningstar 2004 Stock Incentive Plan

Historically, we have maintained the Morningstar 1993 Stock Option Plan, the Morningstar 2000 Stock Option Plan, and the Morningstar 2001 Stock Option Plan (collectively, the Prior Plans), under which we have granted stock options to certain of our employees and non-employee directors. The Morningstar 2004 Stock Incentive Plan (2004 Equity Plan) amended and restated the Prior Plans.

As of September 30, 2004, 8,501,293 shares were issuable upon exercise of outstanding options granted under the Prior Plans, of which options to purchase 7,015,025 shares of common stock were exercisable. 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 an option or in payment of any required income tax withholding, will not be available for awards under the 2004 Equity Plan.

The 2004 Equity Plan provides for grants of options, stock appreciation rights, restricted stock, restricted stock units, and performance shares. All of our employees are eligible for awards under the 2004 Equity Plan. Joe Mansueto does not participate in the Plan. Awards may also be made to our non-employee directors under the Plan. A total of 5,628,843 options may be granted under the Plan from 2004 through 2008.

In December 2004, approximately 1.6 million options to purchase shares of our common stock were granted under the 2004 Equity Plan. As indicated in the following table, 760,000 of these options were granted to our executive officers, all with an initial exercise price of $14.70, with the exercise price increasing over the term of the options at a rate equal to the 10-year Treasury yield rate as of the date of grant.

Executive Officer	Number of Options
Joe Mansueto	—
Tim Armour	25,000
Martha Dustin Boudos	80,000
Tao Huang	110,000
Don Phillips	40,000
David W. Williams	55,000
Named executive officers as a group	310,000
Executive officers as a group (13 persons)	760,000

Options to acquire 9,370,467 shares of our common stock were outstanding at September 30, 2004, 7,739,623 of which were exercisable at a weighted average exercise price of $9.79 per share. An additional 5,628,843 shares of common stock were reserved for issuance under our 2004 Equity Plan. Shares delivered pursuant to awards may consist of authorized but unissued common stock or authorized and issued common stock held in treasury. Any shares subject to an award under the 2004 Equity Plan that are forfeited, canceled, settled, or otherwise terminated without a distribution of shares, or withheld by us in connection with the exercise of an option or in payment of any required income tax withholding, will again be available for awards under this plan.

The compensation committee administers the 2004 Equity Plan. It has the authority to construe, interpret, and implement the 2004 Equity Plan; prescribe, amend, and rescind rules relating to the Plan; and grant awards and determine who receives awards. The compensation committee may also modify, extend, or renew outstanding awards, as long as participants consent if their rights are impaired. It also has the authority to adjust the terms of any outstanding awards and the number of shares of the common stock issuable under the 2004 Equity Plan to prevent the enlargement or dilution of rights, or for any increase or decrease in the number of issued shares of our common stock (or the issuance of shares of stock other than shares of common stock) resulting from a recapitalization, stock split, reverse stock split, stock dividend, spin-off, combination, or reclassification or exchange of the shares of our common stock, merger, consolidation, rights offering, separation, reorganization, or any other change in corporate structure or event the compensation committee determines in its sole discretion affects our capitalization. The determination of the compensation committee on all matters relating to the 2004 Equity Plan or any award agreement is final, binding, and conclusive.

Except to the extent otherwise provided in the award agreement or approved by the compensation committee, no award or right granted to any person under the 2004 Equity Plan is assignable or transferable other than by will or by the laws of descent and distribution, or through a qualified domestic relations order. All awards and rights are exercisable during the life of the grantee only by the grantee or the grantee's legal representative.

The 2004 Equity Plan automatically terminates 10 years after its adoption by the board, or if earlier, when all reserved shares have been issued. Except as otherwise provided in an award agreement, the board of directors may from time to time suspend, discontinue, revise, or amend the 2004 Equity Plan provided that no amendment will materially adversely affect a grantee without that person's prior written consent.

401(k) Plan

Our employees are eligible to participate in our 401(k) plan. Under our 401(k) plan, employees may elect to make annual salary reduction contributions up to the lesser of 100% of eligible compensation less applicable tax withholding or the statutorily prescribed annual limit, which was $13,000 in 2004. The 401(k) plan is intended to qualify under Section 401 of the Code, so that the contributions by our employees will be deductible by us when made and income earned on plan contributions will not be taxable to the employees until withdrawn or distributed. We match the contributions of our employees up to 7% of their salary, with 50% of the matching contributions vesting after the first year and 100% vesting after the second year.

Deferred Compensation Agreement with Don Phillips

In February 1999, Don Phillips held options to acquire 1,500,000 shares of our common stock at an exercise price of $0.075 per share. Under the terms of the options, which were granted to him in 1989 and scheduled to expire in 1999, he had the ability to exercise the options at an aggregate exercise price of $112,500. Rather than require him to exercise the options and potentially obligate ourselves to repurchase his shares, we entered into an arrangement with him under which the options granted to him in 1989 were permitted to expire and we granted him, on February 15, 1999, new options to purchase 1,500,000 shares of our common stock at an exercise price of $2.77 per share, representing the fair market value of our common stock as determined by our board. Of these option shares, 1,138,560 were fully vested and exercisable upon grant and 361,440 vest in equal annual installments over 10 years.

To compensate Don Phillips for the $2.69 per share increase in exercise price between his expired and new options, we entered into a deferred compensation agreement dated February 15, 1999 that obligates us, subject to certain limitations, to pay him $2.69 for each share of our common stock that he acquires upon exercise of the options that we granted to him in 1999. At our election, this payment may be made in cash or shares of our common stock. If at the time he becomes entitled to a payment, the fair market value of our stock is below $2.77 per share, the amount of deferred compensation payable to him will be reduced proportionately based on the percentage that the then current fair market value of a share of our common stock represents of $2.77. As of December 31, 2003, he had exercised 630,826 of the options granted to him in 1999 for which he received total deferred compensation of $1.7 million and he continued to hold 869,174 of such options for which up to $2.4 million of deferred compensation remains payable.

Limitation of Liability and Indemnification of Officers and Directors

Our articles of incorporation provide that directors will be not personally liable for monetary damages to us for breaches of their fiduciary duty as directors, unless they violated their duty of loyalty to us or to our shareholders, acted in bad faith, knowingly or intentionally violated the law, authorized illegal dividends or redemptions, or derived an improper personal benefit from their actions as directors. Prior to the completion of this offering, we intend to obtain insurance that insures our directors and officers against specified losses. In addition, our by-laws provide that our directors, officers and employees shall be indemnified by us to the fullest extent authorized by Illinois law, as it now exists or may in the future be amended, against all expenses and liabilities reasonably incurred in connection with their service for or on behalf of us.

In addition, we have entered into separate indemnification agreements with certain of our directors and executive officers. We believe that these provisions and agreements are necessary to attract and retain qualified persons as directors and executive officers. These indemnification agreements may require us to indemnify our directors and executive officers for related expenses, including attorneys' fees, judgments, fines, and settlement amounts incurred by a director or executive officer in an action or proceeding arising out of his or her service as one of our directors or executive officers.

Certain Relationships and Related Party Transactions

Transactions Involving Joe Mansueto

On August 31, 1999 and as part of our conversion from an S Corporation to a C Corporation for federal income tax purposes, Joe Mansueto, our chairman, chief executive officer, and controlling shareholder, loaned us $6.5 million. As a principal shareholder of the company, the loan enabled him to preserve his proportionate share of the net operating loss carry forwards that we had accumulated through the date of our conversion. The loan, which accrued interest at LIBOR plus 150 basis points per year, was payable on demand or no later than July 6, 2004. We repaid the note in full on March 30, 2004.

Between 1995 and 2003, a corporation owned by Joe Mansueto provided sales and other services for us. We agreed to pay an amount equal to the total costs incurred by the corporation in providing these services, consisting solely of compensation related expenses for the corporation's employees (which did not include him), plus 5.0% of these costs. For 2001, 2002 and 2003, we recorded an expense for these services of $2.1 million, $3.3 million, and $2.9 million, respectively, of which $0.1 million, $0.2 million and $0.1 million, respectively, represented the amount paid in excess of the corporation's actual costs. This arrangement was discontinued effective December 31, 2003, at which time all employees of the corporation were transferred to Morningstar.

Transactions Involving Softbank

On July 8, 1999, we entered into an agreement with Softbank pursuant to which Softbank acquired 7,612,500 shares of common stock for a purchase price of $91 million. Under the agreement Softbank has certain rights that will continue following this offering, including:

- the right to appoint one member to our board of directors as long as it owns at least 3,806,250 shares of our common stock;
- two demand registration rights, subject to our right to delay registration under certain circumstances;
- the right, subject to the ability of an underwriter to limit the number of shares to be included in a registration, to participate in or "piggy back" on any public offering of our common stock (other than this offering or any transaction relating to securities issued under an employee benefit plan or as part of any acquisition, merger or business combination); and
- the right to participate on a pro rata basis in any sale of shares of our common stock by Joe Mansueto, excluding any sales to other shareholders of Morningstar or his family members or other affiliates and excluding any sales not exceeding 3 million of his shares of our common stock.

We own approximately a 35% interest in Morningstar Japan, a Japanese corporation in which an affiliate of Softbank owns a 50.5% interest. We and Morningstar Japan entered into a license agreement dated April 8, 1998 pursuant to which we license to Morningstar Japan certain of our financial information products and services, database systems, and trademarks. In June 2000, Morningstar Japan paid the company $1.8 million, representing a lump sum royalty payment for use of the licensed products and services through 2029.

In April 2000, we and Advanced Internet Visions Limited formed a joint venture, Morningstar Asia Limited, to provide financial information and services in Asia, except in Japan and Korea. Initially, we and our partner each owned approximately equal interests in the venture. Subsequently, each of us sold a 10.0% interest in the venture to Softbank Finance Corporation and Softbank Investment International (Strategic) Limited, respectively. On October 1, 2002, we purchased the 60.1% interest in the venture that we did not then own for approximately $5.8 million in cash. See Note 6 of our Notes to the Consolidated Financial Statements.

Yoshitaka Kitao, president and chief executive officer of Softbank Finance Corporation, was elected to our board of directors in August 1999. Mr. Kitao was appointed to the board by Softbank under the terms of the agreement pursuant to which Softbank acquired shares of our common stock. Mr. Kitao resigned from our board of directors on April 23, 2004. Softbank has not appointed a director to replace Mr. Kitao; however, Softbank retains the right to appoint one member to our board as long as it continues to own at least 3,806,250 shares of our common stock. During his service on the board, Mr. Kitao received compensation consistent with our other non-employee directors. See "Management—Director Compensation." During Mr. Kitao's tenure on our board, Bob Takeuchi, president of Softbank Finance America, an affiliate of Softbank Finance Corporation, regularly attended meetings of our board as a representative of Softbank in Mr. Kitao's absence. In consideration for his services, on September 15, 2000 we granted Mr. Takeuchi options to acquire 20,000 shares of common stock at an exercise price of $14.13 per share.

Transactions Involving our Common Stock

During the period from January 1, 2001 through September 30, 2004, the following executive officers exercised options to acquire shares of our common stock on the terms set forth below:

Executive Officer	# Shares Acquired		Total Exercise Price
Tao Huang	28,657	$	75,330
Don Phillips	53,920		149,358
David W. Williams	3,736		7,472
Catherine Gillis Odelbo	40,062 (1)		34,053

(1) Of the 40,062 options exercised, 12,862 shares were immediately sold back to Morningstar to cover the option price and taxes on the exercise.

During the period from January 1, 2001 through September 30, 2004, the following executive officers exercised their right under our 1993 Stock Option Plan to exercise their options and immediately sell the shares back to us for a purchase price equal to the then-current fair market value of the shares of common stock as determined by our board of directors, less the aggregate exercise price of the options. The rights of option holders to require us to purchase their shares will terminate upon completion of this offering.

Executive Officer	# Options Cancelled		Total Purchase Price
Martha Dustin Boudos	15,000	$	177,330
Catherine Gillis Odelbo	15,000		199,200
Tao Huang	8,612		97,832
Don Phillips	214,618		2,209,129 (1)
David W. Williams	6,000		72,780

(1) Excludes $577,687 paid to Don Phillips under a deferred compensation agreement in connection with his exercise of these options. See "Management—Executive Compensation—Deferred Compensation Agreement with Don Phillips."

In addition, we acquired shares of our common stock from the following executive officers at a purchase price equal to the then-current fair market value of our shares as determined by our board of directors:

Executive Officer	# Shares We Acquired	Total Purchase Price
Catherine Gillis Odelbo (1)	31,500	$ 445,095
Tao Huang (2)	157,746	2,228,951

(1) Effective July 23, 2001.

(2) Effective March 19, 2001.

On April 30, 2003, two executive officers purchased shares of our common stock at a purchase price equal to the then-current fair market value of our shares as determined by our board of directors:

Executive Officer	# Shares Acquired	Total Purchase Price
Patrick Reinkemeyer	11,668	$ 99,995
David W. Williams	1,000	8,570

Principal and Selling Shareholders

The following table sets forth certain information regarding beneficial ownership of our common stock as of November 30, 2004 and as adjusted to reflect the sale of the shares of common stock offered pursuant to this prospectus by:

- each of our directors;
- each named executive officer;
- all of our directors and executive officers as a group; and
- the selling shareholder, who is the only other person or group of affiliated persons who we know owns beneficially more than 5.0% of our common stock.

Beneficial ownership is determined in accordance with the rules of the SEC. To compute the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to options held by that person that are currently exercisable or will become exercisable within 60 days after November 30, 2004, are deemed outstanding. However, the shares are not deemed outstanding for purposes of computing percentage ownership of any other person. Unless otherwise indicated in the footnotes below, the persons and entities named in the table have sole voting and/or investment power with respect to all shares beneficially owned, subject to community property laws where applicable.

The table below is based on 38,440,765 shares of our common stock outstanding as of November 30, 2004 and shares outstanding immediately after this offering. As of November 30, 2004, we had 49 shareholders of record.

	Shares Beneficially Owned Prior to this Offering		Number of Shares Being Sold in this Offering	Shares Beneficially C after this Offering
Principal and Selling Shareholders	**# Shares**	**% Shares**	**# Shares**	**# Shares**
Joe Mansueto	30,000,000	78.0%	—	30,000,00
Tim Armour (1)	701,049	1.8	—	701,04
Martha Dustin Boudos (2)	161,845	*	—	161,84
Tao Huang (3)	1,272,803	3.2	—	1,272,80
Don Phillips (4)	1,714,113	4.3	—	1,714,11
David W. Williams (5)	132,750	*	—	132,75
Cheryl Francis (6)	48,000	*	—	48,00
Steve Kaplan (7)	116,000	*	—	116,00
Jack Noonan (7)	116,000	*	—	116,00
Paul Sturm (7)	416,000	1.1	—	416,00
All directors and executive officers as a group (17 persons) (8)	35,879,203	82.3	—	35,879,20
Softbank Finance Corporation (9)	7,612,500	19.8		

* Represents beneficial ownership of less than 1%.

(1) Includes 551,049 shares of common stock issuable upon exercise of stock options exercisable within 60 days of November 30, 2004.

(2) Includes 161,845 shares of common stock issuable upon exercise of stock options exercisable within 60 days of November 30, 2004.

(3) Includes 1,244,146 shares of common stock issuable upon exercise of stock options exercisable within 60 days of November 30, 2004.

(4) Includes 1,536,674 shares of common stock issuable upon exercise of stock options exercisable within 60 days of November 30, 2004.

(5) Includes 128,014 shares of common stock issuable upon exercise of stock options exercisable within 60 days of November 30, 2004.

(6) Includes 48,000 shares of common stock issuable upon exercise of stock options exercisable within 60 days of November 30, 2004.

(7) Includes 116,000 shares of common stock issuable upon exercise of stock options exercisable within 60 days of November 30, 2004.

(8) Includes 5,171,607 shares of common stock issuable upon exercise of stock options exercisable within 60 days of November 30, 2004.

(9) Softbank Finance Corporation's address is 20F Izumi Garden Tower 1-6-1 Roppongi, Minato-ku, Tokyo 106-6020 Japan.

Description of Capital Stock

Our authorized capital stock consists of 200 million shares of common stock, no par value per share, and 5 million shares of preferred stock, no par value per share. After completion of this offering, assuming no exercise of over-allotment option, shares of our common stock and no shares of our preferred stock will be issued and outstanding. The following description of our capital stock and certain provisions of our articles of incorporation and by-laws is a summary. The description below is qualified in its entirety by the provisions of our articles of incorporation and by-laws, which have been filed as exhibits to the registration statement, which includes this prospectus.

Common Stock

The issued and outstanding shares of our common stock are, and the shares of our common stock being offered by us in this offering will be, upon payment for the shares, validly issued, fully paid, and nonassessable. Holders of shares of our outstanding common stock are entitled to receive dividends if our board of directors decides to declare any dividends. See "Dividend Policy." Our common stock is neither redeemable nor convertible. Upon liquidation, dissolution, or winding up of Morningstar, holders of shares of our common stock are entitled to receive, pro rata, our assets that are legally available for distribution, after payment of all debts and other liabilities. Each outstanding share of common stock is entitled to one vote on all matters submitted to a vote of shareholders. Our bylaws do not allow for cumulative voting in the election of directors.

Preferred Stock

Our articles of incorporation authorize the issuance of 5 million shares of preferred stock, no par value per share. Our board of directors is authorized to provide for the issuance of shares of preferred stock in one or more series, and to fix for each series voting rights, if any, designation, preferences and relative, participating, optional or other special rights and such qualifications, limitations, or restrictions as provided in a resolution or resolutions adopted by our board of directors.

The purpose of authorizing our board of directors to issue preferred stock and determine its rights and preferences is to eliminate delays associated with a shareholder vote on specific issuances. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions, future financings, and other corporate purposes, could have the effect of making it more difficult for a third party to acquire, or could discourage a third party from seeking to acquire, a majority of our outstanding voting stock. Upon completion of this offering, there will be no shares of preferred stock outstanding, and we have no present plans to issue any shares of preferred stock.

Options

Options to acquire 9,370,467 shares of our common stock were outstanding at September 30, 2004, 7,739,623 of which were exercisable at a weighted average exercise price of $9.79 per share. An additional 5,628,843 shares of common stock were reserved for issuance under our 2004 Equity Plan.

Co-Sale Rights

We have entered into shareholder agreements with Joe Manseuto, Tim Armour, and Paul Sturm and purchase agreements with Patrick Reinkemeyer and David W. Williams in connection with their purchases of shares of our common stock. Under these agreements, these shareholders are entitled to participate in any proposed sale by a shareholder or shareholders of shares representing a majority of the outstanding shares of our capital stock. If any of these shareholders elects to participate in a proposed sale, such shareholder will be required to sell in the contemplated sale, at the same price and on the same terms as the majority shareholder or shareholders propose to sell, the number of shares equal to the product of (i) such shareholder's pro rata interest in the aggregate number of shares owned by all of the shareholders and (ii) the number of shares to be sold in the contemplated sale. Patrick Reinkemeyer's and David W. Williams' rights under their respective purchase agreements automatically terminate upon the completion of this offering.

Anti-Takeover Effects of Illinois Law and our Articles of Incorporation and Bylaws

Illinois law and our articles of incorporation and by-laws contain several provisions that may make it more difficult for another person to acquire control of us by means of tender offer, open market purchases, proxy contest or otherwise. Set forth below is a description of those provisions.

Illinois Law

Following the completion of this offering, we will be subject to Section 7.85 of the Illinois Business Corporation Act (IBCA). Section 7.85 prohibits a publicly held Illinois corporation from engaging in a business combination unless, in addition to any affirmative vote required by law or the articles of incorporation of the company, the proposed business combination:

- receives the affirmative vote of the holders of at least 80% of the combined voting power of the then outstanding shares of all classes and series of the corporation entitled to vote generally in the election of directors voting together as a single class (the voting shares), and the affirmative vote of a majority of the voting shares held by disinterested shareholders;
- is approved by at least two-thirds of the disinterested directors; or
- provides for consideration offered to shareholders that meets certain fair price standards and satisfies certain procedural requirements.

Such fair price standards require that the fair market value per share of the consideration offered be equal to or greater than the higher of:

- the highest per share price paid by the interested shareholder during the two-year period immediately prior to the first public announcement of the proposed business combination or in the transaction by which the interested shareholder became an interested shareholder; and
- the fair market value per common share on the first trading date after the first public announcement of the proposed business combination or on the first trading date after the date of the first public announcement that the interested shareholder has become an interested shareholder.

For purposes of Section 7.85, disinterested director means any member of the board of directors of the corporation who:

- is neither the interested shareholder nor an affiliate or associate of the interested shareholder;

- was a member of the board of directors prior to the time that the interested shareholder became an interested shareholder or was a director of the corporation before January 1, 1997, or was recommended to succeed a disinterested director by a majority of the disinterested directors then in office; and

- was not nominated for election as a director by the interested shareholder or any affiliate or associate of the interested shareholder.

For purposes of Section 7.85 and Section 11.75 described below, a business combination generally includes a merger, asset sale or other transaction resulting in a financial benefit to an interested shareholder, and an interested shareholder is generally a person who, together with affiliates and associates, owns (or within the prior three years, did own) 15% of the voting shares.

We are also subject to Section 11.75 of the IBCA, which prohibits business combinations with interested shareholders for a period of three years following the date that such shareholder became an interested shareholder, unless:

- prior to such date, the board of directors approved the transaction that resulted in the shareholder becoming an interested shareholder;

- upon consummation of such transaction, the interested shareholder owned at least 85% of the voting shares outstanding at the time such transaction commenced (excluding shares owned by directors who are also officers, and shares owned by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer); or

- on or after such date, the business combination is approved by the board of directors and authorized at a meeting of the shareholders by $66\,^{2}/_{3}\,\%$ of the outstanding voting shares not owned by the interested shareholder.

Illinois law requires the affirmative votes of at least two-thirds of the shares entitled to vote to approve or authorize any:

- merger or consolidation of us with or into another corporation;

- sale, lease, or other disposition of all or substantially all of our assets;

- our dissolution; or

- amendment of our articles of incorporation.

The two-thirds voting requirement may delay, deter, or prevent a change of control of us if the proposed change is not favored by a shareholder or group of shareholders holding more than one-third of our outstanding voting stock.

Elimination of Liability in Certain Circumstances

Our articles of incorporation eliminate the liability of our directors to us or our shareholders for monetary damages resulting from breaches of their fiduciary duties as directors. Directors remain liable for breaches of their duty of loyalty to us or our shareholders, as well as for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law and transactions from which a director derives improper personal benefit. Our articles of incorporation also do not absolve directors of liability under Section 8.65 of the IBCA, which makes directors personally liable for:

- unlawful distributions to shareholders if the director did not act in good faith,
- loss or damage to known creditors resulting from failure to give these creditors notice of the barring of known claims against the corporation after dissolution, or
- debts incurred by a dissolved corporation in carrying on its business except as may be necessary to wind up the business.

The effect of this provision is to eliminate the personal liability of directors for monetary damages for actions involving a breach of their fiduciary duty of care, including any such actions involving gross negligence. We believe that this provision does not eliminate the liability of our directors to us or our shareholders for monetary damages under the Federal securities laws. The articles of incorporation and by-laws also provide indemnification for the benefit of our directors and officers to the fullest extent permitted by Illinois law as it may be amended from time to time, including most circumstances under which indemnification otherwise would be discretionary.

Number of Directors; Removal; Vacancies

Our by-laws provide that we will have no fewer than five and no more than 12 directors, as may be determined by resolution of the board of directors. Vacancies on the board of directors, or any directorship to be filled by reason of an increase in the number of directors, may be filled by the board of directors. Under Illinois law, one or more directors may be removed, with or without cause, at meetings of shareholders by the affirmative vote of the holders of a majority of the outstanding shares that are entitled to vote at an election of directors.

Special Meetings of Shareholders

Our by-laws provide that special meetings of our shareholders may be called only by our chairman of the board, our chief executive officer, our board of directors, or the holders of not less than a majority of all the outstanding shares entitled to vote on the matter for which the meeting is being called or the purpose or purposes stated in the meeting notice.

Authorized But Unissued Shares

The authorized but unissued shares of common stock and preferred stock are available for future issuance without shareholder approval. These additional shares may be utilized for a variety of corporate purposes, including future public offerings to raise additional capital, corporate acquisitions and employee benefit plans. The existence of authorized but unissued shares of common stock and preferred stock could render more difficult or discourage an attempt to obtain control of us by means of a proxy contest, tender offer, merger, or otherwise.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is   .

Listing

We intend to apply to list our shares of common stock on NASDAQ under the symbol "MORN."

Shares Eligible for Future Sale

Following this offering, we will have shares of common stock outstanding. If the underwriter exercises its over-allotment option in full, we will have shares of common stock outstanding. All the shares sold in this offering will be freely tradable without restriction or further registration under the Securities Act, except that any shares purchased by our affiliates, as that term is defined in Rule 144, may generally only be sold in compliance with the limitations of Rule 144 described below.

The remaining shares of common stock outstanding following this offering will be "restricted securities" as the term is defined under Rule 144. We issued and sold these restricted securities in private transactions in reliance on exemptions from registration under the Securities Act. Restricted securities may be sold in the public market only if they are registered or if they qualify for an exemption under Rule 144 or Rule 701 under the Securities Act, as summarized below.

We have agreed with the underwriter that we will not, without the prior written consent of WR Hambrecht + Co, issue any additional shares of common stock or securities convertible into, exercisable for or exchangeable for shares of common stock for a period of 180 days after the date of this prospectus, except that we may grant options to purchase shares of common stock under our stock incentive plans, and issue shares of common stock upon the exercise of outstanding options.

Our officers and directors and the holders of substantially all of our shares of common stock have agreed subject to certain exceptions that they will not, without the prior written consent of WR Hambrecht + Co, offer, sell, pledge or otherwise dispose of any shares of our common stock or any securities convertible into or exercisable or exchangeable for, or any rights to acquire or purchase, any of our common stock, or publicly announce an intention to effect any of these transactions, for a period of 180 days after the date of this prospectus without the prior written consent of WR Hambrecht + Co, except that nothing will prevent any of them from exercising outstanding options.

Taking into account the lock-up agreements, and assuming WR Hambrecht + Co does not release shareholders from these agreements, the following shares will be eligible for sale in the public market at the following times:

- on the date of this prospectus, shares (including the shares sold in this offering) will be immediately available for sale in the public market;
- 90 days after the date of this prospectus, approximately shares will be eligible for sale pursuant to Rule 144 and Rule 701, of which will be subject to volume, manner of sale, and other limitations under Rule 144;
- 180 days after the date of this prospectus, approximately shares will be eligible for sale, of which will be subject to volume, manner of sale, and other limitations under Rule 144; and
- the remaining shares will be eligible for sale under Rule 144 from time to time upon the expiration of various one-year holding periods applicable to those shares.

Shares issuable upon exercise of options we granted prior to the date of this prospectus will also be available for sale in the public market pursuant to Rule 701 under the Securities Act, subject to certain Rule 144 limitations, and, in the case of some holders, to the lock-up agreements. Rule 701 permits resales of these shares beginning 90 days after the date of this prospectus by persons other than affiliates.

In general, under Rule 144, a shareholder who owns restricted shares that have been outstanding for at least one year is entitled to sell, within any three-month period, a number of these restricted shares that does not exceed the greater of:

- 1% of the then outstanding shares of common stock, or approximately shares immediately after this offering; or
- the average weekly trading volume in the common stock on NASDAQ during the four calendar weeks preceding the sale.

Our affiliates must comply with the restrictions and requirements of Rule 144, other than the one-year holding period requirement, to sell any shares of common stock they may own or acquire which are not restricted securities.

Under Rule 144(k), a shareholder who is not currently, and who has not been for at least three months before the sale, an affiliate of ours and who owns restricted shares that have been outstanding for at least two years may resell these restricted shares without compliance with the above requirements. The one- and two-year holding periods described above do not begin to run until the full purchase price is paid by the person acquiring the restricted shares from us or an affiliate of ours.

As of the date of this prospectus, we have granted options to purchase shares of common stock to specified persons pursuant to our stock incentive plans. We intend to file, after the effective date of this offering, a registration statement on Form S-8 to register the sale of approximately shares of common stock upon exercises of options granted under our stock incentive plans. The registration statement on Form S-8 will become effective automatically upon filing. Shares issued under our stock incentive plans, after the filing of a registration statement on Form S-8, may be sold in the open market, subject, in the case of some holders, to the Rule 144 limitations applicable to affiliates and subject to lock-up agreements similar to those described above which we have entered into with holders of substantially all options.

Underwriting

In accordance with the terms of the underwriting agreement between WR Hambrecht + Co, as the sole underwriter, and us, WR Hambrecht + Co has agreed to purchase from us that number of shares of common stock set forth opposite its name below at the public offering price less the underwriting discounts and commissions described on the cover page of this prospectus.

Underwriter	Number of Shares
WR Hambrecht + Co, LLC	

The underwriting agreement provides that the obligations of the underwriter are subject to conditions, including the absence of any material adverse change in our business, and the receipt of certificates, opinions, and letters from the selling shareholder, us, and our respective counsel. Subject to those conditions, the underwriter is committed to purchase all of the shares of our common stock offered by this prospectus if any of the shares are purchased.

The underwriter proposes to offer the shares of our common stock directly to the public at the offering price set forth on the cover page of this prospectus, as this price is determined by the OpenIPO process described below, and to certain dealers at this price less a concession not in excess of $ per share. The underwriter may allow, and dealers may reallow, a concession not to exceed $ per share on sales to other dealers. Any dealers that participate in the distribution of our common stock may be deemed to be underwriters within the meaning of the Securities Act, and any discount, commission, or concession received by them and any provided by the sale of the shares by them may be deemed to be underwriting discounts and commissions under the Securities Act. After completion of the initial public offering of the shares, the underwriter may change the public offering price and other selling terms.

The following table shows the per share and total underwriting discount to be paid to the underwriter by the selling shareholder and us in connection with this offering. The underwriting discount has been determined through negotiations among the selling shareholder, us, and the underwriter, and has been calculated as a percentage of the offering price. These amounts are shown assuming both no exercise and full exercise of the over-allotment option.

	Per Share	Full Exercise	No Exercise
Public Offering Price	$	$	$
Underwriting Discount	$	$	$
Proceeds, before expenses, to us	$	$	$
Proceeds, before expenses, to the selling shareholder	$	$	$

The expenses of this offering payable by us, not including underwriting discounts and commissions, are estimated to be approximately $, which include, among other things, our legal fees, accounting fees, printing expenses, expenses incurred in connection with meetings with potential investors, filing fees of the Securities and Exchange Commission and the National Association of Securities Dealers, Inc., fees of our transfer agent and registrar, and the listing fees of the Nasdaq National Market. The selling shareholder's legal fees are not payable by us.

An electronic prospectus is available on the Web site maintained by WR Hambrecht + Co, the sole underwriter in this offering, and may also be made available on Web sites maintained by selected dealers and selling group members participating in this offering.

The OpenIPO Auction Process

The distribution method being used in this offering is known as the OpenIPO auction, which differs from methods traditionally used in underwritten public offerings. In particular, the public offering price and the allocation of shares are determined primarily by an auction conducted by the underwriter. All qualified individual and institutional investors may place bids in an OpenIPO auction, and investors submitting valid bids have an equal opportunity to receive an allocation of shares.

The following describes how the underwriter and some selected dealers conduct the auction process and confirm bids from prospective investors:

Prior to Effectiveness of the Registration Statement

Before the registration statement relating to this offering becomes effective, the underwriter and participating dealers solicit bids from prospective investors through the Internet and by telephone and facsimile. The bids specify the number of shares of our common stock the potential investor proposes to purchase and the price the potential investor is willing to pay for the shares. These bids may be above or below the range set forth on the cover page of the prospectus. The minimum size of any bid is 100 shares.

The shares offered by this prospectus may not be sold, nor may offers to buy be accepted, prior to the time that the registration statement filed with the SEC is declared effective. A bid received by the underwriter or a dealer involves no obligation or commitment of any kind prior to the closing of the auction. Bids can be modified or revoked at any time prior to the closing of the auction.

Approximately two business days prior to the registration statement being declared effective, prospective investors receive, by e-mail, telephone, or facsimile, a notice indicating the proposed effective date. Potential investors may at any time expressly request that all, or any specific, communications between them and the underwriter and participating dealers be made by specific means of communication, including e-mail, telephone, and facsimile. The underwriter and participating dealers will contact the potential investors in the manner they request.

