Morningstar, Inc.
Form 10-Q
November 04, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

OR

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

For the transition period from to

Commission File Number: 000-51280

MORNINGSTAR, INC.

(Exact Name of Registrant as Specified in its Charter)

Illinois (State or Other Jurisdiction of Incorporation or Organization)	**36-3297908** (I.R.S. Employer Identification Number)

225 West Wacker Drive

Chicago, Illinois

60606-6303

(Address of Principal Executive Offices)

(312) 696-6000

(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of October 31, 2008, there were 46,774,802 shares of the Company s common stock, no par value, outstanding.

Table of Contents

MORNINGSTAR, INC. AND SUBSIDIARIES

INDEX

Table of Contents

PART 1: FINANCIAL INFORMATION

Item 1: Unaudited Condensed Consolidated Financial Statements

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Income

	Three Months Ended September 30		Nine Months Ended September 30	
(in thousands except per share amounts)	**2008**	**2007**	**2008**	**2007**
Revenue	$ 125,505	$ 111,859	$ 383,186	$ 316,991
Operating expense (1):				
Cost of goods sold	32,828	28,674	98, 930	83,549
Development	10,271	9,010	30,187	26,199
Sales and marketing	19,457	17,132	62,547	50,332
General and administrative	22,507	19,936	62,392	57,150
Depreciation and amortization	6,266	5,662	18,699	15,843
Total operating expense	91,329	80,414	272,755	233,073
Operating income	34,176	31,445	110,431	83,918
Non-operating income (expense):				
Interest income, net	1,568	1,812	4,468	4,998
Other income (expense), net	(278)	408	(575)	103
Non-operating income, net	1,290	2,220	3,893	5,101
Income before income taxes and equity in net income of unconsolidated entities	35,466	33,665	114,324	89,019
Income tax expense	13,547	14,229	42,127	36,516
Equity in net income of unconsolidated entities	268	417	1,065	1,409
Net income	$ 22,187	$ 19,853	$ 73,262	$ 53,912
Net income per share:				
Basic	$ 0.48	$ 0.46	$ 1.60	$ 1.26
Diluted	$ 0.45	$ 0.41	$ 1.49	$ 1.13
Weighted average shares outstanding:				
Basic	46,499	43,393	45,883	42,889
Diluted	49,421	48,232	49,221	47,919

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	**2007**	**2008**	**2007**
(1) Includes stock-based compensation expense of:				

Cost of goods sold	$	547	$	408	$	1,511	$	1,259
Development		359		302		1,047		926
Sales and marketing		366		327		1,090		1,038
General and administrative		1,546		1,560		4,883		4,911
Total stock-based compensation expense	$	2,818	$	2,597	$	8,531	$	8,134

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(in thousands except share amounts)	September 30 2008	December 31 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 233,615	$ 159,576
Investments	76,005	99,012
Accounts receivable, less allowance of $367 and $161, respectively	90,567	86,812
Income tax receivable	3,586	8,998
Other	15,677	13,163
Total current assets	419,450	367,561
Property, equipment, and capitalized software, net of accumulated depreciation of $67,293 and $57,304, respectively	52,291	19,108
Investments in unconsolidated entities	20,330	19,855
Goodwill	166,147	128,141
Intangible assets, net	103,211	95,767
Deferred tax asset, net	9,391	15,658
Other assets	3,930	3,217
Total assets	$ 774,750	$ 649,307
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 32,114	$ 22,325
Accrued compensation	56,012	64,709
Deferred revenue	130,353	129,302
Deferred tax liability, net	52	557
Other	119	945
Total current liabilities	218,650	217,838
Accrued compensation	10,852	13,913
Other long-term liabilities	19,841	9,253
Total liabilities	249,343	241,004
Shareholders equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 46,702,161 and 44,843,166 shares were outstanding as of September 30, 2008 and December 31, 2007, respectively	4	4
Treasury stock at cost, 233,332 shares at September 30, 2008 and December 31, 2007	(3,280)	(3,280)
Additional paid-in capital	380,020	332,164
Retained earnings	145,019	71,757
Accumulated other comprehensive income:		
Currency translation adjustment	3,751	7,606
Unrealized gains (losses) on available-for-sale investments	(107)	52
Total accumulated other comprehensive income	3,644	7,658
Total shareholders equity	525,407	408,303
Total liabilities and shareholders equity	$ 774,750	$ 649,307