Effectiveness of the Registration Statement

After the registration statement relating to this offering has been declared effective, potential investors who have submitted bids to the underwriter or a dealer are contacted by e-mail, telephone, or facsimile. Potential investors are advised that the registration statement has been declared effective and that the auction may close in as little as one hour following effectiveness. Bids will continue to be accepted in the time period after the registration statement is declared effective but before the auction closes. Bidders may also withdraw their bids in the time period following effectiveness but before the close of the auction.

Reconfirmation of Bids

The underwriter will require that bidders reconfirm the bids that they have submitted in the offering if any of the following events shall occur:

- more than 15 business days have elapsed since the bidder submitted its bid in the offering;
- there is a material change in the prospectus that requires recirculation of the prospectus by us and the underwriter; or
- the initial public offering price is more than 20% above the high end of the price range or more than 20% below the low end of the price range.

If a reconfirmation of bids is required, the underwriter will send an electronic notice to everyone who has submitted a bid notifying them that they must reconfirm their bids by contacting the underwriter or participating dealers with which they have their brokerage accounts. Bidders will have the ability to cancel, modify, or reconfirm their bid at any time until the auction closes. If bidders do not reconfirm their bids before the auction is closed, we and the underwriter will disregard their bids in the auction, and they will be deemed to have been withdrawn.

Changes in the Price Range Prior to Effectiveness of the Registration Statement

If, prior to the date on which the SEC declares our registration statement effective, there is a change in the price range or the number of shares to be sold in this offering, in each case in a manner that is not otherwise material to this offering, we and the underwriter will:

- provide notice on our respective Web sites of the revised price range or number of shares to be sold in this offering, as the case may be;
- issue a press release announcing the revised price range or number of shares to be sold in this offering, as the case may be; and
- send an electronic notice to everyone who has submitted a bid notifying them of the revised price range or number of shares to be sold in this offering, as the case may be.

In these situations, the underwriter could accept an investor's bid after the SEC declares the registration statement effective without requiring a bidder to reconfirm. However, the underwriter may decide at any time to require potential investors to reconfirm their bids, and if they fail to do so, unconfirmed bids will be invalid.

Closing of the Auction and Pricing

The auction will close and a public offering price will be determined after the registration statement is declared effective at a time agreed to by the selling shareholder, us and WR Hambrecht + Co, which we anticipate will be after the close of trading on the Nasdaq National Market on the same day on which the registration statement is declared effective. The auction may close in as little as one hour following effectiveness of the registration statement. However, the date and time at which the auction will close and a public offering price will be determined cannot currently be predicted and will be determined by the selling shareholder, us and WR Hambrecht + Co based on general market conditions during the period after the registration statement is declared effective. If we are unable to close the auction, determine a public offering price, and file a final prospectus with the SEC within 15 days after the registration statement is initially declared effective, we will be required to file with the SEC and have declared effective a post-effective amendment to the registration statement before the auction may be closed and before any bids may be accepted.

Once a potential investor submits a bid, the bid remains valid unless subsequently withdrawn by the potential investor. Potential investors are able to withdraw their bids at any time before the close of the auction by notifying the underwriter or a participating dealer.

Following the closing of the auction, the underwriter determines the highest price at which all of the shares offered, including shares that may be purchased by the underwriter to cover any over-allotments, may be sold to potential investors. This price, which is called the "clearing price," is determined based on the results of all valid bids at the time the auction is closed. The clearing price is not necessarily the public offering price, which is set as described in "Determination of Public Offering Price" below. The public offering price determines the allocation of shares to potential investors, with all valid bids submitted at or above the public offering price receiving a pro rata portion of the shares bid for.

You will have the ability to withdraw your bid at any time until the closing of the auction. The underwriter will accept successful bids by sending notice of acceptance after the auction closes and a public offering price has been determined, and bidders who submitted successful bids will be obligated to purchase the shares allocated to them regardless of (1) whether such bidders are aware that the registration statement has been declared effective and that the auction has closed or (2) whether they are aware that the notice of acceptance of that bid has been sent. Once the auction has closed, a public offering price has been determined, and notices of acceptance have been sent, the underwriter will not cancel or reject a valid bid.

Once the auction closes and a clearing price is set as described below, the underwriter or a participating dealer accepts the bids from those bidders whose bids are at or above the public offering price but may allocate to a prospective investor fewer shares than the number included in the investor's bid, as described in "Allocation of Shares" below.

Determination of Public Offering Price

The public offering price for this offering is ultimately determined by negotiation between the underwriter and us after the auction closes and does not necessarily bear any direct relationship to our assets, current earnings, or book value or to any other established criteria of value, although these factors are considered in establishing the initial public offering price. Prior to the offering, there has been no public market for our common stock. The principal factor in establishing the public offering price is the clearing price resulting from the auction. The clearing price is used by the underwriter and us as the principal benchmark in determining the public offering price for the stock that will be sold in this offering.

The clearing price is the highest price at which all of the shares offered, including the shares that may be purchased by the underwriter to cover any over-allotments, may be sold to potential investors, based on the valid bids at the time the auction is closed. The shares subject to the underwriter's over-allotment option are used to calculate the clearing price whether or not the option is actually exercised.

Depending on the outcome of negotiations between the underwriter, the selling shareholder, and us, the public offering price may be lower, but will not be higher, than the clearing price. The bids received in the auction and the resulting clearing price are the principal factors used to determine the public offering price of the stock that will be sold in this offering. The public offering price may be lower than the clearing price depending on a number of additional factors, including general market trends or conditions, the underwriter's assessment of our management, operating results, capital structure, and business potential, and the demand and price of similar securities of comparable companies. The underwriter, the selling shareholder and we may also agree to a public offering price that is lower than the clearing price in order to facilitate a wider distribution of the stock to be sold in the offering.

The public offering price always determines the allocation of shares to potential investors. Therefore, if the public offering price is below the clearing price, all valid bids that are at or above the public offering price receive a pro rata portion of the shares bid for. If sufficient bids are not received, or if we do not consider the clearing price to be adequate, or if the underwriter, the selling shareholder and we are not able to reach agreement on the public offering price, then the underwriter and we will either postpone or cancel this offering. Alternatively, we may file with the SEC a post-effective amendment to the registration statement in order to conduct a new auction.

The following simplified example illustrates how the public offering price is determined through the auction process:

Company X offers to sell 1,000 shares in its public offering through the auction process. The underwriter, on behalf of Company X, receive five bids to purchase, all of which are kept confidential until the auction closes.

The first bid is to pay $10.00 per share for 200 shares. The second bid is to pay $9.00 per share for 300 shares. The third bid is to pay $8.00 per share for 600 shares. The fourth bid is to pay $7.00 per share for 400 shares. The fifth bid is to pay $6.00 per share for 800 shares.

Assuming that none of these bids are withdrawn or modified before the auction closes, and assuming that no additional bids are received, the clearing price used to determine the public offering price would be $8.00 per share, which is the highest price at which all 1,000 shares offered may be sold to potential investors who have submitted valid bids. However, the shares may be sold at a price below $8.00 per share based on negotiations between Company X and the underwriter.

If the public offering price is the same as the $8.00 per share clearing price, the underwriter would accept bids at or above $8.00 per share. Because 1,100 shares were bid for at or above the clearing price, each of the three potential investors who bid $8.00 per share or more would receive approximately 90% of the shares for which bids were made. The two potential investors whose bids were below $8.00 per share would not receive any shares in this example.

If the public offering price is $7.00 per share, the underwriter would accept bids that were made at or above $7.00 per share. No bids made at a price of less than $7.00 per share would be accepted. The four potential investors with the highest bids would receive a pro rata portion of the 1,000 shares offered, based on the 1,500 shares they requested, or two-thirds of the shares for which bids were made. The potential investor with the lowest bid would not receive any shares in this example.

As described in "Allocation of Shares" below, because bids that are reduced on a pro rata basis may be rounded down to round lots, a potential investor may be allocated less than two-thirds of the shares bid for. Thus, the potential investor who bids for 200 shares may receive a pro rata allocation of 100 shares (one-half of the shares bid for), rather than receiving a pro rata allocation of 133 shares (two-thirds of the shares bid for).

The following table illustrates the example described above, before rounding down any bids to the nearest round lot, assuming that the initial public offering price is set at $8.00 per share. The table also assumes that these bids are the final bids, and that they reflect any modifications that have been made to reflect any prior changes to the offering range, and to avoid the issuance of fractional shares.

	Bid Information			Auction Results			
Initial Public Offering of Company X	**Shares Requested**	**Cumulative Shares Requested**	**Bid Price**	**Shares Allocated**	**Approx. Allocated Requested Shares**	**Clearing Price**	**Amount Raised**
	200	200	$ 10.00	180	90%	$ 8.00	$ 1,440
	300	500	$ 9.00	270	90%	$ 8.00	$ 2,160
Clearing Price	600	1,100	$ 8.00	550	90%	$ 8.00	$ 4,400
	400	1,500	$ 7.00	0	0%	—	—
	800	2,300	$ 6.00	0	0%	—	—
Total				1,000			$ 8,000

Allocation of Shares

Bidders receiving a pro rata portion of the shares they bid for generally receive an allocation of shares on a round-lot basis, rounded to multiples of 100 or 1,000 shares, depending on the size of the bid. No bids are rounded to a round lot higher than the original bid size. Because bids may be rounded down to round lots in multiples of 100 or 1,000 shares, some bidders may receive allocations of shares that reflect a greater percentage decrease in their original bid than the average pro rata decrease. Thus, for example, if a bidder has confirmed a bid for 200 shares, and there is an average pro rata decrease of all bids of 30%, the bidder may receive an allocation of 100 shares (a 50% decrease from 200 shares), rather than receiving an allocation of 140 shares (a 30% decrease from 200 shares). In addition, some bidders may receive allocations of shares that reflect a lesser percentage decrease in their original bid than the average pro rata decrease. For example, if a bidder has submitted a bid for 100 shares, and there is an average pro rata decrease of all bids of 30%, the bidder may receive an allocation of all 100 shares to avoid having the bid rounded down to zero.

Generally the allocation of shares in the offering will be determined in the following manner:

- Any bid with a price below the public offering price is allocated no shares.
- The pro-rata percentage is determined by dividing the number of shares offered (including the overallotment option) by the total number of shares bid at or above the public offering price. For example, if there are 200,000 shares bid for at or above the public offering price, and 150,000 shares offered in the offering, then the pro-rata percentage is 75%.

- All of the successful bids are then multiplied by the pro-rata percentage to determine the allocations before rounding. For example, three winning bids for 1,700 shares (Bid 1), 650 shares (Bid 2) and 100 shares (Bid 3) would be allocated 1,275 shares, 487 shares and 75 shares respectively, based on the pro rata percentage.

- The bids are then rounded down to the nearest 100 share round lot, so the bids would be rounded to 1,200, 400 and 0 shares respectively. This creates a stub of 237 unallocated shares.

- The 237 stub shares are then allocated to the bids. Continuing the example above, because Bid 3 for 100 shares was rounded down to 0 shares, 100 of the stub shares would be allocated to Bid 3. If there were not sufficient stub shares to allocate at least 100 shares to Bid 3, Bid 3 would not receive any shares in the offering. After allocation of these shares, 137 unallocated stub shares would remain.

- Because Bid 2 for 650 shares was reduced, as a result of rounding, by more total shares then Bid 1 for 1,700 shares, Bid 2 would then be allocated stub shares up to the nearest 100 round lot (from 400 shares to 500 shares). This reduces the unallocated stub shares to 37 total shares.

The remaining 37 stub shares are not enough shares to enable Bid 1 to be rounded up to a round lot of 100 shares. Therefore the remaining 37 unallocated stub shares would be allocated to smaller orders that are below their bid amounts. The table below illustrates the allocations in the example above.

Initial Public Offering of Company X	Initial Bid	Pro-Rata Allocation (75% of Initial Bid)	Initial Rounding	Allocation of Stub Shares	Final Allocation
Bid 1	1,700	1,275	1,200	0	1,200
Bid 2	650	487	400	100	500
Bid 3	100	75	0	100	100
Total	2,450	1,837	1,600	200	1,800

Requirements for Valid Bids

Valid bids are those that meet the requirements, including eligibility, account status and size, established by the underwriter or participating dealers. In order to open a brokerage account with WR Hambrecht + Co, a potential investor must deposit $2,000 in its account. This brokerage account will be a general account subject to WR Hambrecht + Co's customary rules, and will not be limited to this offering. In addition, within one hour of the auction closing, a prospective investor submitting a bid through a WR Hambrecht + Co brokerage account must have an account balance equal to or in excess of the amount of its bid or WR Hambrecht + Co may not accept its bid. The auction may close in as little as one hour after the registration statement is declared effective. However, other than the $2,000 described above, prospective investors are not required to deposit any money into their accounts until after the registration statement is declared effective. No funds will be transferred to WR Hambrecht + Co, and any amounts in excess of $2,000 may be withdrawn at any time until the auction closes and the bid is accepted. Conditions for valid bids, including eligibility standards and account funding requirements of participating dealers may vary.

The Closing of the Auction and Allocation of Shares

The auction will close on a date and at a time estimated and publicly disclosed in advance by the underwriter on the Web sites of WR Hambrecht + Co at www.wrhambrecht.com and www.openipo.com. The auction may close in as little as one hour following effectiveness of the registration statement. The shares offered by this prospectus, or shares if the underwriter's over-allotment option is exercised in full, will be purchased from the selling shareholder and us by the underwriter and sold through the underwriter and participating dealers to investors who have submitted valid bids at or higher than the public offering price.

The underwriter or a participating dealer notify successful bidders by sending a notice of acceptance by e-mail, telephone, facsimile, or mail informing bidders that the auction has closed and that their bids have been accepted. The notice will indicate the price and number of shares that have been allocated to the successful bidder. Other bidders are notified that their bids have not been accepted.

Each participating dealer has agreed with the underwriter to sell the shares it purchases from the underwriter in accordance with the auction process described above, unless the underwriter otherwise consents. The underwriter does not intend to consent to the sale of any shares in this offering outside of the auction process. The underwriter reserves the right in its sole discretion to reject any bids that it deems manipulative or disruptive in order to facilitate the orderly completion of this offering, and it reserves the right, in exceptional circumstances, to alter this method of allocation as it deems necessary to ensure a fair and orderly distribution of the shares of our common stock. For example, large orders may be reduced to ensure a public distribution, and bids may be rejected or reduced by the underwriter or participating dealers based on eligibility or creditworthiness criteria. In addition, the underwriter or the participating dealers may reject or reduce a bid by a prospective investor who has engaged in practices that could have a manipulative, disruptive or otherwise adverse effect on the offering.

Some dealers participating in the selling group may submit firm bids that reflect indications of interest from their customers that they have received at prices within the initial public offering price range. In these cases, the dealer submitting the bid is treated as the bidder for the purposes of determining the clearing price and allocation of shares.

Price and volume volatility in the market for our common stock may result from the somewhat unique nature of the proposed plan of distribution. Price and volume volatility in the market for our common stock after the completion of this offering may adversely affect the market price of our common stock.

We have granted the underwriter an option, exercisable no later than 30 days after the date of this prospectus, to purchase up to an aggregate of additional shares of our common stock from us at the offering price, less the underwriting discounts and commissions set forth on the cover page of this prospectus. To the extent that the underwriter exercises this option, it will have a firm commitment to purchase the additional shares, and we will be obligated to sell the additional shares to it. The underwriter may exercise the option only to cover over-allotments made in connection with the sale of shares offered.

We have agreed not to offer, sell, contract to sell, pledge, grant any option to purchase, make any short sale, or otherwise dispose of any shares of common stock, or any options or warrants to purchase common stock other than the shares of common stock or options to acquire common stock issued under our stock incentive plans, for a period of 180 days after the date of this prospectus, except with the prior written consent of WR Hambrecht + Co. Each of our directors and executive officers and additional holders of a substantial majority of our outstanding capital stock have agreed to restrictions on their ability to sell, offer, contract, or grant any option to sell, pledge, transfer, or otherwise dispose of shares of our common stock for a period of 180 days after the date of this prospectus, without the prior written consent of WR Hambrecht + Co. The persons signing the lock-up agreements will be able to transfer their shares of common stock as a bona fide gift to immediate family members or to a trust or partnership or other business entity, or as a distribution without compensation to partners, members, or shareholders of a business entity, subject to the transferees agreeing to enter into a lock-up agreement. In considering any request to release shares subject to a lock-up agreement, WR Hambrecht + Co will consider the possible impact of the release of the shares on the trading price of the stock sold in the offering.

In connection with the offering, the underwriter may purchase and sell shares of common stock in the open market. These transactions may include short sales, stabilizing transactions, and purchases to cover positions created by short sales. Any short sales made by the underwriter would be made at the public offering price. Short sales involve the sale by the underwriter of a greater number of shares than it is required to purchase in the offering. "Covered" short sales are sales made in an amount not greater than the underwriter's option to purchase additional shares from us in the offering. The underwriter may close out any covered short position by either exercising its option to purchase additional shares or purchasing shares in the open market. As described above, the number of shares that may be sold pursuant to the underwriter's overallotment option is included in the calculation of the clearing price. In determining the source of shares to close out the covered short position, the underwriter will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which it may purchase shares through the over-allotment option. "Naked" short sales are any sales in excess of such option. To the extent that the underwriter engages in any naked short sales, the naked short position would not be included in the calculation of the clearing price. The underwriter must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriter is concerned that there may be downward pressure on the price of the common stock in the open market after pricing that could adversely affect investors who purchase in the offering. Stabilizing transactions consist of various bids for or purchases of common stock made by the underwriter in the open market prior to the completion of the offering.

These activities by the underwriter may stabilize, maintain, or otherwise affect the market price of the common stock. As a result, the price of the common stock may be higher than the price that otherwise might exist in the open market. If these activities are commenced, the underwriter may discontinue them at any time. These transactions may be effected on the Nasdaq National Market, in the over-the-counter market or otherwise.

The underwriter currently intends to act as a market maker for the common stock following this offering. However, the underwriter is not obligated to do so and may discontinue any market making at any time.

Indemnity

We and the selling shareholder, on the one hand, and the underwriter, on the other hand, have agreed to indemnify each other against certain civil liabilities, including liabilities under the Securities Act.

Legal Matters

Winston & Strawn LLP, Chicago, Illinois will pass upon the validity of the shares of common stock offered hereby for us. Sidley Austin Brown & Wood LLP, Chicago, Illinois will pass upon the validity of the shares of common stock offered hereby for the underwriter.

Experts

The consolidated financial statements of Morningstar, Inc. and subsidiaries as of December 31, 2002 and 2003, and for each of the three years in the period ended December 31, 2003, included in this prospectus and the related financial statement schedule included elsewhere in the registration statement have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their reports appearing herein and elsewhere in the registration statement (which reports express an unqualified opinion and include explanatory paragraphs relating to the company's change in its method of accounting for goodwill and intangible assets and restatement of its financial statements discussed in Note 16), and have been so included in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

The consolidated financial statements of mPower.com, Inc. and subsidiaries as of December 31, 2001 and 2002 and for each of the two years in the period ended December 31, 2002, included in this prospectus and the related financial statement schedule included elsewhere in the registration statement have been audited by Deloitte & Touche LLP, independent auditors, as stated in their reports appearing herein and elsewhere in this registration statement (which reports express an unqualified opinion and include explanatory paragraphs relating to the company's change in its method of accounting for goodwill and intangible assets and restatement of its financial statements discussed in Note 13), and have been so included in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

Where You Can Find More Information

We have filed with the SEC a registration statement on Form S-1 (including exhibits, schedules, and amendments) under the Securities Act with respect to the shares of common stock to be sold in this offering. This prospectus does not contain all the information set forth in the registration statement. For further information about us and the shares of common stock to be sold in this offering, you should refer to the registration statement. Statements contained in this prospectus relating to the contents of any contract, agreement, or other document are not necessarily complete. Whenever this prospectus refers to any contract, agreement, or other document, you should refer to the exhibits that are a part of the registration statement for a copy of the contract, agreement, or document.

You may read and copy all or any portion of the registration statement or any other information we file at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. You can request copies of these documents, upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1-800-SEC-0330 for further information about the operation of the public reference rooms. Our SEC filings, including the registration statement, are also available to you on the SEC's Web site (http://www.sec.gov).

As a result of this offering, we will become subject to the information and reporting requirements of the Exchange Act and, in accordance with those requirements, will file periodic reports, proxy statements, and other information with the SEC.

Index to Financial Statements

Morningstar Inc. and Subsidiaries

mPower.com, Inc. and Subsidiaries

Morningstar Inc. and Subsidiaries

Report of Independent Registered Public Accounting Firm

Morningstar, Inc.
Chicago, Illinois

We have audited the accompanying consolidated balance sheets of Morningstar, Inc. and subsidiaries (the "Company") as of December 31, 2002 and 2003, and the related consolidated statements of operations, shareholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2002 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, effective January 1, 2002, the Company changed its method of accounting for goodwill and intangible assets to conform to Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* .

As discussed in Note 16, the accompanying 2002 and 2003 consolidated financial statements have been restated for a reclassification between Investments in Unconsolidated Entities and Accumulated Other Comprehensive Income (Loss).

DELOITTE & TOUCHE LLP
Chicago, Illinois
April 30, 2004
(January 25, 2005 as to the effects of
the restatement discussed in Note 16)

Morningstar, Inc. and Subsidiaries
Consolidated Balance Sheets

(in thousands except share amounts)	As of December 31 2002 (As restated, see Note 16)	As of December 31 2003 (As restated, see Note 16)	As of September 30 2004 (Unaudited)
Assets			
Current assets			
Cash and cash equivalents	$ 44,337	$ 53,509	$ 52,497
Investments	20,459	22,649	30,244
Accounts receivable, less allowance of $798, $654 and $646, respectively	19,821	22,174	25,689
Other	8,794	7,108	7,488
Total current assets	93,411	105,440	115,918
Property, equipment, and capitalized software, net	15,291	17,600	18,185
Investments in unconsolidated entities	13,325	13,918	14,419
Goodwill	5,995	14,075	14,135
Intangible assets, net	—	1,860	1,645
Other assets	24,759	27,372	25,596
Total assets	$ 152,781	$ 180,265	$ 189,898
Liabilities and shareholders' equity			
Current liabilities			
Accounts payable and accrued liabilities	$ 15,273	$ 19,360	$ 10,208
Accrued compensation	11,237	14,010	17,468
Income tax payable	—	—	1,673
Deferred revenue	47,731	55,554	56,398
Accrued stock-based compensation	5,680	12,530	13,863
Long-term debt—current portion	157	6,577	25
Other	3,328	3,319	3,308
Total current liabilities	83,406	111,350	102,943
Long-term debt—net of current portion	6,567	12	—
Accrued stock-based compensation	8,847	19,396	20,444
Other long-term liabilities	5,829	4,686	3,284
Total liabilities	104,649	135,444	126,671
Shareholders' equity			
Common stock, no par value, 200,000,000 shares authorized, of which 38,366,415; 38,395,480; and 38,438,610 shares were outstanding at December 31, 2002, December 31, 2003 and September 30, 2004, respectively	4	4	4
Treasury stock at cost, 233,334 shares at December 31, 2002, December 31, 2003 and September 30, 2004	(3,280)	(3,280)	(3,280)
Additional paid-in capital	127,790	139,161	145,456
Accumulated deficit	(78,637)	(90,534)	(80,586)
Accumulated other comprehensive income (loss)	2,255	(530)	1,633
Total shareholders' equity	48,132	44,821	63,227
Total liabilities and shareholders' equity	$ 152,781	$ 180,265	$ 189,898

See notes to consolidated financial statements.

Morningstar, Inc. and Subsidiaries
Consolidated Statements of Operations

	Year Ended December 31			Nine Months Ended September 30 (Unaudited)	
(in thousands except per share amounts)	**2001**	**2002**	**2003**	**2003**	
Revenue	$ 91,230	$ 109,619	$ 139,496	$ 102,393	$
Operating expense (1):					
Cost of goods sold	39,536	39,035	43,521	32,227	
Development	7,686	11,881	14,663	11,178	
Sales and marketing	20,651	24,992	30,798	23,128	
General and administrative	34,175	36,504	54,145	38,084	
Depreciation and amortization	5,573	5,547	7,123	4,911	
Total operating expense	107,621	117,959	150,250	109,528	
Operating income (loss)	(16,391)	(8,340)	(10,754)	(7,135)	
Non-operating income (expense):					
Gain on sale of investment in unconsolidated entity	—	3,398	510	—	
Interest income, net	1,559	1,042	279	236	
Other income (expense), net	(883)	23	321	68	
Non-operating income, net	676	4,463	1,110	304	
Income (loss) before income taxes, equity in net income of unconsolidated entities, minority interest in net loss of consolidated entities, and extraordinary gain	(15,715)	(3,877)	(9,644)	(6,831)	
Income tax expense (benefit)	(5,276)	(311)	2,950	3,732	
Equity in net income of unconsolidated entities	359	750	697	420	
Minority interest in net loss of consolidated entities	785	178	—	—	
Income (loss) before extraordinary gain	(9,295)	(2,638)	(11,897)	(10,143)	
Extraordinary gain—acquisition	—	3,084	—	—	
Net income (loss)	$ (9,295)	$ 446	$ (11,897)	$ (10,143)	$
Basic income (loss) per share:					
Income (loss) before extraordinary gain	$ (0.24)	$ (0.07)	$ (0.31)	$ (0.26)	$
Extraordinary gain—acquisition	—	0.08	—	—	
Basic income (loss) per share	$ (0.24)	$ 0.01	$ (0.31)	$ (0.26)	$
Diluted income (loss) per share:					
Income (loss) before extraordinary gain	$ (0.32)	$ (0.17)	$ (0.31)	$ (0.26)	$
Extraordinary gain—acquisition	—	0.08	—	—	
Diluted income (loss) per share	$ (0.32)	$ (0.09)	$ (0.31)	$ (0.26)	$
Weighted average common shares outstanding:					
Basic	38,298	38,345	38,382	38,377	
Diluted	41,364	40,361	38,382	38,377	

	Year Ended December 31			Nine Months Ended September 30 (Unaudited)	
(1) Includes stock-based compensation expense (income) of:	**2001**	**2002**	**2003**	**2003**	**2004**
Cost of goods sold	$ (379)	$ (89)	$ 3,091	$ 2,269	$ 1,120
Development	(31)	(59)	2,090	1,707	571
Sales and marketing	(115)	(64)	2,107	1,698	642
General and administrative	6,192	7,504	21,741	15,922	6,436
Total stock-based compensation expense	$ 5,667	$ 7,292	$ 29,029	$ 21,596	$ 8,769

See notes to consolidated financial statements.

Morningstar, Inc. and Subsidiaries
Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss)
for the Years Ended December 31, 2001, 2002 (as restated, see Note 16),
and 2003 (as restated, see Note 16) and the Nine Months Ended September 30, 2004 (Unaudited)

(in thousands except share amounts)	Common Stock Shares Outstanding	Par Value	Treasury Stock	Additional Paid-in Capital	Accumulated Deficit	Accumu (Comprehe Income (
Balance, January 1, 2001	38,424,432	$ 4	$ (221)	$ 107,876	$ (69,788)	$
Comprehensive loss:						
Net loss		—	—	—	(9,295)	
Reclassification adjustment for realized losses included in net loss		—	—	—	—	
Unrealized gain on investments, net of tax of $50		—	—	—	—	
Foreign currency translation adjustment		—	—	—	—	
Total comprehensive loss		—	—	—	(9,295)	
Issuance of common stock	72,234	—	—	242	—	
Repurchase of common stock	(212,145)	—	(2,998)		—	
Stock-based compensation		—	—	8,951	—	
Balance, December 31, 2001	38,284,521	$ 4	$ (3,219)	$ 117,069	$ (79,083)	$
Comprehensive income:						
Net income		—	—	—	446	
Reclassification adjustment for realized losses included in net income		—	—	—	—	
Unrealized loss on investments, net of tax of $135		—	—	—	—	
Foreign currency translation adjustment		—	—	—	—	
Total comprehensive income		—	—	—	446	
Issuance of common stock	87,396	—	—	214	—	
Repurchase of common stock	(5,502)	—	(61)	—	—	
Stock-based compensation		—	—	10,507	—	
Balance, December 31, 2002	38,366,415	$ 4	$ (3,280)	$ 127,790	$ (78,637)	$
Comprehensive loss:						
Net loss		—	—		(11,897)	
Reclassification adjustment for realized gains included in net loss		—	—	—	—	
Unrealized gain on investments, net of tax of $16		—	—	—	—	
Foreign currency translation adjustment		—	—	—	—	(
Total comprehensive loss		—	—	—	(11,897)	(
Issuance of common stock	29,065	—	—	127	—	
Stock-based compensation		—	—	11,244	—	
Balance, December 31, 2003	38,395,480	$ 4	$ (3,280)	$ 139,161	$ (90,534)	$
Comprehensive income:						
Net income		—	—	—	9,948	
Reclassification adjustment for realized gains included in net income		—	—	—	—	
Unrealized loss on investments, net of tax of $51		—	—	—	—	
Foreign currency translation adjustment		—	—	—	—	
Total comprehensive income		—	—	—	9,948	
Issuance of common stock	43,130	—	—	625	—	
Stock-based compensation		—	—	5,670	—	

Balance, September 30, 2004	38,438,610	$	4	$	(3,280)	$	145,456	$	(80,586)	$

See notes to consolidated financial statements.

Morningstar, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

	Year Ended December 31			Nine Months Ended September 30 (Unaudited)	
($000)	**2001**	**2002**	**2003**	**2003**	**2004**
Operating activities					
Net income (loss)	$ (9,295)	$ 446	$ (11,897)	$ (10,143)	$ 9,948
Adjustments to reconcile net income (loss) to net cash flows from operating activities:					
Depreciation and amortization	5,573	5,547	7,123	4,911	5,354
Deferred income taxes	(5,279)	(455)	2,457	3,266	3,046
Stock-based compensation	5,667	7,292	29,029	21,596	8,769
Provision for bad debt	554	1,739	855	355	563
Gain on sale of investment in unconsolidated entity	—	(3,398)	(510)	—	—
Extraordinary gain on acquisition	—	(3,084)	—	—	—
Equity in net income of unconsolidated entities	(359)	(750)	(697)	(420)	(591)
Minority interest in net loss of consolidated entities	(785)	(178)	—		
Other, net	653	(194)	(325)	(11)	(206)
Changes in operating assets and liabilities, net of effects of acquisitions:					
Accounts receivable	(2,159)	(5,160)	(2,218)	(41)	(3,887)
Other assets	(154)	(2,001)	36	(206)	(1,652)
Accounts payable, accrued liabilities, and accrued compensation	1,966	4,894	3,696	(2,230)	(3,150)
Deferred revenue	3,204	14,592	4,435	1,297	700
Accrued stock-based compensation	(3,354)	(1,536)	(320)	(302)	(202)
Other liabilities	(1,415)	(1,212)	(1,959)	(595)	393
Cash provided by (used for) operating activities	(5,183)	16,542	29,705	17,477	19,085
Investing activities					
Purchases of investments	(17,522)	(15,826)	(22,347)	(21,728)	(22,771)
Proceeds from sale of investments	26,675	14,872	20,727	14,458	15,191
Proceeds from the sale of investments in unconsolidated entity	—	4,838	510	—	—
Capital expenditures	(5,932)	(5,989)	(8,607)	(6,361)	(5,758)
Acquisitions, net of cash acquired	—	3,516	(10,801)	(10,419)	(210)
Other, net	(93)	24	37	81	53
Cash provided by (used for) investing activities	3,128	1,435	(20,481)	(23,969)	(13,495)
Financing activities					
Proceeds from issuance of notes payable	635	—	—	—	—
Payments of long-term debt and capital lease obligations	(470)	(2,122)	(153)	(129)	(6,559)
Payments for purchases of treasury stock	(1,456)	(44)	—	—	—
Proceeds from sale of common stock	242	214	127	122	158
Cash used for financing activities	(1,049)	(1,952)	(26)	(7)	(6,401)
Effect of exchange rate changes on cash and cash equivalents	704	345	(26)	(11)	(201)
Net increase (decrease) in cash and cash equivalents	(2,400)	16,370	9,172	(6,510)	(1,012)
Cash and cash equivalents—Beginning of period	30,367	27,967	44,337	44,337	53,509
Cash and cash equivalents—End of period	$ 27,967	$ 44,337	$ 53,509	$ 37,827	$ 52,497
Supplemental disclosures of cash flow information					
Cash paid for interest	$ 477	$ 384	$ 293	$ 138	$ 67
Cash paid for taxes	$ —	$ 8	$ 802	$ 466	$ 3,204
Supplemental information of non-cash investing and financing activities					
Payable for purchases of treasury stock	$ 1,542	$ 17	$ —	—	—
Unrealized gain (loss) on available for sale investments	$ 254	$ (336)	$ 112	$ (75)	$ (204)

See notes to consolidated financial statements.

(Information as of September 30, 2004 and for the nine months ended September 30, 2003 and 2004 is unaudited)

1. Organization

Our company, Morningstar, Inc. and its subsidiaries ("Morningstar," "we," "our") collects, analyzes and sells financial information regarding mutual funds, variable annuities, and equity securities to the investing public, including institutional and individual investors and investment intermediaries. Delivery media for principal products, most of which are subscription-based, include printed materials, CD-ROM software and the Internet. In addition, revenue is also derived from licensing arrangements, Internet advertising and customized data research.

2. Summary of Significant Accounting Policies

Interim Financial Information. The unaudited consolidated financial information for the nine months ended September 30, 2003 and 2004 and as of September 30, 2004 included herein have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the nine month period ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

Principles of Consolidation. The accompanying consolidated financial statements include the accounts of Morningstar, Inc. and our wholly and majority-owned subsidiaries. The assets, liabilities, and results of operations of subsidiaries in which we have a controlling interest have been consolidated. Investments in entities in which we exercise significant influence, but do not control, are accounted for using the equity method. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses during the reporting period. Actual results may differ from these estimates.

Reclassifications. Certain 2001 and 2002 amounts have been reclassified to conform to the presentation used in 2003.

Cash and Cash Equivalents. Cash and cash equivalents consist of cash and money market funds with original maturities of three months or less. They are stated at cost, which approximates fair market value.

Fair Value of Financial Instruments. The carrying values for accounts receivable, accounts payable, and accrued liabilities reasonably approximate fair market value due to the nature of the financial instrument and the short-term maturity of these items. The carrying value of long-term debt approximates fair value as it is borrowed at prevailing interest rates.

Investments. Certain investments, consisting primarily of fixed income and debt securities, are classified as available-for-sale securities. Unrealized gains and losses are reported as other comprehensive income (loss), net of related income taxes. Certain other investments are classified as trading securities. Unrealized gains and losses associated with such investments are included in "Other income (expense), net" in the Consolidated Statements of Operations. Realized gains and losses are included in "Interest income, net," in the Consolidated Statements of Operations.

Concentration of Credit Risk. To the extent receivables from our customers become delinquent, collection activities commence. No single customer is large enough to pose a significant credit risk to our operations and financial condition. For the years ended December 31, 2001, 2002 and 2003 and for the nine months ended September 30, 2003 and 2004, no single customer represented 10% or more of our consolidated revenue. Likewise, no single customer represented 10% or more of our accounts receivable at December 31, 2002 or 2003 or at September 30, 2004. We maintain an allowance for losses based on the probable losses in accounts receivable.

Property, Equipment, Capitalized Software, and Depreciation. Property, equipment, and capitalized software are stated at historical cost and are depreciated using the straight-line method based upon the useful life of the asset which, excluding leasehold improvements, ranges from three to seven years. We record a full month of depreciation expense in the month of acquisition. Leasehold improvements are amortized over the remaining lease term or their useful lives, whichever is shorter.

Goodwill. We adopted Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets* on January 1, 2002. Under the provisions of this standard, goodwill is no longer amortized. Intangible assets with indefinite lives are not amortized. Those with finite lives are amortized over the expected period of benefit. Goodwill, as well as intangible assets with indefinite lives, are now subject to an annual test for impairment. Upon adoption, the required initial benchmark evaluation was performed, and the annual review was performed as of December 31, 2002 and 2003, resulting in no impairment of our recorded goodwill. During the years ended December 31, 2001, 2002 and 2003, all significant changes in the carrying amount of our recorded goodwill were the result of business acquisitions. No impairment losses were recorded in 2001, 2002 or 2003 or in the nine months ended September 30, 2004.

Comparative information as if goodwill had not been amortized in 2001, is as follows:

	Year Ended December 31		
(in thousands except per share amounts)	**2001**	**2002**	**2003**
Reported loss before extraordinary gain	$ (9,295)	$ (2,638)	$ (11,897)
Add back: goodwill amortization, net of tax	375	—	—
Adjusted loss before extraordinary gain	(8,920)	(2,638)	(11,897)
Extraordinary gain—acquisition	—	3,084	—
Adjusted net income (loss)	$ (8,920)	$ 446	$ (11,897)
Basic income (loss) per share:			
Reported loss before extraordinary gain	$ (0.24)	$ (0.07)	$ (0.31)
Add back: goodwill amortization, net of tax	0.01	—	—
Adjusted loss before extraordinary gain	(0.23)	(0.07)	(0.31)
Extraordinary gain—acquisition	—	0.08	—
Adjusted net income (loss) per share	$ (0.23)	$ 0.01	$ (0.31)
Diluted loss per share:			
Reported loss before extraordinary gain	$ (0.32)	$ (0.17)	$ (0.31)
Add back: goodwill amortization, net of tax	0.01	—	—
Adjusted loss before extraordinary gain	(0.31)	(0.17)	(0.31)
Extraordinary gain—acquisition	—	0.08	—
Adjusted net loss per share	$ (0.31)	$ (0.09)	$ (0.31)

Intangible Assets. Intangible assets consist of intellectual property and a customer list and are amortized using the straight-line method over their economic useful lives, which have been estimated to be seven years. The gross carrying value and accumulated amortization of intangible assets was $2,003,000 and $143,000, respectively at December 31, 2003 and $2,003,000 and $358,000 respectively at September 30, 2004. No intangible assets were recorded at December 31, 2002. Total amortization expense for the year ended December 31, 2003 was $143,000. For the nine months ended September 30, 2003 and 2004 total amortization expense was $72,000 and $215,000, respectively.

Estimated aggregate amortization expense for intangible assets is $286,000 for each of the years ended December 31, 2004, 2005, 2006, 2007, and 2008.

Revenue Recognition. Revenue from subscription sales, including print publications, CD-ROM software, and other subscription sales, are recognized in equal installments over the term of the subscription, generally one year. Deferred revenue represents the unamortized portion of subscriptions collected in advance. Revenue from products and services that provide data and analysis, and from consulting and retirement advice services is recognized when the product or service is delivered or, when applicable, over the service obligation period defined by the terms of the contract.

Advertising Costs. Advertising costs are expensed as incurred. Advertising expense for the years ended December 31, 2001, 2002 and 2003 totaled $2,482,000, $1,602,000, and $2,051,000, respectively. Advertising expense for the nine months ended September 30, 2003 and 2004 totaled $1,701,000 and $2,273,000, respectively.

Computer Software and Product Development Costs. We capitalize certain costs in accordance with American Institute of Certified Public Accountants Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* , and SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed* , and amortize these costs on a straight-line basis over the estimated economic life of the software, generally three years. Product development costs primarily consist of costs attributable to the development of new Web-based products and certain major enhancements of existing products. Product development costs include primarily personnel costs.

Stock-Based Compensation. We measure compensation expense related to stock option grants in accordance with the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* .

Earnings per Share. We compute and present earnings per share in accordance with SFAS No. 128, *Earnings per Share* . The difference between weighted average shares outstanding and diluted shares outstanding is due to the dilutive effect of stock options for all periods presented.

Income Taxes. We record deferred income taxes for the temporary differences between the carrying amount of assets and liabilities for financial statement purposes and the amounts used for income tax purposes in accordance with SFAS No. 109, *Accounting for Income Taxes* .

Foreign Currency. The financial statements of foreign subsidiaries are translated to U.S. dollars using the period-end exchange rate for assets and liabilities and an average exchange rate for each period for revenues and expenses. The local currency is the functional currency for all of our foreign subsidiaries. Translation adjustments for foreign subsidiaries are recorded as a component of "Accumulated other comprehensive income (loss)" in the Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss). Exchange gains and losses arising from transactions which are denominated in currencies other than the functional currency, are included in "Other income (expense), net" in the Consolidated Statements of Operations.

3. Earnings Per Share

Basic income (loss) per share was computed by dividing net income (loss) by the applicable number of weighted average common shares outstanding during each year. For purposes of determining the diluted income (loss) per share, the recorded net income (loss) is adjusted for the stock-based compensation expense (income) related to stock options recorded under the liability method to reflect the effect based on assumed share settlement, if the impact of this calculation is more dilutive. Diluted income (loss) per share also includes the assumed impact, using the treasury stock method, of converting stock options with a exercise price below the average fair value of our stock.

The computation of weighted average common shares outstanding for the year ended December 31, 2003 excluded incremental shares of 5,163,000 related to employee stock options. These shares were not included in the computation of the loss per share due to their anti-dilutive effect. The computation of weighted average common shares outstanding in the nine months ended September 30, 2003 excluded 2,264,000 incremental shares due to their anti-dilutive effect.

A reconciliation of the net income (loss) and the number of shares used in computing basic and diluted income (loss) per share is as follows:

	Year Ended December 31			Nine Months Ended September 30 (Unaudited)	
(in thousands except per share amounts)	**2001**	**2002**	**2003**	**2003**	**2004**
Calculation of basic income (loss) per share					
Income (loss) before extraordinary gain	$ (9,295)	$ (2,638)	$ (11,897)	$ (10,143)	$ 9,948
Extraordinary gain—acquisition	—	3,084	—	—	—
Net income (loss)	$ (9,295)	$ 446	$ (11,897)	$ (10,143)	$ 9,948
Weighted average common shares outstanding	38,298	38,345	38,382	38,377	38,410
Basic income (loss) per share:					
Income (loss) before extraordinary gain	$ (0.24)	$ (0.07)	$ (0.31)	$ (0.26)	$ 0.26
Extraordinary gain—acquisition	—	0.08	—	—	—
Net income (loss)	$ (0.24)	$ 0.01	$ (0.31)	$ (0.26)	$ 0.26
Calculation of diluted income (loss) per share					
Income (loss) before extraordinary gain	$ (9,295)	$ (2,638)	$ (11,897)	$ (10,143)	$ 9,948
Deduct stock-based compensation income under the liability method, net of tax	(2,488)	(2,613)	—	—	—
Deduct stock-based compensation expense under the equity method, net of tax	(1,565)	(1,411)	—	—	—
Income (loss) before extraordinary gain, as adjusted for computing diluted loss per share	(13,348)	(6,662)	(11,897)	$ (10,143)	$ 9,948
Extraordinary gain—acquisition	—	3,084	—	—	—
Net income (loss), as adjusted for computing diluted income (loss) per share	$ (13,348)	$ (3,578)	$ (11,897)	$ (10,143)	$ 9,948
Weighted average common shares outstanding	38,298	38,345	38,382	38,377	38,410
Net effect of dilutive stock options based on the treasury stock method	3,066	2,016	—	—	3,244
Weighted average common shares outstanding, as adjusted for computing diluted income (loss) per share	41,364	40,361	38,382	38,377	41,654
Diluted income (loss) per share:					
Income (loss) before extraordinary gain	$ (0.32)	$ (0.17)	$ (0.31)	$ (0.26)	$ 0.24
Extraordinary gain—acquisition	—	0.08	—	—	—
Net income (loss)	$ (0.32)	$ (0.09)	$ (0.31)	$ (0.26)	$ 0.24

4. Segment and Geographical Area Information

We organize our operations based on products sold in three segments: Individual, Advisor, and Institutional.

- The Individual business segment focuses on products for the individual investor including our U.S-based Web site, *Morningstar.com* and a variety of print and Web-based publications.

- The Advisor segment focuses on products for financial advisors. Our largest products in this segment are *Morningstar Advisor Workstation* , a comprehensive, Web-based investment planning system and *Principia* , a CD-ROM-based investment research product. We also offer an asset management service, which provides portfolios of mutual funds in which advisors can invest their clients' assets. We sell our advisor-related products both directly to independent financial advisors and through enterprise licenses, which allow financial advisors associated with the licensing enterprise to use our products.

- The Institutional segment focuses on integrated advice and data solution packages for institutional clients, including banks, brokerage firms, insurance companies, mutual funds, and retirement plan sponsors. Our key products and services in this segment are Licensed Data, available as an electronic data feed; Investment Consulting, which helps clients create and maintain investment products; Morningstar Direct, a set of Web-based research tools that combines advanced performance and holdings-based analysis with access to our proprietary statistics; and Morningstar Retirement Manager, a broad-based set of tools for retirement planning.

The segments' operating results are measured based on operating income (loss), including an allocation of corporate costs, depreciation expense, and amortization of purchased capitalized software. Intersegment revenue and expenses are included in segment information. Services and products are sold between segments at predetermined rates primarily based on cost. The recovery of intersegment cost is shown as "Intersegment revenue." By not allocating stock-based compensation expense (income) or the capitalization and amortization of product development expenses to our operating segments, the segment operating income (loss) provides the chief operating decision maker with an indication of the operating segment's cash generating ability or requirements. The operating segment's cash generating ability and requirements is one of the criteria used by the chief operating decision maker in determining how resources are allocated to segments. Segment disclosures are limited to the business segment information provided to the chief operating decision maker on a recurring basis, and, therefore, we do not present information concerning assets by segment.

Segment accounting policies are the same as those described in Note 2, except for stock-based compensation expense and capitalized internal product development costs. Stock-based compensation expense or income is not allocated to business segments and is a reconciling item to arrive at the consolidated financial information. Compensation expense related to ongoing product development is recorded as an expense in the determination of business segment operating results. The capitalization and amortization of these product development expenses are shown as a reconciling item to arrive at the consolidated financial information.

Segment information is as follows:

($000)	Individual	Advisor	Institutional	Eliminations and Corporate Items	Total
	Nine Months Ended September 30, 2003 (Unaudited)				
Revenue					
External customers	$ 24,421	$ 35,462	$ 42,510	$ —	$ 102,393
Intersegment	1,609	747	1,350	(3,706)	—
Total revenue	26,030	36,209	43,860	(3,706)	$ 102,393
Operating expense, excluding depreciation and amortization	20,872	28,231	38,069	17,445	104,617
Depreciation and amortization	653	1,249	1,744	1,265	4,911
Operating income (loss)	$ 4,505	$ 6,729	$ 4,047	$ (22,416)	$ (7,135)
Capital expenditures	$ 93	$ 645	$ 2,647	$ 2,976	$ 6,361
U.S. revenue					$ 87,486
Non-U.S. revenue					$ 14,907
U.S. long-lived assets					$ 15,663
Non-U.S. long-lived assets					$ 1,729

Nine Months Ended September 30, 2004 (Unaudited) ($000)	Individual	Advisor	Institutional	Eliminations and Corporate Items	Total
Revenue					
External customers	$ 31,167	$ 44,128	$ 55,649	$ —	$ 130,944
Intersegment	1,929	1,159	1,885	(4,973)	—
Total revenue	33,096	45,287	57,534	(4,973)	130,944
Operating expense, excluding depreciation and amortization	28,917	33,253	45,154	1,600	108,924
Depreciation and amortization	765	1,222	1,687	1,680	5,354
Operating income (loss)	$ 3,414	$ 10,812	$ 10,693	$ (8,253)	$ 16,666
Capital expenditures	$ 12	$ 1,163	$ 2,277	$ 2,306	$ 5,758
U.S. revenue					$ 112,545
Non-U.S. revenue					$ 18,399
U.S. long-lived assets					$ 16,731
Non-U.S. long-lived assets					$ 1,454

Year Ended December 31, 2001 ($000)	Individual	Advisor	Institutional	Eliminations and Corporate Items	Total
Revenue					
External customers	$ 25,729	$ 34,047	$ 31,454	$ —	$ 91,230
Intersegment	1,913	776	1,088	(3,777)	—
Total revenue	27,642	34,823	32,542	(3,777)	91,230
Operating expense, excluding depreciation and amortization	28,234	35,063	38,627	124	102,048
Depreciation and amortization	916	1,571	1,695	1,391	5,573
Operating loss	$ (1,508)	$ (1,811)	$ (7,780)	$ (5,292)	$ (16,391)
Capital expenditures	$ 100	$ 527	$ 957	$ 4,348	$ 5,932
U.S. revenue					$ 83,827
Non-U.S. revenue					$ 7,403
U.S. long-lived assets					$ 12,859
Non-U.S. long-lived assets					$ 1,731

Year Ended December 31, 2002					
($000)	Individual	Advisor	Institutional	Eliminations and Corporate Items	Total
Revenue					
External customers	$ 29,980	$ 40,142	$ 39,497	$ —	$ 109,619
Intersegment	2,018	830	1,328	(4,176)	—
Total revenue	31,998	40,972	40,825	(4,176)	109,619
Operating expense, excluding depreciation and amortization	26,974	39,953	45,347	138	112,412
Depreciation and amortization	682	1,594	1,876	1,395	5,547
Operating income (loss)	$ 4,342	$ (575)	$ (6,398)	$ (5,709)	$ (8,340)
Capital expenditures	$ 102	$ 410	$ 656	$ 4,821	$ 5,989
U.S. revenue					$ 95,769
Non-U.S. revenue					$ 13,850
U.S. long-lived assets					$ 13,511
Non-U.S. long-lived assets					$ 1,780

Year Ended December 31, 2003					
($000)	Individual	Advisor	Institutional	Eliminations and Corporate Items	Total
Revenue					
External customers	$ 33,259	$ 48,281	$ 57,956	$ —	$ 139,496
Intersegment	2,147	880	1,789	(4,816)	—
Total revenue	35,406	49,161	59,745	(4,816)	139,496
Operating expense, excluding depreciation and amortization	27,127	37,964	53,276	24,760	143,127
Depreciation and amortization	888	1,676	2,309	2,250	7,123
Operating income (loss)	$ 7,391	$ 9,521	$ 4,160	$ (31,826)	$ (10,754)
Capital expenditures	$ 216	$ 274	$ 638	$ 7,479	$ 8,607
U.S. revenue					$ 119,378
Non-U.S. revenue					$ 20,118
U.S. long-lived assets					$ 15,856
Non-U.S. long-lived assets					$ 1,744

5. Investments

We monitor the concentration/diversification, maturity, and liquidity of our investment portfolio. As of December 31, 2002 and 2003 and September 30, 2004, our portfolio of cash, cash equivalents, and investments has an average weighted maturity of six months, and no single security has a maturity greater than 24 months.

The cost, unrealized gains (losses), and fair value related to investments are as follows:

	As of December 31								As of September 30			
	2002				2003				2004 (Unaudited)			
($000)	Cost	Unrealized Gain	Unrealized Loss	Fair Value	Cost	Unrealized Gain	Unrealized Loss	Fair Value	Cost	Unrealized Gain	Unrealized Loss	Fair Value
Corporate bonds	$ 9,462	43	(84)	$ 9,421	$ 5,499	8	(14)	$ 5,493	$ 13,733	$ —	$ (59)	$13,674
Senior notes	3,482	—	(68)	3,414	5,000	3	(5)	4,998	2,855	1	(6)	2,850
Government obligations	4,060	9	(7)	4,062	10,262	15	(2)	10,275	10,144	1	(41)	10,104
Certificate of deposit	2,995	—	—	2,995	1,019	—	—	1,019	2,615	—	—	2,615
Other	659	—	(92)	567	730	138	(4)	864	1,001	—	—	1,001
Total investments	$ 20,658	52	(251)	$ 20,459	$ 22,510	164	(25)	$ 22,649	$ 30,348	2	(106)	$30,244

We sold investments resulting in realized gains and losses as follows:

	Year Ended December 31			Nine Months Ended September 30 (Unaudited)	
($000)	2001	2002	2003	2003	2004
Realized gains	$ 66	$ 46	$ 95	$ 17	$ 10
Realized losses	(128)	(79)	(7)	(7)	(1)
Realized gain (loss), net	$ (62)	$ (33)	$ 88	$ 10	$ 9

The net carrying value and estimated fair value of debt and marketable equity securities at December 31, 2003 and September 30, 2004, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

	As of December 31, 2003		As of September 30, 2004 (Unaudited)	
($000)	**Cost**	**Fair Value**	**Cost**	**Fair Value**
Available for sale:				
Due in one year or less	$ 7,966	$ 7,964	$ 1,545	$ 1,543
Due after one year through three years	12,795	12,802	25,187	25,085
Due after three years	—	—	—	—
Total	20,761	20,766	26,732	26,628
Held to maturity:				
Due in one year or less	456	456	2,615	2,615
Due after one year through three years	563	563	—	—
Total	1,019	1,019	2,615	2,615
Trading securities	730	864	1,001	1,001
Total investments	$ 22,510	$ 22,649	$ 30,348	$ 30,244

6. Acquisitions

Morningstar Norway

In February 2004, we purchased the remaining 51% of Morningstar Norge AS ("Morningstar Norway") that we did not previously own. The purchase price consisted of $210,000 cash and $69,000 of other consideration. Prior to this transaction, our investment in Morningstar Norway was accounted for by the equity method.

mPower.com, Inc.

On July 1, 2003, we acquired 100% ownership of mPower.com, Inc. ("mPower"), an investment advisory firm that specializes in serving the large plan sponsor retirement market. The aggregate purchase price was $4,864,000. The results of mPower's operations have been included in the Consolidated Financial Statements since that date. The acquisition was strategic in nature and gave us immediate entry into the large plan sponsor market. The purchase price was less than the total fair value of the assets acquired. Therefore certain long-term assets were allocated values which were lower than their fair values at the date of acquisition. The aggregate purchase price has been allocated to the acquired assets and liabilities based on estimated fair market values as of the date of acquisition.

The purchase price was allocated to the net assets acquired as follows:

		($000)
Cash	$	397
Other current assets		451
Property, equipment, and capitalized software		161
Deferred tax assets		4,663
Intangible assets		2,003
Liabilities		(2,811)
Purchase price	$	4,864

Of the $2,003,000 of acquired intangible assets, $871,000 was assigned to a customer list and $1,132,000 was assigned to intellectual property. These intangible assets are amortized over their economic useful lives of seven years.

As of December 31, 2003, there were no significant commitments or contingencies associated with the mPower acquisition.

Pro forma consolidated financial information, combining our 2002 and 2003 financial results with mPower's financial results for the years ended December 31, 2002 and 2003, would have been as follows:

	Year Ended December 31			
(in thousands except per share amounts)		**2002 (Unaudited Pro forma)**		**2003 (Unaudited Pro forma)**
Revenue	$	115,822	$	142,222
Operating loss	$	(30,316)	$	(13,280)
Loss before extraordinary gain and cumulative effect of change in accounting principle	$	(24,391)	$	(14,484)
Extraordinary gain		3,084		—
Cumulative effect of change in accounting principle		(417)		—
Net loss	$	(21,724)	$	(14,484)
Basic loss per share	$	(0.57)	$	(0.38)
Diluted loss per share	$	(0.64)	$	(0.38)

Morningstar Canada

On January 14, 2003, we purchased the remaining 50% of Morningstar Research Inc. ("Morningstar Canada") for $6,334,000 in cash. Accordingly, the purchase price has been allocated to the acquired assets and liabilities based on their estimated fair values as of the date of acquisition, with the remainder allocated to goodwill.

The purchase price was allocated as follows:

		($000)
Current assets	$	674
Property, equipment, and capitalized software		223
Other assets		376
Goodwill		8,484
Liabilities		(3,423)
Total purchase price	$	6,334

Prior to January 14, 2003, we controlled the day-to-day operations of Morningstar Canada. As a result, the financial results for Morningstar Canada, adjusted for the minority interest, are included in the Consolidated Financial Statements for the years ended December 31, 2001 and 2002.

Morningstar Asia

In April 2000, we formed a joint venture, Morningstar Asia Limited ("Morningstar Asia"), to provide financial information and services in Asia, except Japan and South Korea. We agreed to contribute technology and services up to a maximum value of $6,600,000 to the operations of Morningstar Asia during the three year period following the date of formation of the joint venture. Our ownership interest and profit and loss sharing interest in Morningstar Asia was 39.9% as of December 31, 2001. On October 1, 2002, we purchased the remaining 60.1% of Morningstar Asia for $5,776,000 in cash. Under the provisions of SFAS No. 142, if the fair value of net assets acquired exceeds the purchase price, the transaction qualifies as a bargain purchase. The purchase price is allocated first to current assets and liabilities and any excess of net asset value over the purchase price is recognized immediately as an extraordinary gain. Accordingly, as our acquired interest in the fair value of Morningstar Asia exceeded the purchase price, an extraordinary gain of $3,084,000, was recognized as a result of the transaction.

The purchase price was allocated as follows:

		($000)
Other current assets	$	8,908
Extraordinary gain		(3,084)
Liabilities		(48)
Total purchase price	$	5,776

Prior to this transaction, the investment was accounted for by the equity method. As of October 1, 2002, we began including the financial results of Morningstar Asia in our Consolidated Financial Statements.

Morningstar Australia/New Zealand

In April 1999, we entered into agreements to purchase a minority ownership interest in Morningstar Research Pty Limited ("Morningstar Australia/New Zealand"), a company that provides financial information products and services in Australia and New Zealand. Throughout 2000 and 2001, we increased our ownership percentage in Morningstar Australia/New Zealand to 65.86% through additional share acquisitions. Beginning in January 2001, we included the financial results of Morningstar Australia/New Zealand, adjusted for the minority interest, in our Consolidated Financial Statements. In March 2002, pursuant to the terms of a shareholders agreement, we exercised our option to purchase all of the remaining shares of Morningstar Australia/New Zealand, thereby increasing our ownership percentage to 100%. See Note 15 to our Notes to Consolidated Financial Statements for information on a legal proceeding that, among other things, seeks an order that certain of the transactions by which we acquired 100% ownership of Morningstar Australia/New Zealand be set aside.

In accordance with the terms of the shareholders agreement, the purchase price of the remaining shares was zero and the fair value of the net assets acquired was as follows:

		($000)
Current assets	$	576
Goodwill		416
Current liabilities		(992)
Purchase price	$	—

7. Investments in Unconsolidated Entities

Investment in Japan. In April 1998, we entered into an agreement with Softbank to form a joint venture, Morningstar Japan K.K. ("MJKK"), which develops and markets Japanese language versions of our products and services. In June 2000, MJKK became a publicly traded company on the Osaka Stock Exchange, "Hercules Market," using the ticker number 4765. Our investment in MJKK is accounted for using the equity method. Our investment in MJKK totaled $12,929,000 and $13,400,000 at December 31, 2002 and 2003, and $13,719,000 at September 30, 2004, respectively. MJKK's market value as of December 31, 2003 was approximately Japanese Yen 9.6 billion (approximately U.S. $89,700,000). MJKK's market value as of September 30, 2004 was approximately Japanese Yen 14.0 billion (approximately U.S. $124,000,000). At December 31, 2003 and September 30, 2004, we owned approximately 35% of MJKK.

Investment in Techfi Corporation. In March 2000, we entered into a stock purchase agreement with Techfi Corporation ("Techfi"), a provider of portfolio management and accounting software, training and support to investment advisors and financial planners. On June 7, 2002, Techfi Corporation and Advent Software, Inc. entered into an Agreement and Plan of Merger, whereby all of the issued and outstanding shares of Techfi common stock and vested options were converted into the right to receive cash. Our share of the total proceeds was $4,838,000, resulting in a gain of $3,398,000 in 2002. In 2003, $510,000 was released from escrow and recorded as a gain. The gains recorded in 2002 and 2003 are included as "Gain on sale of investment in unconsolidated entity," in the Consolidated Statements of Operations.

Joint Venture in Korea. In June 2000, we entered into a joint venture agreement with Shinheung Securities Co., Ltd. and Softbank Finance Corporation, and established a Korean limited liability company named Morningstar Korea Ltd ("Morningstar Korea"). Morningstar Korea develops, markets and sells analytical products and services to assist in the analysis of financial portfolios and provides financial information and services for financial products in South Korea. Our ownership interest and profit and loss sharing interest in Morningstar Korea was 40% as of December 31, 2002 and 2003. This investment totaled $367,000 and $518,000 at December 31, 2002 and 2003, respectively, and $700,000 at September 30, 2004. This investment is accounted for using the equity method.

Condensed combined financial information, a portion of which is unaudited, for all of our investments in entities accounted for under the equity method as discussed above is as follows:

	Year Ended December 31			Nine Months Ended September 30 (Unaudited)	
($000)	**2001**	**2002**	**2003**	**2003**	**2004**
Revenue	$ 8,133	$ 5,701	$ 4,739	$ 2,989	$ 3,302
Operating income (loss)	$ (10,861)	$ 1,240	$ (197)	$ 675	$ 719
Net income (loss)	$ (11,622)	$ 662	$ (282)	$ (368)	$ (34)

	As of December 31			As of September 30
($000)	**2001**	**2002**	**2003**	**2004 (Unaudited)**
Current assets	$ 39,335	$ 29,893	$ 41,564	$ 38,990
Total assets	$ 49,452	$ 38,189	$ 49,862	$ 47,939
Current liabilities	$ 2,752	$ 787	$ 515	$ 435
Total liabilities	$ 3,274	$ 1,028	$ 524	$ 436

8. Property, Equipment, and Capitalized Software

Property, equipment, and capitalized software summarized by major classifications are as follows:

	As of December 31		As of September 30
($000)	**2002**	**2003**	**2004 (Unaudited)**
Computer equipment	$ 12,620	$ 16,064	$ 17,747
Capitalized software	12,621	17,273	18,991
Furniture and fixtures	3,669	3,460	3,185
Leasehold improvements	4,099	6,432	7,901
Telephone equipment	911	1,047	1,050
Binder molds	296	296	296
Property, equipment, and capitalized software, at cost	34,216	44,572	49,170
Less accumulated depreciation	(18,925)	(26,972)	(30,985)
Property, equipment, and capitalized software, net	$ 15,291	$ 17,600	$ 18,185

Depreciation and leasehold amortization expense totaled $5,027,000, $5,547,000 and $6,980,000 in 2001, 2002 and 2003, respectively. Depreciation and leasehold amortization expense totaled $4,839,000 and $5,139,000 for the nine months ended September 30, 2003 and 2004, respectively.

9. Long-Term Debt

Long-term debt consists of the following:

($000)	As of December 31 2002	As of December 31 2003	As of September 30 2004 (Unaudited)
Capital lease obligations, due in monthly installments through 2005	$ 83	$ 56	$ 25
Note payable	6,500	6,500	—
Bank loans	141	33	—
Total long-term debt	6,724	6,589	25
Less current portion of long-term debt	(157)	(6,577)	(25)
Long-term debt—net of current portion	$ 6,567	$ 12	$ —

Future minimum lease payments under the capital lease at December 31, 2003 are as follows:

Year Ending December 31	($000)
2004	$ 47
2005	15
	62
Less amount representing interest	(6)
Total	$ 56

Assets under capital leases at December 31, 2003 consists primarily of computer software with a remaining net book value of $43,000.

The note payable represents borrowings from Joe Mansueto, an executive officer. On August 31, 1999, he loaned Morningstar $6,500,000. Interest on the loan is based on the London Interbank Offered Rate plus 150 basis points, which was 2.62% at December 31, 2003. The loan was repaid on March 30, 2004.

At December 31, 2002, Morningstar Canada had a bank loan of $79,000 which bore interest at the prime rate plus 200 basis points. This loan was repaid in 2003. Morningstar Australia/New Zealand has a bank loan of $62,000 and $33,000 at December 31, 2002 and 2003, respectively. The bank loan bears interest at 7.15% and matures on December 31, 2004.

Aggregate maturities of long-term debt, including capital lease obligations, at December 31, 2003 are as follows:

Year Ending December 31		**($000)**
2004	$	6,577
2005		12
Total	$	6,589

The weighted average interest rate on all debt outstanding was 2.96% and 3.18% at December 31, 2002 and 2003, respectively.

10. Operating Lease

Minimum future rental commitments due in each of the next five years and thereafter for all non-cancelable operating leases, consisting primarily of rent for office space, are as follows:

Year Ending December 31		**($000)**
2004	$	1,788
2005		1,454
2006		1,347
2007		1,024
2008		844
Thereafter		70
Total	$	6,527

Rent expense for 2001, 2002 and 2003 was $2,694,000, $3,353,000, and $3,521,000, respectively, including $1,772,000, $1,837,000, and $2,112,000, respectively, of taxes, insurance, and other operating costs. Rent expense for the nine months ended September 30, 2003 and 2004 was $2,736,000 and $3,169,000, respectively.

Deferred rent in the amount of $908,000 and $1,021,000 at December 31, 2002 and 2003, respectively, and $883,000 at September 30, 2004 relates to build-out and rent abatement allowances received, which are being amortized on a straight-line basis over the remaining portion of the original 15-year term of the lease.