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statement of Shareholders Equity and Comprehensive Income

For the Nine Months Ended September 30, 2008

(in thousands, except share amounts)	Common Stock Shares Outstanding	Par Value	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders Equity
Balance as of December 31, 2007	44,843,166	$ 4	$ (3,280)	$ 332,164	$ 71,757	$ 7,658	$ 408,303
Comprehensive income:							
Net income					73,262		73,262
Unrealized loss on investments, net of income tax ($99)						(159)	(159)
Foreign currency translation adjustment						(3,855)	(3,855)
Total comprehensive income					73,262	(4,014)	69,248
Issuance of common stock upon stock option exercises and vesting of restricted stock units, net	1,858,995			17,282			17,282
Stock-based compensation				8,531			8,531
Tax benefit derived from stock option exercises and vesting of restricted stock units				22,043			22,043
Balance as of September 30, 2008	46,702,161	$ 4	$ (3,280)	$ 380,020	$ 145,019	$ 3,644	$ 525,407

See notes to unaudited condensed consolidated financial statements.

Table of Contents

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)	Nine Months Ended September 30 2008	2007
Operating activities		
Net income	$ 73,262	$ 53,912
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	18,699	15,843
Deferred income tax expense	1,282	436
Stock-based compensation expense	8,531	8,134
Provision for (recovery of) bad debt	27	(9)
Equity in net income of unconsolidated entities	(1,065)	(1,409)
Foreign exchange (gain) loss	(206)	83
Excess tax benefits from stock option exercises and vesting of restricted stock units	(22,043)	(13,275)
Other, net	(240)	(186)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(179)	(6,978)
Other assets	(3,460)	(141)
Accounts payable and accrued liabilities	1,428	698
Accrued compensation	(14,521)	1,237
Income taxes - current	27,107	13,766
Deferred revenue	(1,635)	2,872
Deferred rent	11,399	42
Other liabilities	(22)	(2,149)
Cash provided by operating activities	98,364	72,876
Investing activities		
Purchases of investments	(71,861)	(90,221)
Proceeds from sale of investments	95,793	51,364
Capital expenditures	(29,290)	(9,354)
Acquisitions, net of cash acquired	(55,981)	(60,315)
Other, net		(3)
Cash used for investing activities	(61,339)	(108,529)
Financing activities		
Proceeds from stock option exercises	17,282	11,576
Excess tax benefits from stock option exercises and vesting of restricted stock units	22,043	13,275
Other, net	(3)	
Cash provided by financing activities	39,322	24,851
Effect of exchange rate changes on cash	(2,308)	1,080
Net increase (decrease) in cash and cash equivalents	74,039	(9,722)
Cash and cash equivalents - beginning of period	159,576	96,140
Cash and cash equivalents - end of period	$ 233,615	$ 86,418
Supplemental disclosure of cash flow information:		
Cash paid for taxes	$ 20,356	$ 21,505
Supplemental information of non-cash investing and financing activities:		
Unrealized gain (loss) on available-for-sale investments	$ (258)	$ 104

See notes to unaudited condensed consolidated financial statements.

Table of Contents

MORNINGSTAR, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation of Interim Financial Information

The accompanying unaudited condensed consolidated financial statements of Morningstar, Inc. and subsidiaries (Morningstar, we, our, the Company) included herein have been prepared to conform to the rules and regulations of the Securities and Exchange Commission (SEC). The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue, and expenses. Actual results could differ from those estimates. In the opinion of management, the statements reflect all adjustments, which are of a normal recurring nature, necessary to present fairly our financial position, results of operations, stockholders equity, and cash flows. These financial statements and notes should be read in conjunction with our Consolidated Financial Statements and Notes thereto as of December 31, 2007 included in our Annual Report on Form 10-K filed with the SEC on March 7, 2008.

2. Summary of Significant Accounting Policies

Our significant accounting policies are discussed in Note 2 of our Consolidated Financial Statements included in our Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2007.

SFAS No. 157, Fair Value Measurements

In the first quarter of 2008, we adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances and does not require any new fair value measurements.