11. Stock Options and Deferred Compensation

Our 1993 Stock Option Plan (the "1993 Plan") provides for the grant of options to management and other employees to purchase shares of common stock at an exercise price equal to fair value at the date of grant. All employees were eligible for participation in the 1993 Plan after two years of employment. In general, options vest ratably over a five-year period and expire 10 years after the date of grant. Under the terms of the 1993 Plan, at the option holder's election, the option may be settled in cash, subject to certain conditions, based on the difference in exercise price and the fair market value at the date of exercise, or the option may be exercised resulting in issuance of common stock to the employee. In the event an employee exercises an option and elects net cash settlement, Morningstar has the right to make payment to the employee over a period of time, currently five years. Interest accrues on any unpaid balance due the employee at a floating rate equal to the yield on the 13-week U.S. Treasury Bill, adjusted on January 1 and July 1 of each year. We account for options granted under the 1993 Plan as a liability which is measured each period, in accordance with SFAS No. 123. Changes in the liability, due to changes in the estimated fair market value of our stock during the period, are recorded in the Consolidated Statements of Operations.

Under our 1989 Nonqualified Stock Option Plan (the "1989 Plan"), options to purchase 1,500,000 shares of common stock at an exercise price of $0.075 per share, equal to the fair value at date of issue, were granted in 1989 to an officer of Morningstar. These options were not exercised and expired on February 1, 1999. On February 15, 1999, we entered into an Incentive Stock Option Agreement and a Nonqualified Stock Option Agreement under the 1999 Incentive Stock Option Plan (the "1999 Plan") with the officer. Under these agreements, options to purchase 1,500,000 shares of common stock at an exercise price of $2.77 per share, equal to the fair value at the grant date, were granted to the officer. Options granted are fully vested and expire on February 15, 2009. On the date of grant, 1,174,704 options were fully exercisable and an additional 36,144 shares became and continue to become exercisable each January 1, through January 1, 2008. The officer has periodically exercised options under the 1999 Plan which have been net settled in cash, based on the difference in exercise price and the fair market value of common stock at the date of exercise. As a result, we account for options granted under the 1999 Plan as a liability which is measured each period, in accordance with SFAS No. 123. Changes in the liability, due to changes in the estimated fair market value of our stock during the period, are recorded in the Consolidated Statements of Operations. There were 869,174 options remaining to be exercised as of December 31, 2002 and 2003, and September 30, 2004.

On February 15, 1999, in conjunction with the expiration of options granted under the 1989 Plan, we entered into a Deferred Compensation Agreement (the "Agreement") with an officer of Morningstar. Under the terms of the Agreement, on any date that the officer exercises the right to purchase shares under the 1999 Plan, we shall pay to the officer $2.69 per share in the form of cash or, at our election, shares of common stock. If on the date of purchase the fair market value of Morningstar's stock is below $2.77 per share, the amount paid per share will be reduced based on the terms of the Agreement. Our obligation to pay deferred compensation will not be increased by any imputed interest or earnings amount. The liability related to the Agreement is included in the Consolidated Balance Sheets as follows:

	As of December 31		As of September 30
($000)	2002	2003	2004 (Unaudited)
Current liabilities—other	$ 1,853	$ 1,950	$ 1,950
Non-current—other long-term liabilities	487	390	390
Total	$ 2,340	$ 2,340	$ 2,340

On March 17, 2000, we adopted the 2000 Morningstar Stock Option Plan (the "2000 Plan"). All remaining options available for future grants under the 1993 plan were canceled. Under the 2000 Plan, all employees are eligible for participation on the first day of employment, all options expire 10 years after the date of grant and, in general, options vest ratably over a four-year period. On May 1, 2001, we adopted the 2001 Morningstar Stock Option Plan (the "2001 Plan"), which will utilize the remaining options available for grant under the 2000 Plan. The terms under the 2001 Plan are substantially consistent with the 2000 Plan. We account for options granted under the 2000 and 2001 Plans as equity instruments in accordance with the provisions of SFAS No. 123.

During 2001, Morningstar Europe, a majority owned subsidiary of Morningstar, granted 1,449,000 options in the common stock of Morningstar Europe to certain of its employees. The options vest over a four-year period and none have been exercised as of December 31, 2003. We account for these options as equity instruments in accordance with the provisions of SFAS No. 123.

Stock-based compensation expense is as follows:

	Year Ended December 31			Nine Months Ended September 30 (Unaudited)	
($000)	2001	2002	2003	2003	2004
Stock-based compensation expense (income) under the liability method	$ (3,336)	$ (3,283)	$ 17,796	$ 13,223	$ 3,099
Stock-based compensation expense under the equity method	9,003	10,575	11,233	8,373	5,670
Stock-based compensation expense, net	$ 5,667	$ 7,292	$ 29,029	$ 21,596	$ 8,769

The liability in the Consolidated Balance Sheets for stock-based compensation expense related to stock options accounted for as liabilities, is as follows:

	As of December 31				As of September 30	
($000)		2002		2003		2004 (Unaudited)
Current liabilities—accrued stock-based compensation	$	5,680	$	12,530	$	13,863
Non-current liabilities—accrued stock-based compensation		8,847		19,396		20,444
Total	$	14,527	$	31,926	$	34,307

We periodically granted options to purchase common stock at an exercise price that was below the fair market value of our common stock at the date of grant. A summary of these option grants is as follows:

	Year Ended December 31												Nine Months Ended September 30			
	2001				2002				2003				2004 (Unaudited)			
	Underlying Shares			Weighted Average Exercise Price	Underlying Shares			Weighted Average Exercise Price	Underlying Shares			Weighted Average Exercise Price	Underlying Shares			Weighted Average Exercise Price
Options outstanding—beginning of period	2,801,212		$	6.66	2,278,318		$	7.12	1,937,174		$	6.80	1,936,624		$	6.78
Granted	—			—	60,000		$	8.57	14,750		$	8.57	—			—
Canceled	(330,000)		$	5.76	(300,000)		$	10.98	(15,300)		$	10.93	(1,025)		$	8.57
Exercised	(192,894)		$	2.77	(101,144)		$	2.77	—		$	—	—			—
Options outstanding—end of period	2,278,318		$	7.12	1,937,174		$	6.80	1,936,624		$	6.78	1,935,599		$	6.78
Options exercisable	1,082,685		$	5.25	1,208,560		$	6.11	1,487,329		$	6.69	1,758,943		$	7.07

A summary of stock option activity, excluding activity for options to purchase common stock at an exercise price that was below the fair market value at the time of grant is as follows:

	Year Ended December 31						Nine months ended September 30	
	2001		2002		2003		2004 (Unaudited)	
	Underlying Shares	Weighted Average Exercise Price	Underlying Shares	Weighted Average Exercise Price	Underlying Shares	Weighted Average Exercise Price	Underlying Shares	Weighted Average Exercise Price
Options outstanding—beginning of period	6,376,984	$ 9.55	6,853,791	$ 10.91	6,949,790	$ 10.85	7,556,364	$ 10.62
Granted	2,213,895	$ 14.12	794,827	$ 10.97	834,988	$ 8.57	—	—
Canceled	(1,519,251)	$ 11.15	(595,967)	$ 13.17	(168,810)	$ 13.20	(62,574)	$ 11.83
Exercised	(217,837)	$ 2.17	(102,861)	$ 2.23	(59,604)	$ 1.72	(58,922)	$ 3.22
Options outstanding—end of period	6,853,791	$ 10.91	6,949,790	$ 10.85	7,556,364	$ 10.62	7,434,868	$ 10.67
Options exercisable	2,052,500	$ 6.52	3,292,486	$ 8.76	4,648,302	$ 9.84	5,980,680	$ 10.59

Additional information for options outstanding and options exercisable at December 31, 2003 is as follows:

	Options Outstanding As of December 31, 2003			Options Exercisable As of December 31, 2003	
Range of Exercise Prices	**Outstanding Shares**	**Weighted Average Remaining Contractual Life (Years)**	**Weighted Average Exercise Price**	**Exercisable Shares**	**Weighted Average Exercise Price**
$0.85 – $2.77	2,546,968	4.45	$ 2.46	2,338,194	$ 2.44
$8.57 – $14.13	6,946,020	7.11	$ 12.53	3,797,437	$ 13.17
$0.85 – $14.13	9,492,988	6.39	$ 9.83	6,135,631	$ 9.08

Additional information for options outstanding and options exercisable as of September 30, 2004 is as follows:

	Options Outstanding As of September 30, 2004 (Unaudited)				Options Exercisable As of September 30, 2004 (Unaudited)		
Range of Exercise Prices	Outstanding Shares	Weighted Average Remaining Contractual Life		Weighted Average Exercise Price	Exercisable Shares		Weighted Average Exercise Price
$1.72 – $2.77	2,498,702	3.80	$	2.49	2,347,762	$	2.48
$8.57 – $14.13	6,871,765	6.34	$	12.53	5,391,861	$	12.97
$1.72 – $14.13	9,370,467	5.66	$	9.85	7,739,623	$	9.79

The number of shares available for future stock option grants, as of December 31, 2001, 2002, 2003 and September 30, 2004 is 3,091,600, 3,278,006, 2,287,365, and 2,367,033 respectively.

The weighted average fair value of the options granted in 2001, 2002 and 2003 calculated using a Black-Scholes option-pricing model is $6.95, $5.40 and $4.08 per share, respectively. No options were granted during the nine months ended September 30, 2004. The fair value of each option granted is estimated on the date of grant using a Black-Scholes option-pricing model with the following weighted average assumptions:

	Year Ended December 31		
	2001	2002	2003
Expected life (years)	5.0	5.0	5.0
Expected volatility (%)	50%	50%	50%
Dividend yield (%)	—	—	—
Interest rate (%)	4.76%	4.19%	2.89%
Fair value of common stock (per share)	$14.13	$8.57 – $10.95	$8.57 – $14.70

For all options granted under the 1993 Plan and 1999 Plan, which are accounted for under the liability method, the liability for such options was recorded using the fair value per share of common stock of $14.70 as of December 31, 2003 and $15.60 at September 30, 2004.

For all options granted under the 2000 Plan and 2001 Plan, which are accounted for under the equity method, including those options granted in the 12 months prior to September 30, 2004, the fair value of common stock of

$14.70, was included in the Black-Scholes option pricing model used to determine stock-based compensation expense.

Following is a summary of options granted during the 12 months prior to September 30, 2004:

Grant Date	Number of Underlying Shares	Exercise Price	Fair Value of Common Stock Used in the Determination of Stock-based Compensation Expense
Fourth quarter 2003	8,100	$ 8.57	$ 14.70
First quarter 2004	—	—	—
Second quarter 2004	—	—	—
Third quarter 2004	—	—	—

12. Related Party Transactions

Between December 1995 and December 2003, a corporation wholly owned by Joe Mansueto provided sales and other services for us. We agreed to pay an amount equal to the total costs incurred by the corporation in providing these services, consisting solely of compensation related expenses for the corporation's employees (which did not include Joe Mansueto), plus 5% of such costs. For 2001, 2002 and 2003, we recorded expense for these services of $2,122,000, $3,302,000, and $2,915,000, respectively of which $101,000, $157,000, and $139,000, respectively, represented the amount paid in excess of the corporation's actual costs. At December 31, 2002 and 2003, we recorded an amount payable to such corporation of $391,000 and $398,000, respectively, included in "Accounts payable and accrued liabilities" in the Consolidated Balance Sheets. This arrangement was discontinued on December 31, 2003 at which time all employees of the corporation were transferred to Morningstar.

Under the 1993 Plan, employees are able to exercise options and elect net cash settlement, based on the difference between the exercise price and the fair market value of the stock. In the event an employee exercises an option and elects net cash settlement, we have the right to make payment over a period of time, which is currently five years. Interest accrues on any unpaid balance due the employee at a floating rate equal to the yield on the 13-week U.S. Treasury Bill, adjusted on January 1 and July 1 of each year. Additionally, certain employees, including an officer of Morningstar, sold common stock back to Morningstar. The purchase price of these shares is also being paid to employees over a five-year period.

The liabilities for stock options exercised and for common stock repurchases are as follows:

($000)	As of December 31 2002		As of December 31 2003		As of September 30 2004 (Unaudited)	
Liability for stock options exercised	$	2,923	$	2,029	$	1,173
Liability for common stock repurchases		1,214		804		414
Total	$	4,137	$	2,833	$	1,587

The liabilities for stock options exercised and for common stock repurchases are included in the Consolidated Balance Sheets as follows:

($000)	As of December 31 2002		As of December 31 2003		As of September 30 2004 (Unaudited)	
Current liabilities—other	$	1,475	$	1,369	$	1,358
Non-current—other long-term liabilities		2,662		1,464		229
Total	$	4,137	$	2,833	$	1,587

Interest expense incurred on all amounts due was $157,000, $74,000, and $36,000 for the years ended December 31, 2001, 2002 and 2003, respectively and $30,000 and $19,000 for the nine months ended September 30, 2003 and 2004, respectively.

We had a note payable related to borrowings from Joe Mansueto, an executive officer, of $6,500,000 as of December 31, 2003. (See Note 9, Long-Term Debt.)

13. Defined Contribution Profit-Sharing Plan

We sponsor a defined contribution cash or deferred arrangement 401(k) plan. The plan allows our U.S.-based employees to voluntarily contribute pre-tax dollars up to a maximum amount allowable by the U.S. Internal Revenue Service. We contribute an amount equal to the employee's contributions, up to 7% of the employee's salaries. Our matching contributions were $1,613,000, $2,478,000, and $2,324,000 for the years ended December 31, 2001, 2002 and 2003, respectively and $2,113,000 and $2,502,000 for the nine months ended September 30, 2003 and 2004, respectively.

14. Income Taxes

For the nine months ended September 30, 2003, our loss before income taxes and equity in net income of unconsolidated entities was $6.8 million and our income tax expense was $3.7 million. For the nine months ended September 30, 2004, our income before income taxes and equity in net income of unconsolidated entities was $17.7 million and our income tax expense was $8.3 million. Our effective tax rate for the nine months ended September 30, 2004 was 47.2%. In both periods, the tax provision reflects the impact of expense related to incentive stock options for which no tax benefit is recorded, and the fact that we are not recording a tax benefit related to losses recorded by our non-U.S. operations.

The income tax expense (benefit) consists of the following:

	Year Ended December 31		
($000)	**2001**	**2002**	**2003**
Federal—deferred	$ (4,310)	$ (376)	$ 2,047
Federal—current	—	—	353
State—deferred	(969)	(79)	410
State—current	—	144	137
Foreign—current	3	—	3
Income tax expense (benefit)	$ (5,276)	$ (311)	$ 2,950

A reconciliation of our income tax expense (benefit) at the U.S. federal income tax rate of 35% to income tax expense (benefit) as recorded is as follows:

	Year Ended December 31					
(in thousands except percentages)	**2001**		**2002**		**2003**	
Income tax expense (benefit) at U.S. federal rate	$ (5,100)	(35.0)%	$ 47	35.0 %	$ (3,132)	(35.0)%
State income taxes—net of federal income tax effect	(632)	(4.3)	(94)	(70.2)	342	3.8
Equity in losses of foreign joint ventures	2,922	20.0	329	246.7	1,273	14.2
Stock option activity	(2,474)	(17.0)	51	38.2	4,405	49.2
Foreign taxes	3	—	—	—	3	—
Gain on sale of investment in unconsolidated entity	—	—	(571)	(427.5)	—	—
Other—net	5	0.1	(73)	(55.1)	59	0.8
Total income tax expense (benefit)	$ (5,276)	(36.2)%	$ (311)	(232.9)%	$ 2,950	33.0%

We recognize deferred income taxes for the temporary differences between the carrying amount of assets and liabilities for financial statement purposes and their tax bases. The tax effects of the temporary differences that give rise to the deferred income tax assets and liabilities is as follows:

	As of December 31					
	2002				**2003**	
($000)	**Current asset**	**Non-current asset**	**Non-current liability**	**Net Non-current asset**	**Current asset**	**Non-current asset**
Net operating loss carryforwards	$ —	$ 9,946	$ —	$ 9,946	$ —	$ 6,341
Stock-based compensation	—	12,065	—	12,065	—	18,047
Deferred compensation	784	190	—	190	784	191
Property, equipment, and capitalized software	—	—	(35)	(35)	—	975
Deferred rent	—	355	—	355	—	296
Allowance for doubtful accounts	297	—	—	—	227	—
Deferred royalty revenue	—	650	—	650	—	624
Accrued liabilities	4,022	—	—	—	2,277	—
Unrealized loss on available-for-sale securities	134	—	—	—	16	—
	$ 5,237	$ 23,206	$ (35)	$ 23,171	$ 3,304	$ 26,474

During 2003 our operating results included a loss before income taxes, however, for tax purposes we recorded taxable income in the United States, primarily as a result of recording stock based compensation expense which is not deductible for tax purposes until employees exercise their options. Therefore, we were able to use $14.4 million of NOLs during 2003. We believe that it is more likely than not that these remaining net deferred tax assets will be realized based on income tax laws and expectations of future taxable income stemming from ordinary operations. Therefore, we do not believe a valuation allowance for our net deferred tax assets is required at December 31, 2003 or 2002. Uncertainties surrounding income tax law changes and future operating income tax levels may, however, affect the ultimate realization of all or some of these deferred tax assets.

At December 31, 2002 and 2003, we had U.S. federal and state operating tax loss carryforwards of $26,313,000 and $16,184,000 that expire in 2021 and 2022, respectively.

A portion of the net operating losses ("NOLs") generated by mPower in the years prior to July 1, 2003 (the date of acquisition) is available to Morningstar. On July 1, 2003, mPower had $121,430,000 of NOLs. Because of limitations on the use of the NOLs imposed by the U.S. Internal Revenue Service, our use of the NOLs is limited to approximately $200,000 per year. On the date of acquisition, we recorded a valuation allowance of $116,932,000 representing a portion of these NOLs, as it is more likely than not that the benefit of the NOLs will not be realized.

15. Contingencies

Morningstar Australia/New Zealand

In 2001, Mr. Graham Rich, the then managing director and chief executive officer of Morningstar Australia/New Zealand, and one of two companies controlled by Mr. Rich, filed a suit in the Supreme Court of New South Wales, Australia against Morningstar and certain of its officers and nominee directors on the board of Morningstar Australia/New Zealand. Mr. Rich also was a beneficial owner of shares in Morningstar Australia/New Zealand. Mr. Rich and his company originally sought an injunction which, if granted, would have precluded Morningstar Australia/New Zealand from terminating the services of Mr. Rich and from issuing additional shares to Morningstar in exchange for the provision of further funding by Morningstar to Morningstar Australia/New Zealand. Further, Mr. Rich and his company sought an order that a provisional liquidator be appointed for Morningstar Australia/New Zealand. The court rejected this injunction application, observing that Morningstar Australia/New Zealand would be insolvent without financial backing from Morningstar. The application for the appointment of a provisional liquidator also failed.

The services of Mr. Rich were terminated in November 2001. Mr. Rich and his company have since been ordered to pay Morningstar's costs of the injunction proceedings, although such costs have not been paid to date.

Mr. Rich and the two companies noted above have additional pending claims alleging, among other things, breaches by Morningstar of contracts and statutory and general law duties, misleading, deceptive, and unconscionable conduct by Morningstar, oppression by Morningstar and its nominee directors, relief under the Industrial Relations Act of New South Wales, breaches of directors' duties by Morningstar's nominee directors, and conflict of interest. The claims seek various forms of relief including monetary damages, the setting aside of transactions which resulted in Morningstar obtaining control of Morningstar Australia/New Zealand, and an order either setting aside Morningstar's acquisition of the shares formerly beneficially owned by Mr. Rich and his companies or determining a different price for such acquisition. In the alternative, Mr. Rich and his companies seek an order that they be entitled to purchase the shares in Morningstar Australia/New Zealand at a price to be determined by the court or book value (as defined in the shareholders agreement of Morningstar Australia/New Zealand). Morningstar has denied the claims and filed counter-claims against Mr. Rich and certain of his companies, alleging breaches of statutory, general law and contractual duties.

In July 2004, the court decided Morningstar's application for security for its potential additional costs in the litigation by ordering the two companies controlled by Mr Rich to pay approximately Australian $925,000 to the court as security for such costs. The court stayed the proceedings by such companies until such amount is paid and indicated that it would entertain an application by Morningstar for additional security at a later time in the proceedings. The companies have not paid the security as ordered and have indicated to the court that they do not intend to pay the security and that their claims have been stayed. The court's order does not prevent Mr. Rich from pursuing his individual claims against Morningstar and its nominee directors.

Mr. Rich is also seeking leave of the court to begin a proceeding in the name of Morningstar Australia/New Zealand against Morningstar and its nominee directors. A hearing on this application is expected in April 2005.

In May 2003, the parties adverse to Morningstar offered to settle all claims for Australian $6,500,000 plus costs of Australian $500,000, which then approximated U.S. $5,275,900. That offer has expired. In February 2004, we offered to settle all claims for Australian $1,250,000, which then approximated U.S. $942,000, and we recorded a reserve in this amount for these claims in the fourth quarter of 2003. While we are vigorously contesting the claims against us, this proceeding is not yet in the documentary discovery stage and its likely outcome cannot be determined at this time.

Securities and Exchange Commission "Wells Notice"

The Securities and Exchange Commission is conducting an investigation related to incorrect total return data that we published during a short period in early 2004 with respect to a single mutual fund, the Rock Canyon Top Flight Fund. On May 24, 2004, we received a "Wells Notice" from the Division of Enforcement of the SEC indicating that it intended to recommend that the SEC take legal action against us alleging that we violated U.S. securities laws. We cannot predict the scope, timing, or outcome of the investigation, which may include the institution of administrative, civil injunctive, or criminal proceedings, the imposition of fines and penalties, and other remedies and sanctions.

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 matters will have a material adverse effect on our business, operating results, or financial condition.

16. Restatement

Subsequent to the issuance of the Consolidated Financial Statements for the period ended December 31, 2003, we determined our Investments in Unconsolidated Entities and Accumulated Other Comprehensive Income were overstated. As a result, the accompanying Consolidated Financial Statements have been restated to decrease Investments in Unconsolidated Entities and Accumulated Other Comprehensive Income in the amounts of $2,331,000 and $ 2,955,000 as of December 31, 2002 and December 31, 2003, respectively. The restatement has no impact to net income (loss) or cash flows for any period presented in these Consolidated Financial Statements.

17. Subsequent Events (unaudited)

Recently Issued Accounting Pronouncements

In October 2004, the Financial Accounting Standards Board ("FASB") concluded that SFAS No. 123 (Revised 2004), *Share-Based Payment* , which would require all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, would be effective for public companies (except small business issuers as defined in SEC Regulation S-B) for interim or annual periods beginning after June 15, 2005. Management is in the process of reviewing the provisions of SFAS No. 123 (Revised 2004) as it impacts our existing practice in which we recognize stock-based compensation expense.

Stock Options

In November 2004, we adopted the Morningstar 2004 Stock Incentive Plan (the "2004 Equity Plan"). The 2004 Equity Plan amends and restates the 1993 Plan, the 2000 Plan, and 2001 Plan (collectively, the "Prior Plans"). Under the 2004 Equity 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, will not be available for awards under the 2004 Equity Plan.

The 2004 Equity Plan provides for grants of options, stock appreciation rights, restricted stock, restricted stock units, and performance shares. All of our employees will be eligible for awards under the 2004 Equity Plan. Joe Mansueto will not participate in the 2004 Equity Plan. Awards may also be made to our non-employee directors under the 2004 Equity Plan. A total of 5,628,843 options may be granted under the Plan.

On December 1, 2004, the Board of Directors authorized the cancellation of the Morningstar Europe option plan and the exchange of all options outstanding under the Morningstar Europe Plan for options granted under the 2004 Equity Plan. The Board of Directors also authorized a grant of approximately 1,600,000 options to purchase common stock under the 2004 Equity Plan (including options resulting from the exchange of Morningstar Europe options for Morningstar Inc. options).

Morningstar Associates, LLC Subpoena from New York Attorney General's Office and Examination by Securities and Exchange Commission

In December 2004, Morningstar Associates, LLC, a wholly owned susidiary of Morningstar, Inc., received a request in the form of a subpoena from the New York Attorney General's office, seeking information and documents from Morningstar Associates, LLC related to an investigation the New York Attorney General's office is conducting. While the subpoena is very broad, it specifically asks for information and documents about the investment consulting services Morningstar Associates, LLC offers to retirement plan providers, including fund lineup recommendations for retirement plan sponsors. Shortly after the New York Attorney General's office issued the subpoena, the Securities and Exchange Commission notified Morningstar Associates, LLC that it had begun an examination of the investment consulting services Morningstar Associates, LLC offers to retirement plan providers. We cannot predict the scope, timing, or outcome of the investigation or examination, which may include the institution of administrative, civil injunctive, or criminal proceedings, the imposition of fines and penalties, and other remedies and sanctions.

Acquisition

In January 2005 we acquired the Variable Annuity Research and Data Service ("VARDS") unit from Finetre Corporation for $9 million in cash, subject to an adjustment for working capital. VARDS provides research and data on variable annuity products and is used by nearly every firm that offers variable annuities. The service is also used by many brokerage firms for research, due diligence, and suitability determination.

18. Recently Issued Accounting Pronouncements

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* , which is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. Adoption of the provisions of SFAS No. 146 did not have a material impact on our financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* . FASB Interpretation No. 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. The disclosure provisions of FASB Interpretation No. 45 are effective for financial statements for fiscal years ending after December 15, 2002. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002. The adoption of FASB Interpretation No. 45 did not have a material impact on our financial statements.

In December 2003, the FASB issued Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* , which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. This Interpretation replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* , which was issued in January 2003. We will be required to apply FASB Interpretation No. 46 (revised December 2003) to variable interests in variable interest entities created after December 31, 2003. We currently do not have any controlling financial interests that meet the requirements of this Interpretation.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* . SFAS No. 150 establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 also includes required disclosures for certain financial instruments within its scope. SFAS No. 150 was effective for instruments entered into or modified after May 31, 2003 and otherwise will be effective as of January 1, 2004, except for mandatorily redeemable financial instruments. For certain mandatorily redeemable financial instruments, the Statement will be effective on January 1, 2005. The effective date has been deferred indefinitely for certain other types of mandatorily redeemable financial instruments. We currently do not have any financial instruments that are within the scope of SFAS No. 150.

In December 2003, the FASB revised SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits* . The disclosure requirements of SFAS No. 132 were revised to require more complete information in both annual and interim financial statements about pension and postretirement benefits as well as to increase the transparency of the financial reporting related to those plans and benefits. We currently do not have any pension or other postretirement benefit obligations that are within the scope of revised SFAS No. 132.

Independent Auditors' Report

To the Stockholder of mPower.com, Inc.:

We have audited the accompanying consolidated balance sheets of mPower.com, Inc. and subsidiaries as of December 31, 2001 and 2002, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for the years then ended. These financial statements are the responsibility of mPower.com, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of mPower.com, Inc. and subsidiaries as of December 31, 2001 and 2002 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, effective January 1, 2002, mPower.com, Inc. changed its method of accounting for goodwill and intangible assets upon adoption of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* .

As discussed in Note 13, the accompanying consolidated statements of operations have been restated.

DELOITTE & TOUCHE LLP
Chicago, Illinois
April 1, 2004
(January 31, 2005 as to the effects of
the restatement discussed in Note 13)

mPower.com, Inc. and Subsidiaries
Consolidated Balance Sheets as of December 31, 2001 and 2002

	2001	2002
Assets		
Current assets		
Cash and cash equivalents	$ 7,692,120	$ 4,106,832
Restricted cash	3,841,050	150,000
Accounts receivable—net of allowance for doubtful accounts of $90,280 in 2001 and $54,425 in 2002	761,060	711,917
Prepaid expenses and other assets	1,049,630	1,061,060
Total current assets	13,343,860	6,029,809
Property and equipment—net	4,645,309	365,464
Intellectual property—net	6,525,233	1,197,656
Goodwill	378,166	—
Other assets	1,537,707	—
Total assets	$ 26,430,275	$ 7,592,929
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	$ 3,817,657	$ 1,888,633
Deferred revenue	1,322,715	2,133,586
Current portion of note payable	3,841,050	625,000
Total current liabilities	8,981,422	4,647,219
Note payable, less current portion	625,000	1,081,274
Total liabilities	9,606,422	5,728,493
Stockholders' equity		
Convertible preferred stock, $.0001 par value, 10,523,283 shares authorized in 2002:		
Series A, 62,824 shares authorized, issued and outstanding in 2001 (aggregate liquidation preference of $6,282,380)	1,266,386	—
Series AA, 21,224 shares authorized; 15,823 issued and outstanding in 2002	—	318,946
Series B, 28,509 shares authorized, issued and outstanding in 2001 (aggregate liquidation preference of $5,578,291)	6,128,545	—
Series BB, 28,509 shares authorized; 1,232 issued and outstanding in 2002	—	264,907
Series C, 73,697 shares authorized, issued and outstanding in 2001 (aggregate liquidation preference of $17,487,602)	17,714,054	—
Series CC, 73,697 shares authorized; 37,122 issued and outstanding in 2002	—	8,922,780
Series D, 64,516 shares authorized, issued and outstanding in 2001 (aggregate liquidation preference of $46,998,931)	41,325,587	—
Series DD, 64,516 shares authorized; 31,774 issued and outstanding in 2002	—	17,056,239
Series F & G, 341,132 shares authorized in 2001; 300,938 shares issued and outstanding in 2001 (aggregate liquidation preference of $65,917,018)	62,246,830	—
Series FF & GG, 305,337 shares authorized in 2002; 179,557 shares issued and outstanding in 2002	—	37,140,111
Series A-1, 10,000,000 shares authorized in 2002; 2,870,247 shares issued and outstanding in 2002	—	7,371,111
Common stock, $.01 par value, 1,000,000 shares authorized in 2001 and 2002, respectively; 85,645 and 363,090 shares issued and outstanding in 2001 and 2002, respectively	12,934,847	77,909,605
Notes receivable from stockholders		
Accumulated other comprehensive income (loss)	(89,606)	121,723
Less treasury stock—at cost, 32,675 shares in 2001 and 2002	(3,409,066)	(3,409,066)
Accumulated deficit	(121,293,724)	(143,831,920)
Total stockholders' equity	16,823,853	1,864,436
Total liabilities and stockholders' equity	$ 26,430,275	$ 7,592,929

See notes to consolidated financial statements.

mPower.com, Inc. and Subsidiaries
Consolidated Statements of Operations for the Years Ended December 31, 2001 (restated) and 2002 (restated)

	2001 (As restated, see Note 13)	2002 (As restated, see Note 13)
Revenue		
Advice fees	$ 2,862,373	$ 5,104,958
Development fees	1,323,833	849,500
Other	329,940	248,988
Total revenue	4,516,146	6,203,446
Operating expense		
Personnel and consulting	23,712,454	9,011,499
Sales and marketing	3,785,658	1,899,053
Software, technology, and communication	3,069,419	3,961,642
General and administrative	2,900,237	2,286,382
Depreciation and amortization	8,116,269	4,868,969
Impairment of fixed assets and intangible assets and loss on disposal of fixed assets	2,272,187	4,862,416
Rent and other	3,054,169	1,527,027
Total operating expenses	46,910,393	28,416,988
Operating loss	(42,394,247)	(22,213,542)
Interest income—net	640,860	92,632
Loss before cumulative effect of change in accounting principle	(41,753,387)	(22,120,910)
Cumulative effect of change in accounting principle	—	(417,286)
Net loss	(41,753,387)	(22,538,196)
Accretion of mandatorily redeemable preferred stock	(2,030,886)	—
Loss attributable to common stockholders	$ (43,784,273)	$ (22,538,196)

See notes to consolidated financial statements.

mPower.com, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the Years Ended December 31, 2001 and 2002

	Series A Convertible Preferred Stock		**Series AA Convertible Preferred Stock**		**Series B Convertible Preferred Stock**		**Series BB Convertible Preferred Stock**	
	Shares	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**
Balance—January 1, 2001	62,824	$ 1,266,386	—	$ —	—	$ —	—	$ —
Comprehensive loss:								
Net loss		—		—		—		—
Foreign currency transaction income (loss)		—		—		—		—
Total comprehensive income (loss)		—		—		—		—
Issuance of common stock		—		—		—		—
Repurchase of common stock for notes		—		—				
Exercise of stock options		—		—				
Common stock options and warrants issued for services		—		—				
Amendment of warrants and cancellation of note payable to stockholder		—		—				
Conversion of mandatorily redeemable convertible to convertible preferred stock		—		—	28,509	6,128,545		—
Conversion of Series E to Series F & G		—		—				
Issuance of preferred stock—net		—		—				
Accretion of mandatorily redeemable preferred stock		—		—		—		
Balance—December 31, 2001	62,824	1,266,386	—	—	28,509	6,128,545	—	—
Comprehensive loss:								
Net loss		—		—		—		—
Foreign currency transaction income (loss)		—		—		—		—
Total comprehensive income (loss)		—		—		—		—
Conversion of convertible preferred stock to shadow preferred stock	(15,823)	(318,946)	15,823	318,946	(1,232)	(264,907)	1,232	264,907
Conversion of convertible preferred stock to common stock	(47,001)	(947,440)	—	—	(27,277)	(5,863,638)	—	—
Issuance of preferred stock—net								
Balance—December 31, 2002	—	$ —	15,823	$ 318,946	—	$ —	1,232	$ 264,907

	Series C Convertible Preferred Stock		Series CC Convertible Preferred Stock		Series D Convertible Preferred Stock		Series DD Convertible Preferred Stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance—January 1, 2001	—	$ —	—	$ —	—	$ —	—	$ —
Comprehensive loss:								
Net loss		—		—		—		—
Foreign currency transaction income (loss)		—		—		—		—
Total comprehensive income (loss)		—		—		—		—
Issuance of common stock								
Repurchase of common stock for notes								
Exercise of stock options								
Common stock options and warrants issued for services								
Amendment of warrants and cancellation of note payable to stockholder								
Conversion of mandatorily redeemable convertible to convertible preferred stock	73,697	17,714,054		—	64,516	41,325,587		—
Conversion of Series E to Series F & G								
Issuance of preferred stock—net								
Accretion of mandatorily redeemable preferred stock								
Balance—December 31, 2001	73,697	17,714,054	—	—	64,516	41,325,587	—	—
Comprehensive loss:								
Net loss		—		—		—		—
Foreign currency transaction income (loss)		—		—		—		—
Total comprehensive income (loss)		—		—		—		—
Conversion of convertible preferred stock to shadow preferred stock	(37,122)	(8,922,780)	37,122	8,922,780	(31,774)	(17,056,239)	31,774	17,056,239
Conversion of convertible preferred stock to common stock	(36,575)	(8,791,274)	—	—	(32,742)	(24,269,348)	—	—
Issuance of preferred stock—net								
Balance—December 31, 2002	—	$ —	37,122	$ 8,922,780	—	$ —	31,774	$ 17,056,239

	Series E Convertible Preferred Stock		Series F & G Convertible Preferred Stock		Series FF & GG Convertible Preferred Stock		Series A-1 Convertible Preferred Stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance—January 1, 2001	—	$ —	—	$ —	—	$ —	—	$ —
Comprehensive loss:								
Net loss		—		—		—		—
Foreign currency transaction income (loss)		—		—		—		—
Total comprehensive income (loss)		—		—		—		—
Issuance of common stock		—		—		—		—
Repurchase of common stock for notes		—		—		—		—
Exercise of stock options		—		—		—		—
Common stock options and warrants issued for services		—		—		—		—
Amendment of warrants and cancellation of note payable to stockholder		—		—		—		—
Conversion of mandatorily redeemable convertible to convertible preferred stock	112,034	35,498,195		—		—		—
Conversion of Series E to Series F & G	(112,034)	(35,498,195)		35,498,195				—
Issuance of preferred stock—net			300,938	26,748,635				—
Accretion of mandatorily redeemable preferred stock		—		—		—	—	—
Balance—December 31, 2001	—	—	300,938	62,246,830	—	—	—	—
Comprehensive loss:								
Net loss		—		—		—		—
Foreign currency transaction income (loss)		—		—		—		—
Total comprehensive income (loss)		—		—		—		—
Conversion of convertible preferred stock to shadow preferred stock		—	(179,557)	(37,140,111)	179,557	37,140,111		—
Conversion of convertible preferred stock to common stock		—	(121,381)	(25,106,719)	—	—		—
Issuance of preferred stock—net				—		—	2,870,247	7,371,111
Balance—December 31, 2002	—	$ —	—	$ —	179,557	$ 37,140,111	2,870,247	$ 7,371,111

	Common Stock		Treasury Stock			Accumulated other comprehensive income (loss)—		
	Shares	Amount	Shares	Amount	Notes receivable	cumulative translation adjustment	Accumulated deficit	Total stockholders' equity
Balance—January 1, 2001	62,412	$ 6,502,967	—	$ —	$ (4,367,205)	$ —	$ (77,509,451)	$ (74,107,303)
Comprehensive loss:								
Net loss						—	(41,753,387)	(41,753,387)
Foreign currency transaction income (loss)						(89,606)	—	(89,606)
Total comprehensive income (loss)		—		—	—	(89,606)	(41,753,387)	(41,842,993)
Issuance of common stock	21,429	2,592,261						2,592,261
Repurchase of common stock for notes			(32,675)	(3,409,066)	4,367,205	—	—	958,139
Exercise of stock options	1,804	71,427		—	—	—	—	71,427
Common stock options and warrants issued for services		268,192		—	—	—	—	268,192
Amendment of warrants and cancellation of note payable to stockholder		3,500,000		—	—	—	—	3,500,000
Conversion of mandatorily redeemable convertible to convertible preferred stock		—		—	—	—	—	100,666,381
Conversion of Series E to Series F & G		—		—	—	—	—	—
Issuance of preferred stock—net		—		—	—	—	—	26,748,635
Accretion of mandatorily redeemable preferred stock		—		—	—	—	(2,030,886)	(2,030,886)
Balance—December 31, 2001	85,645	12,934,847	(32,675)	(3,409,066)		(89,606)	(121,293,724)	16,823,853
Comprehensive loss:								
Net loss		—		—	—	—	(22,538,196)	(22,538,196)
Foreign currency transaction income (loss)		—		—	—	211,329	—	211,329
Total comprehensive income (loss)		—		—	—	211,329	(22,538,196)	(22,326,867)
Conversion of convertible preferred stock to shadow preferred stock		—		—	—	—	—	—
Conversion of convertible preferred stock to common stock	277,445	64,974,758		—	—	—	—	(3,661)
Issuance of preferred stock—net		—		—	—	—	—	7,371,111
Balance—December 31, 2002	363,090	$ 77,909,605	(32,675)	$ (3,409,066)	$ —	$ 121,723	$ (143,831,920)	$ 1,864,436

See notes to consolidated financial statements.

mPower.com, Inc. and Subsidiaries
Consolidated Statements of Cash Flows for the Years Ended December 31, 2001 and 2002

	2001	2002
Cash flows from operating activities		
Net loss	$ (41,753,387)	$ (22,538,196)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	8,247,723	4,868,969
Provision for bad debts	369,686	41,794
Stock-based compensation on restricted stock repurchase	1,861,704	—
Common stock, warrants and options issued for services	268,192	—
Loss on purchase commitment	1,225,000	—
Foreign currency transaction losses	—	166,552
Impairments of intellectual property and other intangibles	—	3,339,012
Impairments of property and equipment	—	1,371,945
Loss on disposal of assets	2,272,187	151,459
Cumulative effect of change in accounting principle	—	417,286
Changes in assets and liabilities		
Restricted cash	60,480	3,717,600
Accounts receivable	(140,037)	12,227
Prepaid expenses and other current assets	412,233	(30,020)
Other assets	660,623	1,371,177
Accounts payable and accrued liabilities	(3,459,170)	(1,931,444)
Deferred revenue	746,143	805,051
Net cash used in operating activities	(29,228,623)	(8,236,588)
Cash flows from investing activities		
Acquisitions of property and equipment	(426,170)	(4,311)
Proceeds from sale of assets	57,207	52,903
Payments on capital lease obligations	(4,288)	
Acquisitions of businesses and intellectual property—net of cash acquired	(783,022)	
Net cash provided by (used in) investing activities	(1,156,273)	48,592
Cash flows from financing activities		
Proceeds from issuance of preferred stock—net	21,463,457	7,367,450
Proceeds from issuance of common stock	71,427	
Borrowings from notes payable		1,803,163
Repayment of notes payable	(60,480)	(4,594,927)
Net cash provided by financing activities	21,474,404	4,575,686
Decrease in cash and cash equivalents	(8,910,492)	(3,612,310)
Effect of exchange rate changes on cash	(78,043)	27,022
Cash and cash equivalents		
Beginning of year	16,680,655	7,692,120
End of year	$ 7,692,120	$ 4,106,832
Other cash flow information—		
Cash paid for interest	$ 811	$ —
Noncash investing and financing activities		
Issuance of common stock for acquisition	$ 2,678,571	$ —
Issuance of preferred stock for acquisition	$ 3,982,391	$ —
Issuance of preferred stock for reduction in purchase obligation	$ 1,225,000	$ —
Conversion of mandatorily redeemable convertible preferred stock to convertible preferred stock	$ 100,666,381	$ —
Amendment of warrants and cancellation of note payable to shareholder	$ 3,500,000	$ —

See notes to consolidated financial statements.

1. Organization and Significant Accounting Policies

Organization. mPower.com, Inc. (the "Company") is a Delaware corporation. The Company was formed to provide customized asset allocation and retirement planning advice to employee retirement plan participants via the Internet.

Basis of Presentation. The consolidated financial statements include the accounts of mPower.com, Inc. and its wholly-owned subsidiaries, mPower Advisors LLC, a registered investment advisor, and mPower Europe Limited ("mPower Europe"), a limited liability company incorporated in England and Wales, and located in London, England. All significant intercompany balances and transactions are eliminated in consolidation.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Currency Translation. Assets and liabilities of mPower Europe have been translated at the period-end exchange rate and income and expenses have been translated using weighted average exchange rates for the period. Translation adjustments are included as a component of accumulated other comprehensive income (loss).

Cash Equivalents. The Company considers cash investments with a maturity of three months or less at the time of purchase to be cash equivalents. Cash equivalents include money market instruments and short term corporate obligations.

Property and Equipment. The Company records furniture, fixtures, equipment and leasehold improvements at cost. Except for depreciation on leasehold improvements, depreciation is computed using the straight-line method over estimated useful lives of three years. Leasehold improvements are depreciated using the straight-line method over the remaining period of the lease, or the estimated useful life of the improvement, whichever is shorter.

Intellectual Property. Intellectual property consists of a patent which is being amortized using the straight-line method over its economic useful life, which has been estimated to be five years (see Note 5).

Goodwill and Intangible Assets. The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets* , on January 1, 2002. Under the provisions of this standard, goodwill is no longer amortized. Intangible assets with indefinite lives are not amortized. Those with finite lives are amortized over the expected period of benefit. Goodwill and intangible assets with indefinite lives are subject to an annual test for impairment. Upon adoption, the required initial benchmark evaluation was performed. Due to projected operating cash flow losses for mPower Europe, a goodwill impairment loss of $417,286 was recognized as a cumulative effect of a change in accounting principle in 2002. The fair value of that reporting unit was estimated using the expected present value of future cash flows. The discontinuation of goodwill amortization required under this standard had no material effect on the Company's results of operations in 2001 or 2002. In addition to goodwill, a customer list intangible asset is being amortized using the straight-line method over its economic useful life, which has been estimated to be three years (see Note 3), and is included in other assets.

Revenue Recognition. The Company derives its revenue primarily from development services and direct advice services. Development services may include web site development, web site customization, performing the initial financial analyses of the various investment options of the customer retirement plans, compiling databases and fund profiles, and building a database of plan participants. Direct advice services typically include ongoing retirement planning investment advice, maintenance, and customer support. Revenue associated with development services and direct advice services are recognized when the product or service is delivered or, when applicable, over the service obligation period defined by the terms of the contract.

In 2001, one customer accounted for approximately 11% of total revenues. In 2002, one customer accounted for approximately 12% of total revenues.

Product Development and Engineering Expenses. Product development and engineering expenses are charged to operations as incurred.

Stock-Based Compensation. The Company accounts for its employee stock option plan in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees* . The Company accounts for stock options and warrants issued to non-employees in accordance with the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* and Emerging Issues Task Force ("EITF") Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* , under the fair value based method using the Black-Scholes option pricing model.

If the Company had accounted for its employee stock option plans in accordance with the provisions of SFAS No. 123, the net loss on a pro forma basis (as compared to such items as reported) would have been as follows:

	Year Ended December 31	
	2001	**2002**
Net loss—as reported	$ (41,753,387)	$ (22,538,196)
Add: Stock-based compensation expense included in reported net loss, net of tax effects	1,861,704	—
Deduct: Total stock-based compensation expense determined under fair value based method, net of tax effects	(2,029,672)	(191,358)
Pro forma net loss	$ (41,921,355)	$ (22,729,554)

Income Taxes. Deferred tax liabilities are recognized for future taxable amounts, and deferred tax assets are recognized for future deductions, net of a valuation allowance to reduce net deferred tax assets to amounts that are more likely than not to be realized.

Concentration of Credit Risk. Financial instruments that potentially subject the Company to concentration of credit risk consist of trade receivables. The Company's credit risk is mitigated by the Company's credit evaluation process and the reasonably short collection terms. No single customer is large enough to pose a significant credit risk to the Company, and no single customer accounted for more than 10% of accounts receivable at December 31, 2001 or 2002. The Company does not require collateral or other security to support accounts receivable and maintains an allowance for potential credit losses.

Impairment of Long-Lived Assets and Long-Lived Assets To Be Disposed Of. The Company evaluates its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Reclassifications. Certain prior years amounts have been reclassified to conform to the current year presentation.

Recently Issued Accounting Pronouncements. Effective January 1, 2001, the Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* , as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* , which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133, as amended, requires the recognition of all derivative instruments as either assets or liabilities in the statement of financial position measured at fair value. The adoption of this standard had no material effect on the Company's financial position or results of operations.

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, *Business Combinations* , which was effective for the Company on July 1, 2001. SFAS No. 141 prohibits pooling-of-interests accounting for acquisitions. The adoption of this standard had no material effect on the Company's financial position or results of operations.

In October 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* , which was effective for the Company on January 1, 2002. This standard supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of* . The adoption of this standard had no material effect on the Company's financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No. ("FIN") 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* . FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. The disclosure provisions of FIN 45 are effective for financial statements for fiscal years ending after December 15, 2002. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002. The disclosure provisions of FIN 45 have been considered in the Company's consolidated financial statements. The Company does not expect that the adoption of the remaining provisions of FIN 45 will have a material impact on its financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity* , effective in June 2003. SFAS No. 150 requires an issuer to classify, as liabilities, any financial instruments that fall within the scope of this pronouncement. Adoption of SFAS No. 150 is not expected to have a material effect on the financial position or results of operations of the Company.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities* . FIN 46 requires that the assets, liabilities, and results of the activity of variable interest entities be consolidated into the financial statements of the entity that has the controlling financial interest. FIN 46 also provides the framework for determining whether a variable interest entity should be consolidated based on voting interest or significant financial support provided to it.

In December 2003, the FASB issued FASB Interpretation No. 46 (Revised December 2003) ("FIN 46(R)"), *Consolidation of Variable Interest Entities* , to replace FIN 46 and to clarify the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements* , as amended by SFAS No. 94, *Consolidation of All Majority-Owned Subsidiaries* , to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The Company will apply FIN 46(R) to any interest in an entity subject to its provisions created after December 31, 2003. The Company will also apply FIN 46(R) to all entities subject to its provisions created before December 31, 2003 beginning January 1, 2005. The adoption of FIN 46(R) is not expected to have a material impact on the Company's financial position or results of operations.

2. mPower Europe

In August 2000, the Company acquired 42.5% of the outstanding equity of mPower Europe. In May 2001, a restructuring of mPower Europe occurred. As part of this transaction, the Company relinquished 18.7% of its ownership interest in mPower Europe, decreasing its ownership to 23.8%. The Company's ownership interest in mPower Europe increased an additional 1.8% upon the forfeiture of mPower Europe shares by an mPower Europe senior executive upon resignation, also in May 2001.

In September 2001, the Company entered into an Agreement for the Sale and Purchase of Shares in mPower Europe with the other shareholders of mPower Europe, pursuant to which the Company acquired from such shareholders their shares of mPower Europe, representing 74.4% of the capital stock of mPower Europe on an as converted basis, by issuing 1,171 shares of Series F Preferred Stock and 17,883 shares of Series G Preferred Stock of the Company. As a result of this transaction, mPower Europe became a wholly-owned subsidiary. The total purchase price of this acquisition was $4,268,821, and was allocated to the assets and liabilities acquired based on their estimated fair values as of the date of acquisition as follows:

Cash	$	3,765,873
Property and equipment		151,435
Goodwill		385,989
Liabilities		(34,476)
Total purchase price	$	4,268,821

As of December 31, 2001, mPower Europe had a loan note agreement of $3,841,040 secured by restricted cash in the same amount. This note was repaid during 2002.

3. Asset Purchases

On May 18, 2001, the Company acquired substantially all of the assets of Rational Investors, Inc. and certain assets of The McGraw-Hill Companies Inc., through its Standard & Poor's Division ("S&P"), in exchange for 21,429 shares of the Company's common stock and up to an additional 35,714 shares of the Company's common stock to be issued over a period of four years based upon the conversion of S&P paid participants to the Company's retirement planning advice product. The total purchase price of this acquisition was $2,689,036, and was allocated to the assets and liabilities acquired based on their estimated fair values as of the date of acquisition as follows:

Receivables	$	334,878
Property and equipment		37,400
Customer list		2,316,758
Total purchase price	$	2,689,036

In May 2002, the Company and S&P amended the agreement to terminate S&P's right to earn additional shares of the Company's common stock (see Note 7). Accumulated amortization of the customer list intangible asset was $479,544 as of December 31, 2001. As a result of an intangible asset impairment analysis performed under SFAS No. 121 as of December 31, 2001, the Company recorded an impairment charge of $1,670,692 related to the customer list. In 2002, the Company recorded amortization expense related to the remaining customer list intangible asset of $94,487. As of December 31, 2002, the carrying value related to the customer list intangible asset was determined to be impaired, as the carrying amount exceeded the sum of the undiscounted cash flows expected to result from the use of the asset. The impairment loss of $72,035 was measured as the amount by which the carrying amount of the asset exceeded its fair value and was recorded in impairment of fixed assets and intangible assets and loss on disposal of fixed assets during the year ended December 31, 2002. As of December 31, 2001 and 2002, the carrying value of the customer list intangible asset was $166,523 and zero, respectively.

4. Property and Equipment

Property and equipment consist of the following:

	As of December 31	
	2001	2002
Computer equipment and software	$ 7,581,836	$ 6,824,062
Office equipment and furniture	2,320,812	1,544,733
Leasehold improvements	1,325,135	1,032,880
Total	11,227,783	9,401,675
Less accumulated depreciation	(6,582,474)	(9,036,211)
Property and equipment—net	$ 4,645,309	$ 365,464

The cost of property and equipment under capital leases was $53,100 as of December 31, 2001, and accumulated depreciation associated with these assets was $50,740. No property and equipment was under capital lease as of December 31, 2002.

The Company recorded a net charge of $2,140,733 in 2001 relating to the disposal of fixed assets resulting from the consolidation of excess facilities. Property and equipment that was disposed of or removed from operations consisted primarily of furniture and fixtures, computer equipment, and leasehold improvements. The Company also recorded a charge of $1,371,945 in 2002 to write down fixed assets held for use to their fair value, as the carrying value related to these assets was determined to be impaired, since the carrying amount exceeded the sum of the undiscounted cash flows expected to result from the use of the fixed assets. The impairment loss was measured as the amount by which the carrying amount of the assets exceeded their fair value. These impairment charges are included in impairment of fixed assets and intangible assets and loss on disposal of fixed assets in 2001 and 2002.

5. Intellectual Property

Derivative Insights Agreement

In February 2000, the Company entered into an agreement to purchase intellectual property consisting of patents and software from Derivative Insights LLC ("Derivative Insights Agreement"). The purchase price consisted of $5,000,000 in cash plus contingent payments of up to $5,000,000 based on a certain percentage of revenue derived from the licensing of the software. In addition, the Company issued a warrant to purchase 7,000 shares of common stock of the Company at an exercise price of $465.00 per share. The vesting terms of the warrant were 25% after one year from the date of the agreement and monthly over the next three years. The warrant expires ten years from the date of grant. The warrant becomes immediately exercisable upon a change in control. Additionally, upon the first anniversary date of the agreement, the counterparty had the right to surrender its right to any future contingent payments in exchange for a cash payment of $10,000,000 less payments previously made and cancellation of unexercised warrants or return of the common stock obtained from exercising such warrant. Upon the second anniversary date of the agreement, the counterparty had the right to surrender its right to any future contingent payments in exchange for a cash payment of $15,000,000 less payments previously made and cancellation of unexercised warrants or return of the common stock obtained from exercising such warrant ("Second Anniversary Cash Option"). In the event of a change in control, the Second Anniversary Cash Option would become immediately exercisable by the counterparty.

In January 2001, the Company amended the Derivative Insights Agreement. Under the amended agreement, the following terms as specified in the original agreement were removed: 1) Cash payment of $2,500,000 due on the anniversary of the effective date, 2) contingent payments of up to $5,000,000 based on a certain percentage of revenue derived from the licensing of the software, 3) right to surrender such contingent payments in exchange for a cash payment, and 4) issuance of 7,000 warrants at an exercise price of $465.00 per share. In consideration for the modification of these terms, the Company made a closing payment to Derivative Insights LLC of $4,252,000 on February 28, 2001, and issued 7,000 warrants at an exercise price of $200.00 per share to the principal owner of Derivative Insights LLC. In addition, the Company recorded a $3,500,000 capital contribution related to the cancellation of the note payable. Accumulated amortization of the patent intangible asset was $3,727,267 as of December 31, 2001. In 2002, the Company recorded $2,060,600 in amortization expense related to the patent. As of December 31, 2002, the carrying value related to the patent was determined to be impaired, as the carrying amount exceeded the sum of the undiscounted cash flows expected to result from the use of the asset. The impairment loss of $3,266,977 was measured as the amount by which the carrying amount of the asset exceeded its fair value, and was recorded in impairment of fixed assets and intangible assets and loss on disposal of fixed assets during the year ended December 31, 2002. As of December 31, 2001 and 2002, the carrying value of the patent was $6,525,233 and $1,197,656, respectively. Future estimated amortization expense related to the patent is as follows: $542,335 in 2003, $542,335 in 2004, and $112,986 in 2005.

Employment Agreement

In February 2000, the Company entered into an employment agreement with a principal owner of Derivative Insights LLC ("Employment Agreement"). The Employment Agreement provided for the issuance of warrants to purchase 3,000 shares of common stock (the "Warrant") for $465.00. 1,000 Warrant shares will become exercisable on February 28, of each of 2005, 2006, and 2007 subject to potential acceleration due to termination or change of control. The Warrant expires in 10 years.

In January 2001, the Company amended the Employment Agreement. Under the amended employment agreement, the Company cancelled its issuance of 3,000 warrants at $465.00 per share and issued a warrant to purchase 3,000 shares of common stock at $200.00 per share, with 25% of the warrants exercisable on February 28, 2001 and the balance exercisable monthly over the next three years. The term of the warrant expires in 10 years. As of December 31, 2001 and 2002, no shares were issued related to this warrant. Of the 10,000 warrants issued, 7,000 were accounted for as a fixed award, and 3,000 were accounted as a variable award. During the years ended December 31, 2001 and 2002, no variable award compensation expense was recorded as the exercise price was below the fair market value of the Company's common stock for all periods.

6. Income Taxes

The primary components of the deferred tax assets are as follows:

	As of December 31	
	2001	**2002**
Net operating loss carryforwards	$ 40,155,610	$ 47,071,034
Deferred revenue	902,591	183,781
Excess book over tax depreciation	1,417,844	4,855,130
Accrued expenses	1,317,720	208,637
Other	159,821	49,795
Total	43,953,586	52,368,377
Valuation allowance	(43,953,586)	(52,368,377)
Net deferred tax asset	$ —	$ —

No tax benefit has been recorded in 2001 or 2002 because of the net operating losses incurred by the Company resulting in the recording of a valuation allowance for all deferred tax assets. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The Company established a valuation allowance for all deferred tax assets at December 31, 2001 and 2002 due to the uncertainty of realizing future tax benefits from its net operating loss carryforwards and other deferred tax assets.

As of December 31, 2002, the Company has net operating loss carryforwards of approximately $118,223,501 for federal and $64,398,293 for California franchise tax purposes, which begin to expire during fiscal years 2010 and 2003, respectively.

7. Stockholders' Equity

Common Stock, Convertible Preferred Stock, and Junior Preferred Stock

In September 1995, 401K Forum was incorporated under the laws of the State of California. In March 1997, 401 K Forum, Inc. was incorporated under the laws of the State of Delaware, and in March 1997, 401K Forum (the original California corporation) was merged with and into 401K Forum, Inc. under the "401K Forum, Inc." name. In February 1999, the name of the Company was changed to Emergent Advisors, Inc. In December 1999, the name of the Company was changed to mPower.com, Inc.

In conjunction with the Company's re-incorporation in March 1997, each issued and outstanding share of the Company's 63,074 shares of common stock was converted into one share of the Company's Series A Preferred Stock ("Series A"). Also in 1997, 35,428 shares of Series B Preferred Stock ("Series B") were issued for $5,243,216 in cash and conversion of $506,784 in notes payable including accrued interest. Additionally, 11,799 warrants for Series B were available for issuance to investors in conjunction with these transactions. Granting of the warrants was contingent upon the occurrence of certain events such as introducing new customers to the Company who as a result, enter into signed agreements with the Company.

In October 1998, the Company issued 73,150 shares of Series C Preferred Stock ("Series C") for total proceeds of $14,630,000. All warrants relating to the purchase of shares of Series B were cancelled at the time of the issuance of Series C pursuant to the execution of an Investor Incentive Program Agreement (see below). In March 1999, the Company issued 547 shares of Series C for total net proceeds of $101,000.

In December 1999, the Company issued 64,516 shares of Series D Preferred Stock ("Series D") for total net proceeds of $37,075,706.

In November 2000, the Company engaged in a bridge loan financing in the amount of $11,479,565 (the "Bridge Financing") with certain existing investors. In connection with the Bridge Financing, the Company issued convertible promissory notes which were convertible into shares of Series E Preferred Stock ("Series E").

In December 2000, the Company issued 112,034 shares of Series E for $23,116,489 in cash and conversion of $11,602,953 in promissory notes, including accrued interest, issued in connection with the Bridge Financing. Additionally, 2,821 warrants for Series E were issued to investors in conjunction with these transactions.

In May 2001, the Company issued 186,713 shares of Series F Preferred Stock ("Series F") and 94,340 shares of Series G Preferred Stock ("Series G") for total net proceeds of $20,617,618. Pursuant to the terms of the financing, new investors were required to invest 50% of their total investment in Series F and the remaining 50% of their total investment in Series G. Any existing investors in the company who participated in the financing purchased Series G only. In addition, pursuant to the terms of the financing, if a holder of Series E elected to invest in the financing in an amount equal to at least 25% of the aggregate amount invested by such holder in the Series E financing, all of the shares of Series E held by such holder, as well as any warrants exercisable for Series E held by such holder, automatically converted into Series F, or warrants exercisable for Series F. All investors in Series E invested the required 25% and therefore all Series E shares and warrants converted to Series F shares and warrants. Reuters America, Inc. ("Reuters") contributed cash and a reduction of the Company's commitment to purchase services under the Company's agreement with Reuters (see Note 11). In June 2001, the Company issued 831 shares of Series G for total net proceeds of $173,641.

In May 2001, in conjunction with the Series F and G financing, the Company authorized 30,000 shares of preferred stock to be designated as "Junior Preferred Stock." The Company adopted the 2001 Stock Option Plan which provides for the grant of 30,000 nonqualified options to certain management, key employees, and former directors of the Company. The options are exercisable for shares of a new series of Junior Preferred Stock. The options granted under the 2001 Stock Option Plan terminate on January 1, 2003 or upon the occurrence of other events (see further discussion in Stock Option Plans section below). As of December 31, 2002, no shares of Junior Preferred Stock had been issued.

In September 2001, the Company issued 1,171 shares of Series F and 17,883 shares of Series G for the acquisition of an additional 74.4% of mPower Europe (see Note 2).

In May 2002, the Company and S&P entered into a letter agreement ("Letter Agreement"), pursuant to which the Company or a third-party purchaser would, within 10 days after execution, purchase from S&P 45,352 shares of common stock, which equaled all of the Company's common stock held by S&P at such time (including 23,923 shares of common stock that were converted upon such closing from 11,962 shares of Series F and 11,962 shares of Series G), for the full consideration of $12,245, which represented the fair value of such shares. Pursuant to this agreement, in May 2002, S&P sold its shares to Capital Z, one of the Company's current investors, and to an individual investor. Additionally, the Company and S&P agreed, as of May 2002, to amend the Purchase Agreement dated May 18, 2001 (see Note 3) to terminate S&P's right to earn shares of the Company's common stock, the number of which was calculated based upon the conversion of S&P customers to the Company's advice product.

Significant terms of the Series A, Series B, Series C, Series D, Series E, Series F, Series G (together, "Convertible Preferred Stock") and Junior Preferred Stock as of December 31, 2001 are as follows:

- Series A, Series B, Series C, Series D, Series E, Series F, and Series G are convertible into common stock at any time after the date of issuance into a number of shares of common stock that is determined by dividing the Series A, Series B, Series C, Series D, Series E, Series F, or Series G issue price by the conversion price, (original issue price adjusted for splits, dividends, and certain other dilutive issuances) which is determined on the date the certificate is surrendered for conversion. Each share of the Convertible Preferred Stock automatically convert into common stock upon the earlier of (a) completion of a public offering with aggregate proceeds not less than $50,000,000 at not less than $418.00 per share or (b) upon the written consent of at least two-thirds of the holders of that series of Convertible Preferred Stock, voting together as a single class. Junior Preferred Stock is not convertible to common stock.

- In the event that a holder of Series E purchased Series G in an amount equal to or greater than 25% of the aggregate purchase price paid by such holder for the shares of Series E then held, the shares of Series E automatically convert into Series F determined by dividing the aggregate Series E issue price paid by such holder by the Series F/G issue price.

- In the event of any liquidation of the Company (which includes the acquisition of the Company by another entity), the holders of Series B, Series C, Series D, Series E, Series F, and Series G have a liquidation preference over common stock and Series A of (i) $162.30 per share, $200.00 per share, $620.00 per share, $326.00 per share, $209.00 per share, and $1,045.00 per share, respectively; plus (ii) a liquidation premium equal to 8% of the original Series B, Series C, Series D, Series E, Series F, and Series G issue price per annum compounded semi-annually for each outstanding share from the date of first issuance; plus (iii) all declared but unpaid dividends. After such payment, the holders of Series A have a liquidation preference of $100.00 per share plus any declared but unpaid dividends. Upon payment of all Convertible Preferred Stock liquidation preferences, any remaining proceeds will be allocated to the common stockholders. Prior to and in preference to any distribution of the assets or surplus funds to the holders of Series B, Series C, Series D, Series E, Series F, Series G, Series A, and common stock, the holders of Junior Preferred Stock shall be entitled to receive 12.75% of the aggregate consideration received by the Company multiplied by a fraction ("Share Ratio") equal to the total number of shares of Junior Preferred Stock outstanding divided by 30,000. In the event the acquiring entity is a private company and the consideration is solely in the form of shares of capital stock of such surviving or acquiring company ("Acquirer"), the holders of Junior Preferred Stock are entitled to receive 12.75% of the Acquirer shares received by the Company multiplied by the Share Ratio. In the event the consideration shall consist of a mix of cash and Acquirer shares, the holders of Junior Preferred Stock shall be entitled to receive 12.75% of the cash consideration and Acquirer shares multiplied by the Share Ratio.

- In conjunction with the Series F and G financing, the mandatory redemption feature was removed on Series B, Series C, Series D, and Series E. Prior to May 2001, the Company was required to redeem Series C and Series D at any time after seven years and six years, respectively, from the date of first issuance following the receipt of a written request from the holders of a majority of the voting power of Series C and Series D, respectively, by paying a cash sum per share of the Series C and Series D issue price, the Series C and Series D liquidation premium plus all declared or accumulated but unpaid dividends on such shares. The Company was required to redeem the Series B on January 31, 2007 by paying cash at a per share amount equal to the original Series B issue price plus the liquidation premium plus all declared or accumulated but unpaid dividends on such shares. After receipt by the Company of a Series C redemption request or Series D redemption request, or the Series B redemption date, the Company was required to redeem the Series E following receipt of a written request from the holders of a majority of the voting power of Series E by paying a cash sum per share of the Series E issue price plus the liquidation premium plus all declared or accumulated but unpaid dividends on such shares. Series A was not redeemable. Subsequent to the Series F and G financing, Series B, Series C, Series D, Series E, Series F, and Series G are not redeemable. The Company must redeem the shares of Junior Preferred Stock outstanding upon the earlier of (i) 90 calendar days after the completion of a public offering or

(ii) May 15, 2006, if no liquidation has occurred prior to such date, by paying a cash sum equal to 10% of the per share price paid by such holder of Junior Preferred Stock.

- Series A, Series B, Series C, Series D, Series E, Series F, and Series G are entitled to dividends, when and if declared by the board of directors, in proportion to the number of shares of common stock which would be held by each such holder if all shares of such preferred stock were converted to common stock at the then-effective conversion rate. Such dividends are not cumulative. Holders of Junior Preferred Stock are not entitled to receive any dividends.

- Holders of Convertible Preferred Stock and Junior Preferred Stock have the same voting rights as the holders of common stock and have one vote for each share of common stock into which the preferred stock could then be converted.

Series A-1 Preferred Stock Financing and Recapitalization

In May 2002, the Board of Directors authorized the Company to issue and sell shares of Series A-1 Preferred Stock ("Series A-1") to raise up to $15 million in the financing at a purchase price of $2.70 per share. Also in May 2002, the Company completed the first closing of the financing by issuing 2,870,247 shares of Series A-1 for total net proceeds of $7,371,111.

In connection with the financing, the Board of Directors authorized a recapitalization plan (the "Recapitalization") which involved two steps: (i) upon the first closing of the financing, all outstanding shares of existing preferred stock, including Series A, Series B, Series C, Series D, Series F, and Series G, converted into corresponding shares of Series AA, Series BB, Series CC, Series DD, Series FF, and Series GG preferred stock ("Shadow Preferred Stock") and/or common stock (the "Preferred Conversion") based on each preferred stockholder's participation in the Series A-1 financing, and (ii) upon the final closing of the financing (which shall occur no later than April 1, 2003, or upon other triggering events which may occur sooner), all outstanding shares of Shadow Preferred will be converted into shares of common stock ("Shadow Preferred Conversion"). Following the financing and the Recapitalization, Series A-1 will become the only series of Convertible Preferred Stock authorized.

Immediately after giving effect to the Shadow Preferred Conversion, each share of the Company's then outstanding shares of common stock and Series A-1 will be split and converted into 0.01 shares of common stock and Series A-1, respectively.

Holders of Series A-1 are entitled to customary rights, preferences and privileges of preferred stock. Specifically, these rights include, among others:

- Holders of Series A-1 are entitled to receive noncumulative dividends, when as declared by the Board of Directors in preference and priority to any payment of any dividend on the Shadow Preferred Stock and common stock at the rate of 8% per annum of the Series A-1 issue price.

- Holders of Series A-1 shall be entitled to receive $2.70 for each outstanding share of Series A-1, plus a liquidation premium equal to 8% of the Series A-1 issue price per annum compounded semi-annually from the date of the first issuance prior to and in preference to any distribution to the holders of common stock.

- In the event that at any time subsequent to May 24, 2009, (i) holders of a majority of Series A-1 have elected to cause the Company to redeem such shares, and (ii) no public offering or liquidation has occurred, then such holders will notify the Corporation by delivery of written notice to the Company. Upon receipt of the Series A-1 redemption notice, the Company shall redeem all of the outstanding shares of Series A-1 at the original Series A-1 issue price.

- Each share of Series A-1 shall be convertible into common stock at any time after the date of issuance into a number of shares of common stock that is determined by dividing the Series A-1 issue price by the conversion price, which is determined on the date the certificate is surrendered for conversion. Each share of the Convertible Preferred Stock automatically converts into common stock upon the earlier of (a) completion of a public offering with aggregate proceeds not less than $50,000,000 at not less than $750.00 per share or (b) upon the written consent of at least two-thirds of the holders of that series of Convertible Preferred Stock, voting together as a single class.

- Holders of Series A-1 have the same voting rights as the holders of common stock and have one vote for each share of common stock into which the preferred stock could then be converted.

Warrants

In November 1999, the Company entered into a Strategic Alliance Agreement (the "Alliance Agreement") with a financial service provider. The Alliance Agreement provided for the granting of warrants to purchase 3,000 shares of common stock ("Initial Warrant") for $200.00 per share and up to 9,000 shares of common stock ("Performance Warrants") based on predetermined performance milestones relating to the referral of plan sponsors and their participants as set forth in the Alliance Agreement. The Initial Warrant expires at the earlier of five years or upon the consummation of an initial public offering. The Performance Warrants are exercisable at the lesser of the price per share of the most recent preferred stock offering, the fair value of the Company's common stock (if publicly traded), or $1,200.00 for grants in 2000, $1,500.00 in 2001, or $1,800.00 in 2002 as determined at the date of grant. The grants expire five years from the date of issuance. Within the first eighteen months of the Alliance Agreement, if the Alliance Agreement is terminated due to breach of contract (as defined by the Alliance Agreement), the Company has the right to repurchase any common stock issued from exercise of any warrants under the Alliance Agreement at the original exercise price. The fair value of the Initial Warrant of $131,252 issued in 1999 was recognized as sales and marketing expense. In December 2001, the Company granted Performance Warrants for 1,000 and 500 shares of common stock for $209.00 per share. The warrants expire on January 1, 2006 and February 5, 2006, respectively. The fair value of these warrants of $11,013 and $5,507 was recognized in 2001 as sales and marketing expense. No Performance Warrants were granted in 2002. As of December 31, 2002, no warrants have been exercised under the Alliance Agreement.

In April and November 1999, the Company granted an executive recruiting firm warrants to purchase 100 shares of common stock for $50.00 per share, and 486 shares of common stock for $125.00 per share, respectively, for services performed. The warrants expire five years from their respective dates of grant. The fair value of these warrants of $3,811 and $46,629 was recognized in 1999 as Software, technology, and communication expense and General and administrative expense, respectively. In April 2001, the Company issued additional warrants to purchase 21 and 13 shares of common stock for $465.00 per share. The warrants expire in five years from their respective dates of grant. The fair value of these warrants of $1,506 and $904 was recognized in 2001 as Software, technology, and communication expense and General and administrative expense, respectively. No warrants were granted in 2002. As of December 31, 2002, none of these warrants have been exercised.

In June 2000, the Company entered into a Web Site Development, Services, and Distribution Agreement (the "Development Agreement") with a financial service provider. The Development Agreement provided for the granting of warrants to purchase 1,000 shares of common stock ("Initial Warrant") for $465.00 per share and up to 1,500 shares of common stock ("Development Warrants") based on predetermined performance milestones relating to the development as set forth in the Development Agreement. The Initial Warrant and the Development Warrants expire at the earlier of five years or upon the consummation of the Company's initial public offering. The Development Warrants are exercisable at the lesser of the fair market value of the Company's common stock as determined in good faith by the board of directors, the average closing price of the Company's common stock as quoted on NASDAQ, the closing prices quoted on any exchange on which the Company's common stock is listed (if publicly traded), or $465.00. Within the first eighteen months of the Development Agreement, if the Development Agreement is terminated due to breach of contract (as defined by the Development Agreement), the Company has the right to repurchase any common stock issued from exercise of any warrants under the agreement at the original exercise price. The fair value of the Initial Warrant of $380,392 was recognized in 2000 as a reduction of revenue. In June 2000, the Company issued a Development Warrant for 500 shares of common stock at $465.00 per share which expires on June 8, 2005. The fair value of the Development Warrant of $190,196 was recognized in 2000 as a reduction of revenue. In February 2001, the Company issued a Development Warrant for 500 shares of common stock at $125.00 which expires on February 20, 2006. The fair value of the Development Warrant of $50,184 was recognized as a reduction of revenue. No Development Warrants were issued in 2002. As of December 31, 2002, no warrants have been exercised under the Development Agreement.

In February 2000, the Company issued a warrant to Derivative Insights LLC to purchase 7,000 shares of common stock of the Company at an exercise price of $465.00 per share. In February 2000, the Company issued a warrant to a principal owner of Derivative Insights LLC to purchase 3,000 of common stock at $465.00 per shares. In January 2001, the Company cancelled the issuance of both warrants and issued a warrant to the principal owner of Derivative Insights LLC to purchase 10,000 shares of common stock at $200.00 per share, with 25% of the warrants exercisable on February 28, 2001 and the balance exercisable monthly over the next three years. The term of the warrant expires in ten years. As of December 31, 2002, none of these warrants have been exercised.

In November 2001, the Company issued to Blue Jeans Equities West, the Company's landlord, a warrant to purchase 10,000 shares of common stock at a per share exercise price of $50.00 per share. The warrant expires on October 1, 2008. The warrant was issued in connection with the First Amendment and Restatement of Office Lease dated as of October 1, 2001. The fair value of the warrant of $209,673 was recognized in 2001 as rent expense. As of December 31, 2002, none of these warrants have been exercised.

Notes Receivable from Stockholders

In November 1999 and March 2000, the Company issued an aggregate of 27,500 and 2,000 shares of common stock, respectively, to three senior executives of the Company. In connection with such issuance and pursuant to Restricted Stock Purchase Agreements ("RSPA"), these senior executives paid for the stock by issuing promissory notes (secured by the shares of the Company's common stock) totaling $4,367,205 to the Company. The shares were subject to repurchase at the original purchase price by the Company upon the occurrence of certain events or conditions, such employment termination. The Company's repurchase rights lapsed over four years.

In February 2001, one of the executives terminated his employment with the Company. As of the executive's termination date, 14,063 shares of the 25,000 shares of common stock purchased by the executive were fully vested. The Company fulfilled its obligation to repurchase the remaining 10,937 shares of unvested common stock in accordance with the terms of the executive's RSPA and by canceling a proportionate part of the principal and interest on the promissory note. Following this cancellation, the remaining balance on the executive's note, including accrued interest, was $1,833,169. Pursuant to a settlement agreement and release, the executive has a right to put all (and not less than all) of these vested shares of common stock to the Company in exchange for forgiveness of all principal and interest remaining on the promissory note. This put right terminates in February 2005. Additionally, the due date of the note was extended to February 2005. In connection with this executive's Settlement Agreement and Release, the Company recorded compensation expense during 2001 of $1,757,563 and recorded a reserve to notes receivable for the same amount.

In March 2001, a second executive terminated his employment with the Company. As of the executive's termination date, all 2,000 shares of common stock purchased by the executive were subject to repurchase by the Company. In connection with this repurchase, the Company cancelled the related principal and interest on the promissory note.

In July 2001, the third executive terminated his employment with the Company. As of the executive's termination date, 833 shares of the 2,500 shares of common stock purchased by the executive were fully vested. The Company exercised its obligation to repurchase the remaining 1,667 shares of unvested common stock in accordance with the terms of the executive's RSPA and by canceling a proportionate part of the principal and interest of the promissory note. Following this cancellation, the remaining balance on the executive's note, including accrued interest, was $114,957. Pursuant to a settlement agreement and release, the executive has the right to put all (and not less than all) of these vested shares of common stock to the Company in exchange for forgiveness of all principal and interest remaining on the executive's note. This put right terminates in July of 2005. Additionally, the due date of the note was extended to July 2005. In connection with this executive's settlement agreement and release, the Company recorded compensation expense during 2001 of $104,142 and recorded a reserve to notes receivable for the same amount.

Stock Option Plans

The Company's 1997 Stock Option Plan (the "1997 Plan") provides for the grant of up to 147,122 incentive or nonqualified options to purchase common stock to employees, directors and consultants of the Company at the fair market value of the common stock for incentive stock options (and not less than 85% of fair market value for nonqualified stock options) on the date of grant as determined by the board of directors. Options granted under the 1997 Plan have various vesting schedules pursuant to individual written agreements, but generally vest ratably over a period of four years and expire ten years from the date of grant. Some option agreements provide for accelerated vesting of options upon the effective date of an initial public offering or a change in control of the Company.

In May 2001, the Company adopted the 2001 Stock Option Plan (the "2001 Plan") which provides for the grant of 30,000 nonqualified options to certain management, key employees, and former directors of the Company. The options are exercisable for shares of Junior Preferred Stock. The options granted under the 2001 Plan terminate on the earlier of (a) January 1, 2003 provided that a change of control has not occurred as of such date; (b) December 2011; (c) the completion of a public offering; (d) one year after the underlying securities for the options received as a result of a change in control become publicly traded. Options granted to employees vest as follows: (i) in the event of the closing of a change of control that occurs prior to January 1, 2003, one-third of the shares will vest three days prior to the closing of such change of control, (ii) an additional one-third of the shares will vest on the six-month anniversary date of such change of control; and (iii) the remaining shares will vest on the twelve-month anniversary date of such change of control. The vesting may accelerate based on the employee's termination date. Options granted to former directors vest 100% in the event of the closing of a change of control that occurs prior to January 1, 2003.

In May 2002, in connection with the Series A-1 financing, the Company adopted the 2002 Stock Plan (the "2002 Plan"), effective upon the first closing. The maximum aggregate number of shares that are subject to option and sold under the 2002 Plan equals the number of shares that constitute approximately 18.205% of the total shares of capital stock of the Company outstanding on a fully diluted basis (excluding options granted under the 1997 Plan and 2001 Plan) upon the Shadow Preferred Conversion (as defined in the Company's Sixth Amended and Restated Certificate of Incorporation), of which shares constituting 0.25% of the capital stock are reserved for option grants to former directors of the Company. The 2002 Plan provides incentive or nonqualified options to employees, directors and consultants of the Company at the fair market value of the common stock for incentive stock options (and not less than 85% of fair market value for nonqualified stock options) on the date of grant as determined by the Board of Directors. The fair market value increases to 110% for both incentive and nonqualified option grants to holders who, at the time of grant, own stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any parent or subsidiary. Options granted under the 2002 Plan have various vesting schedules pursuant to individual written agreements, but generally vest ratably over a period of three to four years and expire ten years from the date of grant. Some option agreements provide for accelerated vesting of options upon the effective date of an initial public offering or a change in control of the Company.

A summary of activity under the Company's 1997, 2001, and 2002 Plans is as follows:

	Number of Option Shares	Exercise Price Range	Weighted Average Exercise Price
Outstanding at January 1, 2001	28,187	$ 16.00 – $620.00	$ 227.00
Granted	74,073	25.00 – 125.00	42.00
Exercised	(1,804)	16.00 – 465.00	40.00
Canceled	(15,661)	16.00 – 465.00	252.00
Outstanding at December 31, 2001	84,795	$ 16.00 – $620.00	$ 65.00
Granted	2,135,495	$ 0.01 – $25.00	$ 2.71
Exercised	—	—	—
Canceled	(28,206)	16.00 – 620.00	65.00
Outstanding at December 31, 2002	2,192,084	$ 0.01 – $620.00	$ 4.32

At December 31, 2002, 2,192,084 shares were outstanding and 1,771,830 shares were available for the granting of additional options under the 1997, 2001, and 2002 Plans.

The following table summarizes information about currently outstanding and exercisable stock options at December 31, 2002 under the 1997, 2001, and 2002 Plans:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Outstanding at December 31, 2002	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Vested at December 31, 2002	Weighted Average Exercise Price
$16.30 – $620.00	91,111	8.35	$ 65.00	64,640	$ 122.00
$0.01	2,100,973	9.96	0.01	1,929,876	0.01
	2,192,084	9.89	$ 4.32	1,994,516	$ 3.96

Additional Stock Plan Information

As discussed in Note 1, the Company accounts for its stock-based awards to employees using the intrinsic value method in accordance with APB 25, *Accounting for Stock Issued to Employees* , and its related interpretations.

SFAS No. 123, *Accounting for Stock-Based Compensation* , requires the disclosure of pro forma net income (loss) had the Company adopted the fair value method since the Company's inception. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards.

The Company's calculations for employee grants were made using the minimum value option pricing model with the following weighted average assumptions:

	Year Ended December 31	
	2001	2002
Dividend yield	None	None
Volatility	None	None
Risk free interest rate	3.9%	4.6%
Expected term, in years	3.6	3.6

The weighted average minimum value per option as of the date of grant for options granted during 2001 and 2002 was $0.05 and $0.00, respectively.

8. Lease Commitments

Future minimum net lease payments under noncancellable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of December 31, 2002 are as follows:

		Year Ending December 31
2003	$	303,366
2004		403,849
2005		408,328
2006		136,109
2007		—
Thereafter		—
Total	$	1,251,652

Total rent expense under operating leases for 2001 and 2002 was $2,625,468 and $1,209,778 respectively.

In 1999, the Company obtained a letter of credit of $2,479,598 for a security deposit on leased office space. The letter of credit is collateralized by certain assets of the Company and is included in other assets as of

December 31, 2001. In October 2001, the Company and the landlord amended the original lease whereby a portion of the premises was returned to the landlord, and the base rent for the remaining portion of the premises was modified. Additionally, the security deposit that the Company was required to maintain with the landlord was reduced from $2,479,598 to $1,345,097. As part of this agreement, the Company recorded $550,469 as lease termination fees. Of this amount, $340,796 was cash and $209,673 was for the fair value of a warrant to purchase 10,000 shares of common stock.

In April 2002, the Company and the landlord further amended the lease whereby a portion of the premises was returned to the landlord as of February 1, 2002. Additionally, the landlord was allowed to draw upon the entire amount of the letter of credit being held as security deposit under the lease agreement. As a result of this amendment, the Company recorded $773,442 as lease termination fees and $571,655 as prepaid rent. The prepaid rent is to be refunded to the Company on a pro rata basis only in the event of an early termination by the landlord, termination of the lease due to destruction or eminent domain, or if the parties mutually agree to the early termination of the lease.

9. 401(k) Plan

Effective January 1, 1997, the Company implemented a 401(k) plan (the "Plan") covering all employees who have met certain eligibility requirements. Under the Plan, employees may elect to contribute up to 20% of their eligible compensation to the Plan, subject to certain limitations. The Company immediately matches employee contributions at 50% up to the first 6% of employees' compensation. Employees are fully vested in the Company's contributions after one year of service with the Company. During 2001 and 2002, the Company made contributions to the Plan of $158,499 and $163,977, respectively.

10. Customer Litigation

In January 2001, a demand for arbitration was served against the Company by one of its customers. The customer claimed that the Company failed to produce software that passed "acceptance testing" pursuant to a software license executed between the customer and Company in June 2000. The customer demanded return of $2,500,000 previously paid to the Company in 2000. In May 2002, the customer and the Company entered into a Settlement Agreement and Mutual Release ("Settlement"), which required the Company to pay to the customer a total sum of $1,375,000, with $750,000 payable at the closing of the Settlement (June 7, 2002). The Company issued an unsecured promissory note to the customer for the remaining $625,000, which will be payable on June 7, 2003.

11. Related Party Transactions

Notes Receivable From Employees

At December 31, 2000, the Company held notes receivable from several senior executives in connection with personal loans made to these individuals. These notes bear interest at the rate of 6.36% per annum and were secured by Company stock owned by employees. In 2001, the employees repaid these notes which totaled to

$526,300, including accrued interest. Of the amount repaid, $483,205 was repaid by surrendering Company common stock owned by the employees, at $50.00 per share.

At December 31, 2001, the Company held notes receivable from a senior executive in connection with personal loan made to the executive. The balance of these notes, including accrued interest, was $96,837 as of December 31, 2001. These notes were issued in August 1999, September 2000 and September 2001 and bear interest at the LIBOR rate effective as of the effective date of the note. These notes are due upon the earlier of the tenth anniversary of the note, nine months following the employee's termination from the Company, nine months following the closing of the Company's initial public offering or nine months following the dissolution, liquidation, or merger with or into another corporation, or sale of substantially all of the assets of the Company. Since the senior executive terminated employment in October 2001, the notes were due in July 2002. As the balance of the notes remained unpaid at December 31, 2002, the Company has recorded an allowance for the entire balance of the notes including interest as of December 31, 2002.

The Company also holds a note from a senior executive in connection with the advance payment of his 2001 bonus. This note had a principal balance, including accrued interest, totaling $25,753 as of December 31, 2001. This note was issued in May 2001 and bears interest at 5% per annum. The note was repaid in March 2002.

In March 2001, the Company issued a note to a senior executive in the amount of $500,000, with interest at 5.41% per annum. This note was repaid in October 2001 upon the termination of the executive. The executive repaid the note by surrendering Company Common Stock at $50.00 per share, plus surrendered vested stock options to purchase 4,031 shares of common stock.

S&P

In May 2001, the Company entered into an agreement with S&P, an investor, to purchase certain licensed information over a three-year period ("S&P Agreement"). The license fees payable to S&P are calculated as a percentage of net revenue, defined as the total fees (excluding development or implementation fees) due to the Company for services that include, incorporate or otherwise utilize the licensed information. The minimum fee due to S&P each year is $500,000 with a maximum of $500,000 in Year 1, $1,500,000 in Year 2, and $2,500,000 in Year 3. During 2001 and 2002, the Company paid $250,000 and $64,290, respectively, in conjunction with this agreement.

In May 2002, the Company and S&P entered into an agreement to cancel the S&P Agreement. In consideration of S&P's cancellation of the S&P Agreement, the Company made a cash payment to S&P of $171,089 and issued a promissory note to S&P for $461,254 with interest at 8% per annum, payable on May 31, 2007 or upon a change of control of the Company. Interest expense incurred on this note totaled $22,181 during 2002. As of December 31, 2002, the balance of this note, including accrued interest, was $483,435.

Reuters

In December 2000, the Company entered into an agreement with Reuters, an investor, to purchase certain Reuters' services in the aggregate of $8,900,000 over a period of five years. As part of the Series F/G Financing, Reuters agreed to reduce the Company's purchase commitment by $1,609,000, in exchange for $1,225,000 of Reuters' $3,725,000 obligation to trigger the conversion right of its Series E into Series F. During 2001 and 2002, the Company paid $314,000 and $548,000, respectively, in conjunction with this agreement.

In May 2002, in connection with the initial closing of the Series A-1 financing, the Company and Reuters revised their existing agreement to reduce the amount of services the Company is obligated to purchase to approximately $2.9 million over a four-year period. In consideration of Reuters' agreement to enter into this agreement, the Company issued an unsecured note to Reuters in the amount of $620,020 with interest at 8% per annum, payable on May 24, 2007 or upon a change of control of the Company. Interest expense incurred on this note totaled $30,812 during 2002. As of December 31, 2002, the balance of this note, including accrued interest, was $650,832.

Fees Paid to Related Parties

A senior executive officer, who terminated his employment in February 2001, served as a board member of a consulting firm and of a professional employer organization to which the Company paid fees. Approximately $427,000 was paid to the consulting firm and $293,000 was paid to the professional employer organization in 2001. No payments were made to the consulting firm or to the professional employer organization in 2002.

12. Subsequent Events

Management Retention Plan and Employee Severance Agreements

In January 2003, the board of directors approved a Management Retention Plan, which created a pool of 20% of the consideration which might be received in an acquisition transaction for allocation to the covered employees. Payments under the plan are senior to payment of Series A-1, are to be made in the same form of the acquisition consideration which might be received, and are to be subject to a vesting schedule. In January 2003, the board of directors also approved severance agreements for employees that provide severance equal to (i) one week's salary for each six months service or portion thereof for staff positions, or (ii) one week's salary for each six months of service or portion thereof plus one month salary for senior management positions, in the event an employee is terminated prior to, or within six months subsequent to an acquisition. Employees who receive severance under their respective employee severance agreements will be entitled to payment under the Management Retention Plan only to the extent the payment under the Management Retention Plan exceeds severance amounts paid.

Amendment to Executive Employment Agreement

In January 2003, the Board of Directors approved an amendment to a senior executive's employment agreement whereby the executive exchanged $105,000 of cash severance due under the employment agreement for 3% of the consideration which might be received in an acquisition transaction, payment of which will be senior to payment of Series A-1.

Shadow Preferred Conversion and Reverse Stock Split

As the final closing of the Series A-1 financing was not consummated prior to April 1, 2003, shares of the Company's Shadow Preferred were converted into shares of common stock by dividing the aggregate conversion preference ($100.00, $162.30, $200.00, $620.00, $209.00, and $1,045.00 for Series AA, Series BB, Series CC, Series DD, Series FF, and Series GG, respectively, plus 8% thereon from initial issuance through April 1, 2003, except for Series AA, compounded semiannually) by the Shadow Preferred conversion price of $28.07. Immediately after giving effect to the Shadow Preferred Conversion, each share of the Company's then outstanding shares of common stock and Series A-1 was automatically split and converted into 0.01 shares of common stock and shares of Series A-1, respectively. Accordingly, all historical financial information has been restated as if the stock split had been in effect for all periods presented. Following the Shadow Preferred Conversion and the reverse stock split, 5,475,837 shares of common stock and 2,870,247 shares Series A-1 were outstanding.

Purchase by Morningstar Associates LLC

In May 2003, the board of directors approved an Agreement and Plan of Reorganization (the "Merger") whereby the Company became a wholly-owned subsidiary of Morningstar Associates LLC. The Merger was approved on June 13, 2003 by the requisite majority of the outstanding shares of the capital stock of the Company, and the Merger closed on June 30, 2003. Of the total acquisition consideration of $4,695,680, $1,279,520 was used to settle existing liabilities of the Company, $1,475,443 was distributed to holders of Series A-1, $383,232 was distributed to employees covered under the Management Retention Plan discussed above, and $57,485 was distributed to the executive discussed above. In addition, $1,500,000 of the total acquisition consideration was placed in escrow until December 31, 2004, to be distributed as follows: $1,155,000 to holders of Series A-1, $300,000 to employees covered under the Management Retention Plan, and $45,000 to the executive discussed above. As the amount of the total acquisition consideration received was not sufficient to allow distribution of proceeds to holders of the Company's common stock, all outstanding shares of the Company's common stock were cancelled and extinguished upon the closing date of the Merger. In addition, all outstanding warrants and options were terminated upon the closing date of the Merger. Also in connection with the Merger, the Board of Directors approved the dissolution of mPower Europe.

Amendment and Termination of 401(k) Plan

In June 2003, the board of directors approved the amendment and restatement of the Company's 401(k) Plan to comply with the Uruguay Round Agreements, the Uniformed Services and Re-employment Rights Act of 1994, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Internal Revenue Service Restructuring and Reform Act of 1998, and the Community Renewal Tax Relief Act of 2000. Also in June 2003, the board of directors approved the termination of the Company's 401(k) Plan in accordance with the Merger discussed above. In accordance with the provisions of the 401(k) Plan, all participants became fully vested in their accrued benefits as of the plan termination date.

13. Restatement

Subsequent to the issuance of the consolidated financial statements for the year ended December 31, 2002, we determined that impairment losses related to fixed assets and intangible assets and loss on disposal of fixed assets for the years ended December 31, 2001 and 2002 should be classified as operating expense. As a result, the accompanying Consolidated Statements of Operations have been restated to increase both operating expense and operating loss; and to decrease non operating expense in the amounts of $2,140,733 and $4,862,416 for the years ended December 31, 2001 and 2002, respectively. The restatement has no impact to net loss, or cash flows for any period presented.

Unaudited Pro Forma Consolidated Statement of Operations

The following Unaudited Pro Forma Consolidated Statement of Operations for the year ended December 31, 2003 gives effect to the acquisition of mPower.com, Inc. ("mPower"), which became effective July 1, 2003, and has been prepared by combining Morningstar Inc. and subsidiaries' ("Morningstar") historical Consolidated Statement of Operations for the year ended December 31, 2003 with the results of operations of mPower for the period January 1, 2003 to June 30, 2003 (period prior to Morningstar's acquisition of mPower.) As such, the Unaudited Pro Forma Consolidated Statement of Operations gives effect to the acquisition of mPower as if it had occurred on January 1, 2003.

The unaudited pro forma Consolidated Statement of Operations is presented for information purposes only and it is not necessarily indicative of the results of operations that would have been achieved had the acquisition been completed as of the date indicated and is not necessarily indicative of Morningstar's future financial position or results of operations.

The Unaudited Pro Forma Consolidated Statement of Operations for the year ended December 31, 2003 should be read in conjunction with the historical consolidated financial statements of Morningstar and mPower, including the notes thereto, which are contained elsewhere in this document.

Morningstar, Inc. and Subsidiaries
Unaudited Pro Forma Consolidated Statement of Operations for the Year Ended December 31, 2003
(in thousands except per share amounts)

	Unaudited			
	Historical Morningstar, Inc. Year Ended December 31, 2003	mPower.com, Inc. Six Months Ended June 30, 2003	Pro Forma Adjustments (See Note 2)	Pro Forma Morningstar, Inc. and mPower.com, Inc. Year Ended December 31, 2003
Revenue	$ 139,496	$ 2,726	—	142,222
Operating expense				
Cost of goods sold	43,521	1,493	—	45,014
Development	14,663	303	—	14,966
Sales and marketing	30,798	1,022	—	31,820
General and administrative	54,145	2,251	—	56,396
Depreciation and amortization	7,123	302	(119)(a)(b)	7,306
Total operating expense	150,250	5,371	(119)	155,502
Operating loss	(10,754)	(2,645)	119	(13,280)
Non-operating income (expense)				
Gain on sale of investment in unconsolidated entity	510	—	—	510
Interest income, net	279	(14)	—	265
Other income (expense), net	321	—	—	321
Total non-operating income, net	1,110	(14)	—	1,096
(Loss) before income taxes and equity in net income of unconsolidated entities	(9,644)	(2,659)	119	(12,184)
Income tax expense	2,950	—	47 (c)	2,997
Equity in net income of unconsolidated entities	697	—	—	697
Net income (loss)	$ (11,897)	$ (2,659)	$ 72	$ (14,484)
Weighted average common shares outstanding basic and diluted	38,382			38,382
Basic and diluted loss per share	$ (0.31)	—	—	$ (0.38)

See accompanying notes to the unaudited pro forma consolidated statement of operations.

Notes to the Unaudited Pro Forma Consolidated Statement of Operations

1. Basis of Presentation

The Unaudited Pro Forma Consolidated Statement of Operations for the year ended December 31, 2003 assumes Morningstar Inc.'s acquisition of mPower.com, Inc. ("mPower") occurred on January 1, 2003.

2. Pro Forma Adjustments

(a) Reflects the elimination of mPower's historical amortization expense for the periods presented.

(b) Reflects the amortization of purchased intangible assets over their economic useful lives of seven years.

(c) Reflects the tax impact of adjustments (a) and (b) above.

[IBC Color Artwork]

Dealer Prospectus Delivery Obligation

Until , 2005 (25 days after the date of this offering), all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

Part II Information Not Required in Prospectus

Item 13. Other Expenses of Issuance and Distribution

The following table sets forth the expenses (other than underwriting discounts and commissions) we expect to incur in connection with the offering described in this registration statement.

Securities and Exchange Commission Registration Fee	$	12,670
NASD Filing Fee		10,500
Listing Fee		*
Accounting Fees and Expenses		*
Printing and Engraving Expenses		*
Legal Fees and Expenses		*
Blue Sky Fees and Expenses		*
Transfer Agent Fees and Expenses		*
Miscellaneous		*
Total		*

* To be completed by amendment.

The foregoing items are estimated. All expenses will be borne by Morningstar.

Item 14. Indemnification of Directors and Officers

Illinois Business Corporation Act

Section 8.75 of the Illinois Business Corporation Act (IBCA) provides generally and in pertinent parts that an Illinois corporation may indemnify its directors, officers, employees and agents, or anyone serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (in the case of actions by or in the right of the corporation) or against expenses, judgments, fines, and settlements (in all other cases) actually and reasonably incurred by them in connection with any action, suit, or proceeding if, in connection with the matters in issue, they acted in good faith and in a manner they reasonably believed to be in, or not opposed to, the best interests of the corporation and, in connection with any criminal suit or proceeding, if in connection with the matters in issue, they had no reasonable cause to believe their conduct was unlawful, *provided that* no indemnification shall be made with respect to any claim, issue, or matter as to which such person has been adjudged to have been liable to the corporation, unless and only to the extent that the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability, such person is fairly and reasonably entitled to indemnity. If a present or former director, officer or employee of an Illinois corporation has been successful in the defense of any such action, suit or proceeding, claim, issue or matter, such person shall be indemnified by the corporation against expenses.

Section 8.75 of the IBCA further permits an Illinois corporation to pay expenses incurred by an officer or director in defending a civil or criminal action, suit or proceeding in advance of the final disposition of such action, suit or proceeding if the director or officer undertakes to repay such amount if it is ultimately determined that such person is not entitled to be indemnified by the corporation. An Illinois corporation may also grant additional indemnification through its by-laws, agreements, votes of shareholders or disinterested directors, or otherwise, and may purchase and maintain insurance on behalf of any indemnifiable person against any liability asserted against such person and incurred by such person in his or her capacity as an indemnifiable person whether or not the corporation would have the power to indemnify such person against liability under the terms of Section 8.75 of the IBCA.

Our Articles of Incorporation and By-laws

Article SEVENTH of our Amended and Restated Articles of Incorporation provides that we shall, to the full extent permitted by Section 8.75 of the IBCA, as amended from time to time, indemnify all persons whom we may indemnify pursuant thereto.

Article VI of our Amended and Restated By-Laws provides that we will indemnify, to the fullest extent allowed, any and all persons whom we have the power to indemnify under the IBCA against any and all expenses, judgments, fines, amounts paid in settlement, and any other liabilities. In addition, we may, at the discretion of our board of directors, purchase and maintain insurance to protect ourselves and any indemnifiable persons against any such expense, fine, amount paid in settlement or other liability, whether or not we would have the power to indemnify such persons under the IBCA.

Directors' and Officers' Liability Insurance

Prior to completion of this offering, Morningstar intends to obtain a directors' and officers' liability insurance policy, which insures against liabilities that directors or officers may incur in such capacities. These insurance policies, together with the indemnification agreements, may be sufficiently broad to permit indemnification of our directors and officers for liabilities, including reimbursement of expenses incurred, arising under the Securities Act of 1933, as amended (Securities Act).

Indemnification Agreements

Prior to the closing of this offering, we will enter into indemnification agreements, a form of which is attached as Exhibit 10.1 to this registration statement, with each of our directors and executive officers which may be broader than the specific indemnification provisions contained in the IBCA, as amended from time to time. These indemnification agreements may require us, among other things, to indemnify our directors, officers, and certain key employees against liabilities that may arise by reason of their status or service. These indemnification agreements may also require us to advance all expenses incurred by the directors, officers, or certain key employees in investigating or defending any such action, suit, or proceeding. However, an individual will not receive indemnification for judgments, settlements, or expenses if he or she is found liable to us (except to the extent the court determines he or she is fairly and reasonably entitled to indemnity for expenses), for settlements not approved by us or for settlements and expenses if the settlement is not approved by the court.

Underwriting Agreement

The Underwriting Agreement (filed as Exhibit 1.1 to this registration statement) is expected to provide that the underwriter is obligated, under certain circumstances, to provide indemnification for Morningstar and its officers, directors, and employees for certain liabilities, including liabilities arising under the Securities Act or otherwise.

Item 15. Recent Sales of Unregistered Securities

In the preceding three years, we have sold the following securities that were not registered under the Securities Act:

- Since January 1, 2002, we have issued to directors, officers and employees options to purchase 3,324,131 shares of common stock with an aggregate exercise price of $40,338,595 and we sold an aggregate of 154,955 shares of common stock to 36 directors, officers, and employees through option exercises at prices ranging from $0.53 to $14.13 per share, for aggregate cash consideration of $464,254. The options were granted pursuant to Morningstar's option plans. At the time the options were granted, each recipient was employed by Morningstar. The issuance of options and the sale of the underlying shares was exempt from registration under the Securities Act pursuant to Rule 701 promulgated under Section 3(b) of the Securities Act as a transaction pursuant to a written compensatory benefits plan. All recipients either received adequate information about Morningstar or had access, through employment or other relationship, to such information.

- Also, on April 30, 2003 we sold an additional 12,668 shares of our common stock to two of our executive officers at a purchase price of $8.57 per share, for aggregate cash consideration of $194,265. The securities described in Item 15 were issued to U.S. investors based on the exemption from the registration requirements of the Securities Act as set forth in Section 4(2) under the Securities Act as a transaction not involving a public offering. The purchasers received written disclosures that the securities had not been registered under the Securities Act and that any resale must be made pursuant to a registration or an available exemption from such registration.

No underwriters were involved in the foregoing sales of securities.

Item 16. Exhibits and Financial Statement Schedules

(a) Exhibits

Exhibit	Description
1.1	Form of Underwriting Agreement.*
3.1	Amended and Restated Articles of Incorporation of Morningstar.*
3.2	Amended and Restated By-laws of Morningstar.*
4.1	Specimen Common Stock Certificate.*
5.1	Opinion of Winston & Strawn LLP.*
10.1	Form of Indemnification Agreement.*
10.2	Morningstar Incentive Plan.*
†10.3	Subscription Agreement dated December 29, 1998 between Morningstar and Tim Armour.
†10.4	Morningstar 1999 Incentive Stock Option Plan.
10.5	Morningstar 2004 Stock Incentive Plan.
†10.6	Deferred Compensation Agreement dated February 15, 1999 between Morningstar and Don Phillips.
†10.7	Shareholders Agreement dated February 1, 1999 among Morningstar, Joe Mansueto, Paul Sturm, and Tim Armour.
†10.8	Purchase Agreement dated April 30, 2003 between Morningstar and Patrick Reinkemeyer.
†10.9	Purchase Agreement dated April 30, 2003 between Morningstar and David Williams.
†10.10	Stock Purchase Agreement dated July 8, 1999 between Morningstar and Softbank.
21.1	Subsidiaries of Morningstar.
23.1	Consent of Deloitte & Touche LLP.
23.2	Consent of Deloitte & Touche LLP.
23.3	Consent of Winston & Strawn LLP (contained in Exhibit 5.1).*
†24.1	Powers of Attorney (included on signature page).

* To be filed by amendment.

† Previously filed.

(b) Financial Statement Schedules

Morningstar Inc. and Subsidiaries

The following financial statement schedule for the years ended December 31, 2001, 2002, and 2003 is a part of this registration statement and should be read in conjunction with the Consolidated Financial Statements of Morningstar, Inc. and Subsidiaries:

	Page
Schedule II—Morningstar, Inc. and Subsidiaries Valuation and Qualifying Accounts	II-6
Report of Independent Registered Public Accounting Firm on Supplemental Schedule	II-7

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the Consolidated Financial Statements or related notes.

The following financial statement schedule for the years ended December 31, 2001 and 2002 is a part of this registration statement and should be read in conjunction with the Consolidated Financial Statements of mPower.com, Inc. and Subsidiaries:

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the Consolidated Financial Statements or related notes.

Schedule II Morningstar, Inc. and Subsidiaries Valuation and Qualifying Accounts ($000)

	Balance at Beginning of Year	Charged to Costs & Expenses	Deductions Including Currency Translation	Balance at End of Year
Allowance for doubtful accounts:				
Year Ended December 31,				
2001	$ 768	$ 554	$ (746)	$ 576
2002	576	1,739	(1,517)	798
2003	798	855	(999)	654

Report of Independent Registered Public Accounting Firm on Supplemental Schedule

Morningstar, Inc.
Chicago, Illinois

We have audited the consolidated financial statements of Morningstar, Inc. and subsidiaries (the "Company") as of December 31, 2002 and 2003, and for each of the three years in the period ended December 31, 2003, and have issued our report thereon dated April 30, 2004 (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the Company's change in its method of accounting for goodwill and intangible assets) (included elsewhere in this Registration Statement). Our audits also included the financial statement schedule listed in Item 16 of this Registration Statement. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP
Chicago, Illinois
April 30, 2004

Schedule II mPower.com, Inc. and Subsidiaries Valuation and Qualifying Accounts ($000)

	Balance at Beginning of Year	Charged to Costs & Expenses	Deductions Including Currency Translation	Balance at End of Year
Allowance for doubtful accounts:				
Year Ended December 31,				
2001	$ 9	$ 370	$ (289)	$ 90
2002	90	42	(78)	54

Independent Auditors' Report on Supplemental Schedule

To the Stockholder of mPower.com, Inc.:
Chicago, Illinois

We have audited the consolidated financial statements of mPower.com, Inc. and subsidiaries ("mPower") as of December 31, 2001 and 2002, and for each of the two years in the period ended December 31, 2002, and have issued our report thereon dated April 1, 2004 (which report expresses an unqualified opinion and includes an explanatory paragraph relating to mPower's change in its method of accounting for goodwill and intangible assets) (included elsewhere in this Registration Statement). Our audits also included the financial statement schedule listed in Item 16 of this Registration Statement. This financial statement schedule is the responsibility of mPower's management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP
Chicago, Illinois
April 1, 2004

Item 17. Undertakings

The undersigned registrant hereby assumes responsibility that:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act of 1933 shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial *bona fide* offering thereof.

(3) It will provide to the underwriter at the closing specified in the underwriting agreement certificates in such denominations and registered in such names as required by the underwriter to permit prompt delivery to each purchaser.

(4) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers, and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer, or controlling person of the registrant in the successful defense of any action, suit, or proceeding) is asserted by such director, officer, or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final judicial decision of such issue.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, as amended, Morningstar has duly caused this amendment to registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Chicago, State of Illinois, on February 3, 2005.

MORNINGSTAR, INC.

By: /s/ JOE MANSUETO

Name: Joe Mansueto
Title: Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, as amended, this amendment to registration statement has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ JOE MANSUETO Joe Mansueto	Chairman of the Board and Chief Executive Officer (principal executive officer)	February 3, 2005
/s/ MARTHA DUSTIN BOUDOS Martha Dustin Boudos	Chief Financial Officer (principal accounting and financial officer)	February 3, 2005
* Donald J. Phillips II	Director	February 3, 2005
* Cheryl Francis	Director	February 3, 2005
* Steven Kaplan	Director	February 3, 2005
* Jack Noonan	Director	February 3, 2005
* Paul Sturm	Director	February 3, 2005

*By:/s/ MARTHA DUSTIN BOUDOS

Martha Dustin Boudos
as attorney-in-fact

Martha Dustin Boudos was appointed attorney-in-fact with power and authority to execute this Amendment No. 1 to Registration Statement on behalf of the Directors named above pursuant to the power of attorney included on the signature page at the time of the initial filing of this registration statement.

QuickLinks

Exhibit 10.5

MORNINGSTAR, INC.
2004 STOCK INCENTIVE PLAN

MORNINGSTAR, INC. 2004 STOCK INCENTIVE PLAN

TABLE OF CONTENTS

MORNINGSTAR, INC. 2004 STOCK INCENTIVE PLAN

ARTICLE 1. ESTABLISHMENT, OBJECTIVES AND DURATION

1.1 ESTABLISHMENT OF THE PLAN. Morningstar, Inc., an Illinois corporation, hereby establishes this Morningstar, Inc. 2004 Stock Incentive Plan (the "Plan") as set forth in this document. Capitalized terms used but not otherwise defined herein will have the meanings given to them in Article
2. The Plan permits the grant of Nonstatutory Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, and Performance Shares. In addition, the Plan provides the opportunity for the deferral of the payment of salary, bonuses and other forms of incentive compensation.

Subject to the approval of the Company's shareholders, the Plan will become effective upon its approval by the Board of Directors, and will remain in effect as provided in Section 1.3 hereof.

1.2 PURPOSE OF THE PLAN. The purpose of the Plan is to promote the success and enhance the value of the Company by linking the personal interests of Participants to those of Company shareholders, and by providing Participants with an incentive for outstanding performance. The Plan is further intended to provide flexibility to the Company in its ability to motivate, attract and retain the services of Participants upon whose judgment, interest, and special effort the successful conduct of its business is largely dependent.

1.3 DURATION OF THE PLAN. The Plan will commence on the Effective Date, as described in Article 2, and will remain in effect, subject to the right of the Committee to amend or terminate the Plan at any time pursuant to Article 14, until all Shares subject to it pursuant to Article 4 have been issued or transferred according to the Plan's provisions. In no event may an Award be granted under the Plan on or after the tenth annual anniversary of the Effective Date.

1.4 PLAN MERGER. The 2001 Morningstar Stock Option Plan, as amended, the Amended and Restated 2000 Morningstar Stock Option Plan, and the Amended and Restated 1993 Morningstar Stock Option Plan shall be merged into this Plan as of the Effective Date. Stock options awarded under the Prior Plans shall be governed by the terms of this Plan.

ARTICLE 2. DEFINITIONS

Whenever used in the Plan, the following terms have the meanings set forth below, and when the meaning is intended, the initial letter of the word is capitalized:

"AFFILIATES" means (a) for purposes of Incentive Stock Options, any corporation that is a Parent or Subsidiary of the Company, and (b) for all other purposes hereunder, an entity that is (directly or indirectly) controlled by, or controls, the Company.

"AWARD" means, individually or collectively, a grant under this Plan to a Participant of Nonstatutory Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, and Performance Shares.

"AWARD AGREEMENT" means an agreement entered into by the Company and a Participant setting forth the terms and provisions applicable to an Award or Awards granted to the Participant or the terms and provisions applicable to an election to defer compensation under Section 8.2.

"BOARD" or "BOARD OF DIRECTORS" means the Board of Directors of the Company.

"CAUSE" shall mean the Participant's:

(a) willful neglect of or continued failure to substantially perform his or her duties with or obligations for the Company or an Affiliate in any material respect (other than any such failure resulting from his or her incapacity due to physical or mental illness);

(b) commission of a willful or grossly negligent act or the willful or grossly negligent omission to act that causes or is reasonably likely to cause material harm to the Company or an Affiliate; or

(c) commission or conviction of, or plea of NOLO CONTENDERE to, any felony or any crime significantly injurious to the Company or an Affiliate.

An act or omission is "willful" for this purpose if it was knowingly done, or knowingly omitted, by the Participant in bad faith and without reasonable belief that the act or omission was in the best interest of the Company or an Affiliate. Determination of Cause shall be made by the Committee in its sole discretion.

"CHANGE IN CONTROL" means the occurrence of any one or more of the following: (a) any "person" (as such term is defined in Section 3(a)(9) of the Exchange Act and as used in Sections 13(d)(3) and 14(d)(2) of the Exchange Act) who, after the Effective Date, becomes a "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of more than fifty percent (50%) of the Shares (other than Joe Mansueto, his spouse and descendants, and any trustee or custodian for and on behalf of any of them), (b) the consummation of a merger, consolidation, statutory share exchange or similar form of corporate transaction involving the Company (a "Business Combination"), unless immediately following such Business Combination more than sixty percent (60%) of the total voting power of (i) the company resulting from such Business Combination (the "Surviving Company"), or (ii) if applicable, the ultimate parent company that directly or indirectly has beneficial ownership of one hundred percent (100%) of the voting securities eligible to elect directors of the Surviving Company (the "Parent Company") is represented by Shares that were outstanding immediately prior to such Business Combination (or, if applicable, is represented by shares into which such Shares were converted pursuant to such Business Combination), and such voting power among the holders thereof is in substantially the same proportion as the voting power of such Shares among the holders thereof immediately prior to the Business Combination, or (c) the stockholders of the Company approve a plan of complete liquidation or dissolution of the Company or a sale of all or substantially all of the Company's assets.

"CODE" means the Internal Revenue Code of 1986, as amended from time to time.

"COMMITTEE" shall mean the Compensation Committee of the Board of Directors, the composition of which shall at all times satisfy the provisions of Section 162(m) of the Code and shall consist of at least two directors who are "independent directors" within the meaning of the NASDAQ marketplace rules, and "nonemployee directors" within the meaning of Exchange Act Rule 16b-3.

"COMPANY" means Morningstar, Inc., an Illinois corporation, and any successor thereto as provided in Article 18.

"CONSULTANT" means any person, including an advisor, engaged by the Company or an Affiliate to render services to such entity and who is not a Director or an Employee.

"DIRECTOR" means any individual who is a member of the Board of Directors.

"DISABILITY" shall mean

(a) A physical or mental condition that would qualify a Participant for a disability benefit under the long-term disability plan of the Company applicable to him or her;

(b) If the Participant is not covered by such a long-term disability plan, disability as defined for purposes of eligibility for a disability award under the Social Security Act;

(c) When used in connection with the exercise of an Incentive Stock Option following termination of employment, disability within the meaning of Code Section 22(e)(3); or

(d) Such other condition as may be determined by the Committee in its sole discretion to constitute Disability.

"EFFECTIVE DATE" means the date of the Plan's adoption by the Board subject to the approval of the Plan by the Company's shareholders.

"EMPLOYEE" means any person employed by the Company or an Affiliate in a common law employee-employer relationship. A Participant shall not cease to be an Employee for purposes of this Plan in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or among the Company, its Parent, any Subsidiary, or any successor. For purposes of Incentive Stock Options, no such leave may exceed ninety (90) days, unless reemployment upon expiration of such leave is guaranteed by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, on the one hundred and eighty-first (181st) day of such leave any Incentive Stock Option held by the Participant shall cease to be treated as an Incentive Stock Option and shall be treated for tax purposes as a Nonstatutory Stock Option. Neither service as a Director nor payment of a director's fee by the Company shall be sufficient to constitute "employment" by the Company.

"EXCHANGE ACT" means the Securities Exchange Act of 1934, as amended from time to time, or any successor act thereto.

"EXERCISE PRICE" means the price at which a Share may be purchased by a Participant pursuant to an Option.

"FAIR MARKET VALUE" shall be determined as follows:

(a) At all times prior to an IPO, "Fair Market Value" shall be determined pursuant to one or more Valuations conducted on behalf of the Company. The Committee shall determine Fair Market Value at its sole discretion, based upon the results of each Valuation, as more fully provided herein. At times when the Fair Market Value of a Share is determined pursuant to a Valuation, the following timing rules shall apply:

(i) In the event that the date on which a transaction involving Shares occurs is within six (6) months following the most recently completed Valuation, the Fair Market Value of the Shares involved in the transaction shall be determined by reference to the results of the most recently completed Valuation.

(ii) In the event that the date on which a transaction involving Shares occurs is six (6) months or more after the most recently completed Valuation, the Fair Market Value of the Shares involved in the transaction shall be determined by reference to the results of the Valuation or Valuations that the Committee, in its sole discretion, deems appropriate.

The Committee shall have the authority to modify the results of any Valuation in any manner that it deems necessary to ensure the consistency of the determination of Fair Market Value throughout the term of the Plan.

(b) At all times following an IPO, "Fair Market Value" means

(i) the average of the high and low trading prices of the Shares on the New York Stock Exchange or on such other national securities exchange on which the Shares are listed, or, if the Shares are not traded on any other exchange and are regularly quoted on the NASDAQ National Market System, on the NASDAQ National Market System if the Shares are admitted for quotation thereon; or

(ii) if the Shares are not traded on any exchange or regularly quoted on the NASDAQ National Market System, the mean between the closing bid and asked prices of the Shares in the over-the-counter market; or

(iii) if those bid and asked prices are not available, then the Fair Market Value as of any given date shall be determined in good faith by the Committee; or

(iv) the actual sale price of the Shares, where a Participant pays the Exercise Price and/or any related withholding taxes to the Company by tendering Shares issuable to the Participant upon exercise of an Option.

"FREESTANDING SAR" means a SAR that is granted independently of any Options, as described in Article 7.

"INCENTIVE STOCK OPTION" or "ISO" means an option to purchase Shares granted under Article 6 that is designated as an Incentive Stock Option and that is intended to meet the requirements of Code Section 422.

"INITIAL PUBLIC OFFERING" or "IPO" means an initial public offering of the Company's Shares pursuant to an effective registration statement filed with the U.S. Securities and Exchange Commission.

"NONSTATUTORY STOCK OPTION" or "NQSO" means an option to purchase Shares granted under Article 6 that is not intended to meet the requirements of Code Section 422.

"OPTION" means an Incentive Stock Option or a Nonstatutory Stock Option, as described in Article 6.

"PARENT" means a "parent corporation," whether now or hereafter existing, as defined in Code Section 424(e).

"PARTICIPANT" means an Employee, Consultant or Director who the Committee has selected to participate in the Plan pursuant to Section 5.2 and who has an Award outstanding under the Plan.

"PERFORMANCE-BASED EXCEPTION" means the performance-based exception from the tax deductibility limitations of Code Section 162 (m) and any regulations promulgated thereunder.

"PERFORMANCE PERIOD" means the time period during which performance objectives must be met in order for a Participant to earn Performance Shares granted under Article 9.

"PERFORMANCE SHARE" means an Award of Shares with an initial value equal to the Fair Market Value of a Share on the date of grant, which is based on the Participant's attainment of certain performance objectives specified in the Award Agreement, as described in Article 9.

"PERSONAL LEAVE" means a leave of absence as described in Section 5.3.

"PLAN" means the Morningstar, Inc. 2004 Stock Incentive Plan, as set forth in this document, and as amended from time to time.

"PRIOR PLANS" means the 2001 Morningstar Stock Option Plan, as amended, the Amended and Restated 2000 Morningstar Stock Option Plan, and the Amended and Restated 1993 Morningstar Stock Option Plan. The Prior Plans shall be merged into this Plan as of the Effective Date and stock options awarded under the Prior Plans shall be governed by the terms of this Plan.

"RESTRICTION PERIOD" means the period during which the transfer of Shares of Restricted Stock is limited in some way (based on the passage of time, the achievement of performance objectives, or the occurrence of other events as determined by the Committee, in its sole discretion) or the Restricted Stock is not vested.

"RESTRICTED STOCK" means a contingent grant of Shares awarded to a Participant pursuant to Article 8. The Shares awarded to the Participant will vest over the Restricted Period and according to the time-based or performance-based criteria, specified in the Award Agreement.

"RESTRICTED STOCK UNIT" or "RSU" means a notional account established pursuant to an Award granted to a Participant, as described in Article 8, that is (a) valued solely by reference to Shares, (b) subject to restrictions specified in the Award Agreement, and (c) payable only in Shares. The RSUs awarded to the Participant will vest according to the time-based or performance-based criteria specified in the Award Agreement.

"SERVICE" means the provision of services to the Company or its Affiliates in the capacity of (i) an Employee, (ii) a Director, or (iii) a Consultant. For purposes of this Plan, the transfer of an Employee from the Company to an Affiliate, from an Affiliate to the Company or from an Affiliate to another Affiliate shall not be a termination of Service. However, if the Affiliate for which an Employee, Director or Consultant is providing services ceases to be an Affiliate of the Company due to a sale, transfer or other reason, and the Employee, Director or Consultant ceases to perform services for the Company or any Affiliate, the Employee, Director or Consultant shall incur a termination of Service.

"SHARES" means the shares of common stock, no par value, of the Company.

"STOCK APPRECIATION RIGHT" or "SAR" means an Award of the contingent right to receive Shares or cash, as specified in the Award Agreement, in the future, based on the value, or the appreciation in the value, of Shares, pursuant to the terms of Article 7. SARs may be granted alone or in connection with a related Option.

"SUBSIDIARY" means a "subsidiary corporation", whether now or hereafter existing, as defined in Code Section 424(f).

"TANDEM SAR" means a SAR that is granted in connection with a related Option pursuant to Article 7, the exercise of which requires forfeiture of the right to purchase a Share under the related Option (and when a Share is purchased under the Option, the Tandem SAR will similarly be canceled).

"VALUATION" means a periodic valuation conducted on behalf of the Company, pursuant to such terms and methodologies that the Committee, in its sole discretion, deems appropriate. At all times prior to an IPO, the Committee shall establish the Fair Market Value of Shares in reliance upon one or more Valuations.

"VESTED" means, with respect to an Option, that such Option has become fully or partly exercisable; provided, however, that notwithstanding its status as a Vested Option, an Option shall cease to be exercisable pursuant to (and while exercisable shall be subject to) such terms as are set forth herein and in the relevant Award Agreement. Similarly, terms such as "Vest," "Vesting," and "Unvested" shall be interpreted accordingly.

ARTICLE 3. ADMINISTRATION

3.1 THE COMMITTEE. The Plan will be administered by the Committee, or by any other committee appointed by the Board whose composition satisfies the "nonemployee director" requirements of Rule 16b-3 under the Exchange Act and the regulations of Rule 16b-3 under the Exchange Act, the "independent director" requirements of the NASDAQ marketplace rules, and the "outside director" provisions of Code Section 162(m), or any successor regulations or provisions.

3.2 AUTHORITY OF THE COMMITTEE. Except as limited by law and subject to the provisions of this Plan, the Committee will have full power to: select Employees, Directors and Consultants to participate in the Plan; determine the sizes and types of Awards; determine the terms and conditions of Awards in a manner consistent with the Plan; construe and interpret the Plan and any agreement or instrument entered into under the Plan; establish, amend or waive rules and regulations for the Plan's administration; and (subject to the provisions of Article 15) amend the terms and conditions of any outstanding Award to the extent they are within the discretion of the Committee as provided in the Plan. Further, the Committee will make all other determinations that may be necessary or advisable to administer the Plan. As permitted by law and consistent with Section 3.1, the Committee may delegate some or all of its authority under the Plan, including to an officer of the Company to designate the Employees (other than such officer himself or herself) to receive Options and to determine the number of Shares subject to the Options such Employees will receive.

3.3 DECISIONS BINDING. All determinations and decisions made by the Committee pursuant to the provisions of the Plan will be final, conclusive and binding on all persons, including, without limitation, the Company, its Board of Directors, its shareholders, all Affiliates, Employees, Participants and their estates and beneficiaries.

3.4 CHANGE IN CONTROL. In the event of a Change in Control, the Committee shall have the discretion to accelerate the vesting of Awards, eliminate any restrictions applicable to Awards, deem the performance measures to be satisfied, or take such other action as it deems appropriate, in its sole discretion.

ARTICLE 4. SHARES SUBJECT TO THE PLAN AND MAXIMUM AWARDS

4.1 NUMBER OF SHARES AVAILABLE FOR AWARDS.

(a) Subject to adjustment as provided below and in Sections 4.2 and 4.3, the maximum number of Shares that may be issued or transferred to Participants under the Plan will be 5,628,843. The maximum number of Shares that may be issued or transferred to Participants as Incentive Stock Options is 1,000,000. The maximum number of Shares and Share equivalent units that may be granted during any calendar year to any one Participant under all types of Awards available under the Plan is 1,000,000 (on an aggregate basis); the foregoing limit will apply whether the Awards are paid in Shares or in cash. All limits described in this Section 4.1(a) are subject to adjustment as provided in Section 4.3.

(b) The Prior Plans shall be merged into and continued in the form of this Plan as of the Effective Date. Awards made and Shares awarded under the Prior Plans prior to the Effective Date, which remain outstanding on the Effective Date, shall be governed by the terms of this Plan, but shall not count against the number of Shares authorized under 4.1(a) above. No additional awards will be made under any Prior Plan on or after the Effective Date.

4.2 LAPSED AWARDS. Any Shares (a) subject to an Award under the Plan that are forfeited, canceled, settled or otherwise terminated without a distribution of Shares to a Participant; or (b) delivered by attestation to, or withheld by, the Company in connection with the exercise of an Option awarded under the Plan or in payment of any required income tax withholding for the exercise of an Option or the vesting of Restricted Stock awarded under the Plan will thereafter be deemed to be available for Award. Any Shares (a) subject to an Award under a Prior Plan that are forfeited, canceled, settled or otherwise terminated without a distribution of Shares to a Participant; or (b) delivered by attestation to, or withheld by, the Company in connection with the exercise of an Option awarded under a Prior Plan or in payment of any required income tax withholding for the exercise of an Option awarded under a Prior Plan will not be available for Award under this Plan or the Prior Plan.

4.3 ADJUSTMENTS IN AUTHORIZED SHARES.

(a) In the event of any merger, reorganization, consolidation, recapitalization, separation, liquidation, split-up, share combination, or other such change in the corporate structure of the Company affecting the Shares, such adjustment shall be made in the number and class of Shares which may be delivered under the Plan, and in the number and class of and/or price of Shares subject to outstanding Awards granted under the Plan, as may be determined to be appropriate and equitable by the Committee, in its sole discretion, to prevent dilution or enlargement of rights and provided that the number of Shares subject to any Award shall always be a whole number.

(b) Fractional Shares resulting from any adjustment in Awards pursuant to this section may be settled in cash or otherwise as the Committee determines. The Company will give notice of any adjustment to each Participant who holds an Award that has been adjusted and the adjustment (whether or not that notice is given) will be effective and binding for all Plan purposes.

ARTICLE 5. ELIGIBILITY AND PARTICIPATION

5.1 ELIGIBILITY. An Employee shall be deemed eligible for participation upon such Employee's first day of employment. Additionally, non-Employee Directors and Consultants and/or their representatives who are chosen from time to time at the sole discretion of the Company to receive one or more Awards are also eligible to participate in the Plan.

5.2 ACTUAL PARTICIPATION. Subject to the provisions of the Plan, the Committee will, from time to time, select those Employees, non-Employee Directors and Consultants to whom Awards will be granted, and will determine the nature and amount of each Award.

5.3 PERSONAL LEAVE STATUS.

(a) Notwithstanding anything in the Plan to the contrary, the Committee, in its sole discretion, reserves the right to designate a Participant's leave of absence as "Personal Leave." No Options shall be granted to a Participant during Personal Leave. A Participant's Unvested Options shall remain Unvested during such Personal Leave and the time spent on such Personal Leave shall not count towards the Vesting of such Options. A Participant's Vested Options that may be exercised pursuant to Section 6.6 hereof shall remain exercisable upon commencement of Personal Leave until the earlier of (i) a period of one year from the date of commencement of such Personal Leave; or (ii) the remaining exercise period of such Options. Notwithstanding the foregoing, if a Participant returns to the Company from a Personal Leave of less than one year and the Participant's Options have not lapsed, the Options shall remain exercisable for the remaining exercise period as provided at the time of grant and subject to the conditions contained herein.

(b) If the Participant leaves the employ of the Company within six (6) months' time of the date on which he or she returned from Personal Leave, the Fair Market Value figure used to calculate the purchase price of any Shares that the Company may choose to repurchase from that individual pursuant to Section 6.9(b) will be the lower of:
(i) the Fair Market Value of the underlying Shares as of the date the Participant commenced his or her Personal Leave, and (ii) the Fair Market Value of such Shares as of the date of that departure. Upon returning to the Company from Personal Leave, the Participant must complete six (6) months of Service before the Participant will be eligible to receive any other Awards under the Plan.

(c) The Committee, in its sole discretion, may waive or alter the provisions of this Section 5.3 with respect to any Participant. The waiver or alteration of such provisions with respect to any Participant shall have no effect on any other Participant.

ARTICLE 6. OPTIONS

6.1 GRANT OF OPTIONS. Subject to the terms and provisions of the Plan, Options may be granted to Employees, non-Employee Directors and Consultants in the number, and upon the terms, and at any time and from time to time, as determined by the Committee.

6.2 AWARD AGREEMENT. Each Option grant will be evidenced by an Award Agreement that specifies the Exercise Price, the duration of the Option, the number of Shares to which the Option pertains, the manner, time and rate of exercise or Vesting of the Option, and such other provisions as the Committee determines. The Award Agreement will also specify whether the Option is intended to be an ISO or an NQSO.

6.3 EXERCISE PRICE. The Exercise Price for each Share subject to an Option will be determined by the Committee; provided, however, that the exercise price of Incentive Stock Options shall in all cases be equal or greater to the Fair Market Value on the date the Option is granted.

6.4 DURATION OF OPTIONS. Each Option will expire at the time determined by the Committee at the time of grant, but no later than the tenth anniversary of the date of its grant.

6.5 DIVIDEND EQUIVALENTS. The Committee may, but will not be required to, grant payments in connection with Options that are equivalent to dividends declared and paid on the Shares underlying the Options. Such dividend equivalent payments may be made in cash or in Shares, upon such terms as the Committee, in its sole discretion, deems appropriate.

6.6 EXERCISE OF OPTIONS. Options will be exercisable at such times and be subject to such restrictions and conditions as the Committee in each instance approves, which need not be the same for each Award or for each Participant. Notwithstanding the foregoing, Vested Options granted under the Plan may be exercised to purchase Shares only upon the earlier of: (a) the date on which the Company completes an IPO; and (b) the date on which the Company undergoes a Change in Control. The only exception to this requirement that the Company first complete an IPO or undergo a Change in Control before the Participant can exercise his or her Vested Options is in those instances where the Participant's Service with the Company has terminated, as more specifically set forth in Section 6.10.

6.7 PAYMENT. The holder of an Option may exercise the Option only by delivering a written notice, or if permitted by the Committee, in its discretion and in accordance with procedures adopted by it, by delivering an electronic notice, of exercise to the Company setting forth the number of Shares as to which the Option is to be exercised, together with full payment at the Exercise Price for the Shares and any withholding tax relating to the exercise of the Option.

The Exercise Price and any related withholding taxes will be payable to the Company in full either: (a) in cash, or its equivalent, in United States dollars; (b) if permitted in the governing Award Agreement, by tendering Shares owned by the Participant for at least six months and duly endorsed for transfer to the Company, or Shares issuable to the Participant upon exercise of the Option; or (c) any combination of (a) and (b); or (d) by any other means the Committee determines to be consistent with the Plan's purposes and applicable law.

6.8 SPECIAL PROVISIONS FOR ISOS. Notwithstanding any other provision of this Article 6, the following special provisions shall apply to any Award of Incentive Stock Options:

(a) The Committee may award Incentive Stock Options only to Employees.

(b) An Option will not constitute an Incentive Stock Option under this Plan to the extent it would cause the aggregate Fair Market Value of Shares with respect to which Incentive Stock Options are exercisable by the Participant for the first time during a calendar year (under all plans of the Company and its Affiliates) to exceed $100,000. Such Fair Market Value shall be determined as of the date on which each such Incentive Stock Option is granted.

(c) If the Employee to whom the Incentive Stock Option is granted owns stock possessing more than ten (10%) percent of the total combined voting power of all classes of the Company or any Affiliate, then: (i) the exercise Price for each Share subject to an Option will be at least one hundred ten percent (110%) of the Fair Market Value of the Share on the Effective Date of the Award; and (ii) the

Option will expire upon the earlier of (A) the time specified by the Committee in the Award Agreement, or (B) the fifth anniversary of the date of grant.

(d) No Option that is intended to be an Incentive Stock Option may be granted under the Plan until the Company's shareholders approve the Plan. If such shareholder approval is not obtained within 12 months after the Board's adoption of the Plan, then no Options may be granted under the Plan that are intended to be Incentive Stock Options. No Option that is intended to be an Incentive Stock Option may be granted under the Plan after the tenth anniversary of the date the Company adopted the Plan or the Company's shareholders approved the Plan, whichever is earlier.

(e) An Incentive Stock Option must be exercised, if at all, by the earliest of (i) the time specified in the Award Agreement, (ii) three months after the Participant's termination of Service for a reason other than death or Disability, or (iii) twelve months after the Participant's termination of Service for death or Disability.

6.9 RESTRICTIONS ON SHARE TRANSFERABILITY.

(a) The Committee may impose such restrictions on any Shares acquired through exercise of an Option as it deems necessary or advisable, including, without limitation, restrictions under applicable federal securities laws, under the requirements of any stock exchange or market upon which the Shares are then listed or traded, and under any blue sky or state securities laws applicable to the Shares.

(b) No person (the "Seller") may sell, assign or otherwise transfer or dispose of all or any part of his or her Shares acquired pursuant to an exercised Option under the Plan except to the Company. In the event the Seller desires to sell his or her Shares to the Company, the Seller shall give the Company notice of the desired transfer and the Company shall have the right, but not the obligation, anytime within thirty (30) days after the receipt of such notice, to purchase the Shares proposed for transfer at their Fair Market Value as of the date the Seller provides written notice to the Company of the desired transfer. Any payment of the purchase price, along with applicable interest thereon, may be made by the Company over a period of up to five (5) years and shall be subject to any additional limitations and/or restrictions that the Company may choose to impose at that time.

The rights and obligations of the Seller and the Company, as set forth in this Section 6.9(b), shall terminate on the earlier of (i) the date on which the Company completes an IPO; and (ii) the date on which the Company undergoes a Change in Control.

6.10 TERMINATION OF SERVICE. Unless the applicable Award Agreement provides otherwise and subject to Section 6.8(e):

(a) In the event that the Service of a Participant is terminated by the Company for any reason other than Cause, Disability or death, Options that are exercisable at the time of such termination shall remain exercisable until the earlier of (i) the remaining exercise period or (ii) one year from the date of such Service termination. Options that are not exercisable at the time of such termination of Service shall expire at the close of business on the date of such termination.

(b) In the event that the Service of a Participant with the Company terminates on account of the Disability or death of the Participant, Options that are exercisable at the time of such termination shall remain exercisable until the expiration of the term of the Option. Options that are not exercisable at the time of such termination shall expire at the close of business on the date of such termination.

(c) In the event of termination of a Participant's Service for Cause, all outstanding Options granted to such Participant shall expire as of the commencement of business on the date of such termination.

(d) In the event of a Participant's termination of Service for any reason other than those described in subsections (a), (b) and (c) of this Section 6.10, Options that are exercisable at the time of such termination shall remain exercisable until the earlier of (i) the remaining exercise period or (ii) 30 days from the date of such termination. Options that are not exercisable at the time of such termination shall expire at the close of business on the date of such termination.

(e) Notwithstanding the foregoing, prior to the date of any IPO, the Company may, in its sole discretion, cancel the portion of any outstanding Option that is Vested as of the date of a Participant's termination of Service in return for a payment to the Participant. In such instance, the amount of money to which the Participant will be entitled will be equivalent to the difference between the Fair Market Value of the underlying Shares (as of the date of termination or as otherwise provided herein) and the Option Price on those Shares multiplied by the number of such Options cancelled. In the event of such a pay out, the Committee may, in its sole discretion, make such payment in installments over a period of up to five (5) years' time and may impose such additional limitations or restrictions that the Company otherwise deems appropriate. If payment is made in installments, the outstanding balance of the value of the Vested Options to be paid to the Participant shall earn interest (at the Company's expense) at a rate determined by the Committee.

Each Option Award Agreement will set forth the extent to which the Participant has the right to exercise the Option after his or her termination of Service. These terms will be determined by the Committee in its sole discretion, need not be uniform among all Options, and may reflect, among other things, distinctions based on the reasons for termination of Service. However, notwithstanding any other provision herein to the contrary, no additional Options will Vest after a Participant's Service ceases or has terminated for any reason, whether such cessation or termination is lawful or unlawful.

ARTICLE 7. STOCK APPRECIATION RIGHTS

7.1 GRANT OF SARS. Subject to the terms and conditions of the Plan, SARs may be granted to Participants at any time and from time to time, as determined by the Committee. The Committee may grant Freestanding SARs, Tandem SARs or any combination of the two, as specified in the Award Agreement.

Within the limits of Article 4, the Committee will have sole discretion to determine the number of SARs granted to each Participant and, consistent with the provisions of the Plan, to determine the terms and conditions pertaining to SARs.

The grant price for any SAR shall be determined by the Committee, but in the case of a Tandem SAR, the grant price shall not be less than the exercise price of the Option to which it relates.

7.2 EXERCISE OF TANDEM SARS. Tandem SARs may be exercised for all or part of the Shares subject to the related Option, upon the surrender of the right to exercise the equivalent portion of the related Option. A Tandem SAR may be exercised only with respect to the Shares for which its related Option is then exercisable.

7.3 EXERCISE OF FREESTANDING SARS. Freestanding SARs may be exercised upon whatever terms and conditions the Committee, in its sole discretion, imposes.

7.4 AWARD AGREEMENT. Each SAR grant will be evidenced by an Award Agreement that specifies the grant price, whether settlement of the SAR will be made in cash or in Shares, the term of the SAR and such other provisions as the Committee determines.

7.5 TERM OF SARS. The term of a SAR will be determined by the Committee, in its sole discretion, but may not exceed ten years.

7.6 PAYMENT OF SAR AMOUNT. Upon exercise of a SAR with respect to a Share, a Participant will be entitled to receive an amount equal to the excess, if any, of the Fair Market Value on the date of exercise of the SAR over the grant price specified in the Award Agreement. At the discretion of the Committee, the payment that may become due upon SAR exercise may be made in cash, in Shares or in some combination of the two.

7.7 TERMINATION OF SERVICE. Each SAR Award Agreement will set forth the extent to which the Participant has the right to exercise the SAR after his or her termination of Service. These terms will be determined by the Committee, in its sole discretion, need not be uniform among all SARs issued under the Plan, and may reflect, among other things, distinctions based on the reasons for termination of Service.

ARTICLE 8. RESTRICTED STOCK AND RESTRICTED STOCK UNITS

8.1 GRANT OF RESTRICTED STOCK OR RESTRICTED STOCK UNITS. Subject to the terms and provisions of the Plan, the Committee may, at any time and from time to time, grant Restricted Stock or Restricted Stock Units to Participants in such amounts as it determines.

8.2 DEFERRAL OF COMPENSATION INTO RESTRICTED STOCK UNITS. Subject to the terms and provisions of the Plan, the Committee may, at any time and from time to time, allow (or require, as to bonuses) selected Employees and Directors to defer the payment of any portion of their salary or bonuses or both pursuant to this section. A Participant's deferral under this section will be credited to the Participant in the form of Shares of Restricted Stock Units. The Committee will establish rules and procedures for the deferrals, as it deems appropriate.

If a Participant's compensation is deferred under this Section 8.2, he or she will be credited, as of the date specified in the Award Agreement, with a number of Restricted Stock Units no less than the amount of the deferral divided by the Fair Market Value on that date, rounded to the nearest whole unit.

8.3 AWARD AGREEMENT. Each grant of Restricted Stock or Restricted Stock Units will be evidenced by an Award Agreement that specifies the Restriction Periods, the number of Shares or Share equivalent units granted, and such other provisions as the Committee determines.

8.4 OTHER RESTRICTIONS. Subject to Article 11, the Committee may impose such other conditions or restrictions on any Restricted Stock or Restricted Stock Units as it deems advisable, including, without limitation, restrictions based upon the achievement of specific performance objectives (Company-wide, business unit, individual, or any combination of them), time-based restrictions on vesting, and restrictions under applicable federal or state securities laws. The Committee may provide that restrictions established under this Section 8.4 as to any given Award will lapse all at once or in installments.

The Company will retain the certificates representing Shares of Restricted Stock in its possession until all conditions and restrictions applicable to the Shares have been satisfied.

8.5 PAYMENT OF AWARDS. Except as otherwise provided in this Article 8, Shares covered by each Restricted Stock grant will become freely transferable by the Participant after the last day of the applicable Restriction Period, and Share equivalent units covered by a Restricted Unit will be paid out in cash or Shares to the Participant following the last day of the applicable Restriction Period, or on the date provided in the Award Agreement.

8.6 VOTING RIGHTS. During the Restriction Period, Participants holding Shares of Restricted Stock may exercise full voting rights with respect to those Shares.

8.7 DIVIDENDS AND OTHER DISTRIBUTIONS. During the Restriction Period, Participants awarded Shares of Restricted Stock or Restricted Stock Units hereunder will be credited with regular cash dividends or dividend equivalents paid on those Shares or with respect to those Share equivalent units. Dividends may be paid currently, accrued as contingent cash obligations, or converted into additional Shares of Restricted Stock or Restricted Stock Units upon such terms as the Committee establishes.

The Committee may apply any restrictions it deems advisable to the crediting and payment of dividends and other distributions. Without limiting the generality of the preceding sentence, if the grant or vesting of Restricted Stock is designed to qualify for the Performance-Based Exception, the Committee may apply any restrictions it deems appropriate to the payment of dividends declared with respect to the Restricted Stock, so that the dividends and the Restricted Stock continue to be eligible for the Performance-Based Exception.

8.8 TERMINATION OF SERVICE. Each Award Agreement will set forth the extent to which the Participant has the right to retain unvested Restricted Stock or Restricted Stock Units after his or her termination of Service. These terms will be determined by the Committee in its sole discretion, need not be uniform among all Awards of Restricted Stock, and may reflect, among other things, distinctions based on the reasons for termination of Service.

ARTICLE 9. PERFORMANCE SHARES

9.1 GRANT OF PERFORMANCE SHARES. Subject to the terms of the Plan, Performance Shares may be granted to Participants in such amounts and upon such terms, and at any time and from time to time, as the Committee determines. The Award of Performance Shares may be based on the Participant's attainment of performance objectives, or the vesting of an Award of Performance Shares may be based on the Participant's attainment of performance objectives, each as described in this Article 9.

9.2 VALUE OF PERFORMANCE SHARES. Each Performance Share will have an initial value equal to the Fair Market Value on the date of grant. The Committee will set performance objectives in its discretion which, depending on the extent to which they are met, will determine the number or value (or both) of Performance Shares that will be paid out to the Participant. For purposes of this Article 9, the time period during which the performance objectives must be met will be called a "Performance Period" and will be set by the Committee in its discretion.

9.3 EARNING OF PERFORMANCE SHARES. Subject to the terms of this Plan, after the applicable Performance Period has ended, the holder of Performance Shares will be entitled to receive payout on the number and value of Performance Shares earned by the Participant over the Performance Period, to be determined as a function of the extent to which the corresponding performance objectives have been achieved.

9.4 AWARD AGREEMENT. Each grant of Performance Shares will be evidenced by an Award Agreement specifying the material terms and conditions of the Award (including the form of payment of earned Performance Shares), and such other provisions as the Committee determines.

9.5 FORM AND TIMING OF PAYMENT OF PERFORMANCE SHARES. Except as provided in Article 12, payment of earned Performance Shares will be made as soon as practicable after the close of the applicable Performance Period, in a manner determined by the Committee in its sole discretion. The Committee will pay earned Performance Shares in the form of cash, in Shares, or in a combination of cash and Shares, as specified in the Award Agreement. Performance Shares may be paid subject to any restrictions deemed appropriate by the Committee.

9.6 TERMINATION OF SERVICE. Each Award Agreement will set forth the extent to which the Participant has the right to retain Performance Shares after his or her termination of Service. These terms will be determined by the Committee, in its sole discretion, need not be uniform among all Awards of Performance Shares, and may reflect, among other things, distinctions based on the reasons for termination of Service.

ARTICLE 10. PERFORMANCE MEASURES

Unless and until the Committee proposes and the Company's shareholders approve a change in the general performance measures set forth in this Article 10, the performance measure(s) to be used for purposes of Awards designed to qualify for the Performance-Based Exception will be chosen from among the following alternatives (or in any combination of such alternatives):

(a) net earnings;
(b) operating earnings or income;
(c) earnings growth;
(d) net income (absolute or competitive growth rates comparative);
(e) net income applicable to Shares;
(f) cash flow, including operating cash flow, free cash flow, discounted cash flow return on investment, and cash flow in excess of cost of capital;
(g) earnings per Share;
(h) return on shareholders' equity (absolute or peer-group comparative);
(i) stock price (absolute or peer-group comparative);
(j) absolute and/or relative return on common shareholders' equity;
(k) absolute and/or relative return on capital;
(l) absolute and/or relative return on assets;
(m) economic value added (income in excess of cost of capital);
(n) customer satisfaction;
(o) expense reduction;
(p) ratio of operating expenses to operating revenues;
(q) gross revenue or revenue by pre-defined business segment (absolute or competitive growth rates comparative);
(r) revenue backlog; and
(s) margins realized on delivered services.

The Committee will have the discretion to adjust targets set for preestablished performance objectives; however, Awards designed to qualify for the Performance-Based Exception may not be adjusted upward, except to the extent permitted under Code Section 162(m), to reflect accounting changes or other events.

If Code Section 162(m) or other applicable tax or securities laws change to allow the Committee discretion to change the types of performance measures without obtaining shareholder approval, the Committee will have sole discretion to make such changes without obtaining shareholder approval. In addition, if the Committee determines it is advisable to grant

Awards that will not qualify for the Performance-Based Exception, the Committee may grant Awards that do not so qualify.

ARTICLE 11. BENEFICIARY DESIGNATION

Each Participant may, from time to time, name any beneficiary or beneficiaries (who may be named contingently or successively) to whom any benefit under the Plan is to be paid in case the Participant should die before receiving any or all of his or her Plan benefits. Each beneficiary designation will revoke all prior designations by the same Participant, must be in a form prescribed by the Committee, and must be made during the Participant's lifetime. If the Participant's designated beneficiary predeceases the Participant or no beneficiary has been designated, benefits remaining unpaid at the Participant's death will be paid to the Participant's estate or other entity described in the Participant's Award Agreement.

ARTICLE 12. DEFERRALS

The Committee may permit or require a Participant to defer receipt of cash or Shares that would otherwise be due to him or her by virtue of an Option or SAR exercise, the lapse or waiver of restrictions on Restricted Stock, or the satisfaction of any requirements or objectives with respect to Performance Shares. If any such deferral election is permitted or required, the Committee will, in its sole discretion, establish rules and procedures for such deferrals. Notwithstanding the foregoing, the Committee in its sole discretion may defer payment of cash or the delivery of Shares that would otherwise be due to a Participant under the Plan if payment or delivery would result in the Company's or an Affiliate's being unable to deduct compensation under Code Section 162(m). Deferral of payment or delivery by the Committee may continue until the Company or Affiliate is able to deduct the payment or delivery under the Code.

ARTICLE 13. RIGHTS OF PARTICIPANTS

13.1 EMPLOYMENT AND SERVICE. Nothing in the Plan will confer upon any Participant any right to continue in the employ of the Company or any Affiliate, or interfere with or limit in any way the right of the Company or any Affiliate to terminate any Participant's employment or Service at any time.

13.2 PARTICIPATION. No Employee, Consultant or Director will have the right to receive an Award under this Plan, or, having received any Award, to receive a future Award.

ARTICLE 14. AMENDMENT, MODIFICATION AND TERMINATION

14.1 AMENDMENT, MODIFICATION AND TERMINATION. The Committee may at any time and from time to time, alter, amend, modify or terminate the Plan in whole or in part. The Committee will not, however, increase the number of Shares that may be issued or transferred to Participants under the Plan, as described in the first sentence of Section 4.1 (and subject to adjustment as provided in Sections 4.2 and 4.3).

Subject to the terms and conditions of the Plan, the Committee may modify, extend or renew outstanding Awards under the Plan, or accept the surrender of outstanding Awards (to the extent not already exercised) and grant new Awards in substitution of them (to the extent not already exercised). The Committee will not, however, modify any outstanding Option so as to specify a lower Exercise Price, without the approval of the Company's shareholders. Notwithstanding the foregoing, no modification of an Award will materially alter or impair any rights or obligations under any Award already granted under the Plan, without the prior written consent of the Participant.

14.2 ADJUSTMENT OF AWARDS UPON THE OCCURRENCE OF CERTAIN UNUSUAL OR NONRECURRING EVENTS. In recognition of unusual or nonrecurring events
(including, without limitation, the events described in Section 4.3) affecting the Company or its financial statements, or in recognition of changes in applicable laws, regulations, or accounting principles, and, whenever the Committee determines that adjustments are appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan, the Committee may, using reasonable care, make adjustments in the terms and conditions of, and the criteria included in, Awards. In case of an Award designed to qualify for the Performance-Based Exception, the Committee will take care not to make an adjustment that would disqualify the Award.

14.3 AWARDS PREVIOUSLY GRANTED. No termination, amendment or modification of the Plan will adversely affect in any material way any Award already granted, without the written consent of the Participant who holds the Award.

14.4 COMPLIANCE WITH CODE SECTION 162(M). Awards will comply with the requirements of Code Section 162(m), unless the Committee determines that such compliance is not desired with respect to an Award available for grant under the Plan. In addition, if changes are made to Code Section 162(m) to permit greater flexibility as to any Award available under the Plan, the Committee may, subject to this Article 14, make any adjustments it deems appropriate.

ARTICLE 15. NONTRANSFERABILITY OF AWARDS.

Except as otherwise provided in a Participant's Award Agreement, no Option, SAR, Performance Share, Restricted Stock, or Restricted Stock Unit granted under the Plan may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution, or pursuant to a domestic relations order (as defined in Code Section 414(p)). All rights with respect to Performance Shares, Restricted Stock and Restricted Stock Units will be available during the Participant's lifetime only to the Participant or his or her guardian or legal representative. Except as otherwise provided in a Participant's Award Agreement or in paragraph (a) below, all Options and SARs will be exercisable during the Participant's lifetime only by the Participant or his or her guardian or legal representative. The Participant's beneficiary may exercise the Participant's rights to the extent they are exercisable under the Plan following the Participant's death. The Committee may, in its discretion, require a Participant's guardian, legal representative or beneficiary to supply it with the evidence the Committee deems necessary to establish the authority of the guardian, legal representative or beneficiary to act on behalf of the Participant.

(a) Notwithstanding the foregoing, with respect to any Nonstatutory Stock Options, each Participant shall be permitted at all times to transfer any or all of the Options, or, in the event the Options have not yet been issued to the Participant, the Company shall be permitted to issue any or all of the Options, to certain trusts designated by the Participant as long as such transfer or issuance is made as a gift (I.E., a transfer for no consideration, with donative intent), whether during lifetime or to take effect upon (or as a consequence of) his or her death, to his or her spouse or children. Gifts in trust shall be deemed gifts to every beneficiary and contingent beneficiary, and so shall not be permitted under this paragraph (a) if the beneficiaries or contingent beneficiaries shall include anyone other than such spouse or children. Transfers to a spouse or child for consideration, regardless of the amount, shall not be permitted under this Section.

(b) Any Options issued or transferred under this Article 15 shall be subject to all terms and conditions contained in the Plan and the applicable Award Agreement. If the Committee makes an Option transferable, such Option shall contain such additional terms and conditions, as the Committee deems appropriate.

ARTICLE 16. WITHHOLDING

16.1 TAX WITHHOLDING. The Company will have the power and the right to deduct or withhold, or require a Participant to remit to the Company, the minimum amount necessary to satisfy federal, state, and local taxes, domestic or foreign, required by law or regulation to be withheld with respect to any taxable event arising under this Plan.

16.2 SHARE WITHHOLDING. With respect to withholding required upon the exercise of Options or SARs, upon the lapse of restrictions on Restricted Stock, or upon any other taxable event arising as a result of Awards granted hereunder, the Company may satisfy the minimum withholding requirement for supplemental wages, in whole or in part, by withholding Shares having a Fair Market Value (determined on the date the Participant recognizes taxable income on the Award) equal to the minimum withholding tax required to be collected on the transaction. The Participant may elect, subject to the approval of the Committee, to deliver the necessary funds to satisfy the withholding obligation to the Company, in which case there will be no reduction in the Shares otherwise distributable to the Participant.

ARTICLE 17. INDEMNIFICATION

Each person who is or has been a member of the Committee or the Board, and any officer or Employee to whom the Committee has delegated authority under Section 3.1 or 3.2 of the Plan, will be indemnified and held harmless by the Company from and against any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by him or her in connection with or as a result of any claim, action, suit or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action taken, or failure to act, under the Plan. Each such person will also be indemnified and held harmless by the Company from and against any and all amounts paid by him or her in a settlement approved by the Company, or paid by him or her in satisfaction of any judgment, of or in a claim, action, suit or proceeding against him or her and described in the previous sentence, so long as he or she gives the Company an opportunity, at its own expense, to handle and defend the claim, action, suit or proceeding before he or she undertakes to handle and defend it. The foregoing right of indemnification will not be exclusive of any other rights of indemnification to which a person who is or has been a member of the Committee or the Board may be entitled under the

Company's Articles of Incorporation or By-Laws, as a matter of law, or otherwise, or any power that the Company may have to indemnify him or her or hold him or her harmless.

ARTICLE 18. SUCCESSORS

All obligations of the Company under the Plan or any Award Agreement will be binding on any successor to the Company, whether the existence of the successor results from a direct or indirect purchase of all or substantially all of the business or assets of the Company or both, or a merger, consolidation, or otherwise.

ARTICLE 19. BREACH OF RESTRICTIVE COVENANTS

An Award Agreement may provide that, notwithstanding any other provision of this Plan to the contrary, if the Participant breaches any competition, nonsolicitation or nondisclosure provisions contained in the Award Agreement, whether during or after termination of Service, the Participant will forfeit:

(a) any and all Awards granted or transferred to him or her under the Plan, including Awards that have become Vested; and

(b) the profit the Participant has realized on the exercise of any Options, which is the difference between the Exercise Price of the Options and the applicable Fair Market Value of the Shares (the Participant may be required to repay such difference to the Company).

ARTICLE 20. LEGAL CONSTRUCTION

20.1 NUMBER. Except where otherwise indicated by the context, any plural term used in this Plan includes the singular and a singular term includes the plural.

20.2 SEVERABILITY. If any provision of the Plan is held illegal or invalid for any reason, the illegality or invalidity will not affect the remaining parts of the Plan, and the Plan will be construed and enforced as if the illegal or invalid provision had not been included.

20.3 REQUIREMENTS OF LAW. The granting of Awards and the issuance of Share or cash payouts under the Plan will be subject to all applicable laws, rules, and regulations, and to any approvals by governmental agencies or national securities exchanges as may be required.

20.4 SECURITIES LAW COMPLIANCE. As to any individual who is, on the relevant date, an officer, director or ten percent beneficial owner of any class of the Company's equity securities that is registered pursuant to
Section 12 of the Exchange Act, all as defined under Section 16 of the Exchange Act, transactions under this Plan are intended to comply with all applicable conditions of Rule 16b-3 under the Exchange Act, or any successor rule. To the extent any provision of the Plan or action by the Committee fails to so comply, it will be deemed null and void, to the extent permitted by law and deemed advisable by the Committee.

If at any time the Committee determines that exercising an Option or SAR or issuing Shares pursuant to an Award would violate applicable securities laws, the Option or SAR will not be exercisable, and the Company will not be required to issue Shares. The Company may require a Participant to make written representations it deems necessary or desirable to comply with applicable securities laws. No person who acquires Shares under the Plan may sell the

Shares, unless he or she makes the offer and sale pursuant to an effective registration statement under the Exchange Act, which is current and includes the Shares to be sold, or an exemption from the registration requirements of the Exchange Act.

20.5 AWARDS TO FOREIGN NATIONALS AND EMPLOYEES OUTSIDE THE UNITED STATES. To the extent the Committee deems it necessary, appropriate or desirable to comply with foreign law or practice and to further the purposes of this Plan, the Committee may, without amending the Plan, (i) establish rules applicable to Awards granted to Participants who are foreign nationals or are employed outside the United States, or both, including rules that differ from those set forth in this Plan, and (ii) grant Awards to such Participants in accordance with those rules. Appendix A to this Plan contains special provisions applicable to foreign nationals and employees outside the United States.

20.6 UNFUNDED STATUS OF THE PLAN. The Plan is intended to constitute an "unfunded" plan for incentive and deferred compensation. With respect to any payments or deliveries of Shares not yet made to a Participant by the Company, the Participant's rights are no greater than those of a general creditor of the Company. The Committee may authorize the establishment of trusts or other arrangements to meet the obligations created under the Plan, so long as the arrangement does not cause the Plan to lose its legal status as an unfunded plan.

20.7 GOVERNING LAW. To the extent not preempted by federal law, the Plan and all agreements hereunder will be construed in accordance with and governed by the laws of the State of Illinois.

20.8 NO LIMITATION ON RIGHTS OF THE COMPANY. The grant of the Award does not and will not in any way affect the right or power of the Company to make adjustments, reclassifications or changes in its capital or business structure, or to merge, consolidate, dissolve, liquidate, sell or transfer all or any part of its business or assets.

20.9 PARTICIPANT TO HAVE NO RIGHTS AS A SHAREHOLDER. Before the date as of which he or she is recorded on the books of the Company as the holder of any Shares underlying an Award, a Participant will have no rights as a shareholder with respect to those Shares.

APPENDIX A

SPECIAL PROVISIONS APPLICABLE TO FOREIGN NATIONALS AND EMPLOYEES OUTSIDE OF THE UNITED STATES

The following special provisions apply to Awards to Employees who are foreign nationals or are employed outside of the United States, or both. In addition to these special provisions and in accordance with Section 20.5, to the extent the Committee deems it necessary, appropriate or desirable to comply with foreign law or practice and to further the purposes of the Plan, the Committee may, without amending the Plan, (i) establish rules applicable to Awards granted to Participants who are foreign nationals or are employed outside the United States, or both, including rules that differ from those set forth in this Plan, and (ii) grant Awards to such Participants in accordance with those rules.

1. With respect to Options issued in Canada:

in addition to any restrictions on resale and transfer in the Plan, Shares purchased under the Plan may be subject to certain restrictions on resale imposed by Canadian provincial securities laws. Participants will be encouraged to seek legal advice prior to any resale of such Shares. In general, Participants resident in Canada may not resell their Shares to purchasers within Canada; and

personal information collected from Participants in furtherance of their participation in the Plan will be used and disclosed to an Option plan administrator for the purposes of managing and administering the Plan and communicating with Participants.

2. With respect to Options issued in France:

the benefits under the Plan and the Plan itself are for a specified, limited duration and future benefits or plans are subject to the sole discretion of the Company; and

notwithstanding any other provision of this Plan, a minimum four-year Vesting period will apply to any Options for which the Company seeks tax-advantaged treatment.

3. With respect to Options issued in Italy, the terms of the Plan may be amended as specified in the Award Agreement, the terms of which shall, to the extent they may be in contrast to the terms of the Plan, and for such purposes, prevail.

4. With respect to Options issued in the Netherlands, the term "Company" shall include both Morningstar, Inc. and Morningstar, Inc.'s Dutch subsidiary for purposes of Article 16 of the Plan.

5. With respect to Options issued in Spain, all beneficiaries shall be bound by the terms of the Plan and any applicable restrictions on the transfer of Shares under the Plan.

6. With respect to Options issued in the U.K., where (i) a mechanism for collecting tax from a Participant's salary is in place; (ii) the salary of the Participant is insufficient to satisfy such tax; and
(iii) the Participant has not otherwise remitted to the Company an amount of funds sufficient to satisfy such tax, the Company may satisfy the withholding requirement, in whole or in part, by withholding Shares having a Fair Market Value (determined in accordance with Section 16.2 of the Plan) equal to the minimum withholding tax required to be collected on the transaction.

EXHIBIT 21.1

SUBSIDIARIES OF THE REGISTRANT

SUBSIDIARIES	JURISDICTION OF INCORPORATION
Morningstar Research Pty Limited (Morningstar Australia)	Australia
Morningstar Research Limited (Morningstar New Zealand)	New Zealand
Morningstar Limited	Australia
Morningstar Korea, Ltd.(1)	Korea
Morningstar Asia, Ltd.	Hong Kong
Morningstar Research (Shenzhen) Ltd.	Hong Kong
Morningstar Japan, K.K.(2)	Japan
Morningstar Investment Services, Inc.	Delaware
Morningstar Canada Group, Inc.	Canada
Morningstar Research, Inc.	Canada
Morningstar Associates, Inc.	Canada
R.S. Bell & Associates, Inc.	Canada
BellCharts, Inc.	Canada
Morningstar Associates, LLC	Delaware
mPower.com, Inc.	Delaware
mPower Advisors, LLC	Delaware
Morningstar Europe, N.V.(3)	The Netherlands
Morningstar Europe, A.B.(4)	Sweden
Morningstar Europe, Ltd.(4)	United Kingdom
Morningstar U.K., Ltd.(4)	United Kingdom
Morningstar Holland, B.V.(4)	The Netherlands
Morningstar Italy, S.R.L.(4)	Italy
SAS Morningstar France(4)	France
Morningstar Norge AS(4)	Norway
Morningstar Deutschland GmbH(5)	Germany
Morningstar Network, S.L.(5)	Spain
Fund Info Center Europe, AB(6)	Sweden
Morningstar Portugal Unipessoal LDA(4)	Portugal
Morningstar Sweden (Fondstar) AB(7)	Sweden
Morningstar Danmark A/S(7)	Denmark

(1) Morningstar, Inc. owns 40%.
(2) Morningstar, Inc. owns approximately 35%.
(3) Morningstar, Inc. owns approximately 98%.
(4) Morningstar Europe, N.V. owns 100%.
(5) Morningstar Holland, B.V. owns 100%.
(6) Morningstar Europe, A.B. owns 100%.
(7) Morningstar Europe, N.V. owns approximately 25%.

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the use in this Amendment No. 1 to Registration Statement of Morningstar, Inc. ("the Company") on Form S-1 of our report dated April 30, 2004 (January 25, 2005 as to Note 16) related to the consolidated financial statements of the Company as of December 31, 2002 and 2003 and for each of the three years in the period ended December 31, 2003, (which report expresses an unqualified opinion and includes explanatory paragraphs as to the Company's change in its method of accounting for goodwill and intangible assets and the effects of the restatement of its consolidated financial statements discussed in Note 16) appearing in the Prospectus, which is part of this Registration Statement, and of our report dated April 30, 2004 relating to the financial statement schedules appearing elsewhere in this Registration Statement.

We also consent to the reference to us under the heading "Experts" in such Prospectus.

DELOITTE & TOUCHE LLP

/s/ Deloitte & Touche LLP

Chicago, Illinois
February 2, 2005

EXHIBIT 23.2

INDEPENDENT AUDITORS' CONSENT

We consent to the use in this Amendment No. 1 to Registration Statement of Morningstar, Inc. on Form S-1 of our report dated April 1, 2004 (January 31, 2005 as to Note 13) related to the consolidated financial statements of mPower.com, Inc. ("mPower") as of December 31, 2001 and 2002 and for each of the two years in the period ended December 31, 2002, (which report expresses an unqualified opinion and includes explanatory paragraphs as to mPower's change in its method of accounting for goodwill and intangible assets and the effects of the restatement of its consolidated financial statements discussed in Note 13) appearing in the Prospectus, which is part of this Registration Statement and of our report dated April 1, 2004 relating to the financial statement schedule appearing elsewhere in the Registration Statement.

We also consent to the reference to us under the heading "Experts" in such Prospectus.

DELOITTE & TOUCHE LLP

/s/ Deloitte & Touche LLP

Chicago, Illinois
February 2, 2005