The Statement utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

- Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

- Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

We hold investments that are subject to valuation under SFAS No. 157. We do not have any liabilities subject to valuation under this Statement. The fair value of our marketable securities subject to fair value measurements and the necessary disclosures are as follows:

($000)	Fair Value as of September 30, 2008	Fair Value Measurements as of September 30, 2008 Using Fair Value Hierarchy Level 1	Level 2	Level 3
Cash equivalents	$ 94,428	$ 94,428	$	$
Available-for-sale investments	68,967	68,967		
Trading securities	3,622	3,622		
Total	$ 167,017	$ 167,017	$	$

The fair values for available-for-sale and trading securities are based on quoted market prices from various stock and bond exchanges.

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* permits entities the option to measure many financial instruments and certain other items at fair value with changes in fair value recognized in earnings each period. SFAS No. 159 allows the fair value option to be elected on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument.

Table of Contents

In the first quarter of 2008, we chose not to apply this fair value option to any of our eligible assets. We account for our investments in accordance with SFAS No.115, *Accounting for Certain Investments in Debt and Equity Securities*. Our available-for-sale investments are reported at fair value with net unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders equity and our held-to-maturity investments are reported at amortized cost. Our trading securities are reported at fair value and unrealized gains and losses are included in earnings. We account for our investments in unconsolidated subsidiaries using the equity method.

3. Acquisitions, Goodwill, and Other Intangible Assets

Acquisition of Financial Computer Support, Inc.

In September 2008, we acquired Financial Computer Support, Inc. (FCSI), a leading provider of practice management software for independent advisors, for $4,931,000 in cash including estimated post-closing adjustments and transaction costs directly related to the acquisition, less acquired cash. We began including the results of this acquisition in our Consolidated Financial Statements on September 2, 2008.

FCSI s flagship product, dbCAMS+, is a portfolio management system that allows advisors to easily track and produce client reports as well as manage client contact information and billing. We plan to rebrand dbCAMS+ and incorporate it into our Morningstar Principia product line.

The following table summarizes our preliminary allocation of the purchase price to the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

		($000)
Cash	$	262
Accounts receivable		47
Other current assets		115
Fixed assets		65
Other non-current assets		28
Intangible assets		2,435
Goodwill		3,306
Deferred revenue		(210)
Accounts payable and accrued liabilities		(124)
Deferred tax liability non-current		(731)
Total purchase price	$	5,193

The deferred tax liability of $731,000 results primarily because the amortization expense related to certain of these intangible assets is not deductible for income tax purposes.

Based on the preliminary purchase price allocation, we recorded $3,306,000 of goodwill. The goodwill we recorded is not considered deductible for income tax purposes. SFAS No. 109, *Accounting for Income Taxes*, prohibits recognition of a deferred tax asset or liability for temporary differences in goodwill if goodwill is not amortizable and deductible for tax purposes.

If this acquisition had occurred as of January 1, 2007 and 2008, our results of operations would not have been significantly different from the amounts reported for the three and nine months ended September 30, 2007 and 2008, respectively.

Acquisition of the Hemscott data, media, and investor relations Web site businesses

In January 2008, we acquired the Hemscott data, media, and investor relations Web site businesses from Ipreo Holdings, LLC for $51,277,000 in cash including post-closing adjustments and transaction costs directly related to the acquisition, less acquired cash. The acquisition includes Hemscott Data, which has more than 20 years of comprehensive fundamental data on virtually all publicly listed companies in the United States, Canada, the United Kingdom, and Ireland; Hemscott India, which operates a data collection center in New Delhi, India; Hemscott.com, a free investment research Web site in the United Kingdom; Hemscott Premium and Premium Plus, subscription-based investment research and data services; and Hemscott IR, a pioneer in best-practice online investor relations and corporate communications services in the United Kingdom. We began including the results of this acquisition in our Consolidated Financial Statements on January 9, 2008.

Table of Contents

The following table summarizes our preliminary allocation of the purchase price to the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

		($000)
Cash	$	1,227
Accounts receivable		4,099
Other current assets		1,144
Fixed assets		1,367
Other non-current assets		309
Intangible assets		18,070
Goodwill		36,817
Deferred revenue		(4,638)
Accounts payable and accrued liabilities		(2,971)
Deferred tax liability non-current		(2,920)
Total purchase price	$	52,504

The preliminary allocation includes $18,070,000 of acquired intangible assets. These assets include customer-related assets of $11,100,000 that will be amortized over a weighted average period of 10 years; technology-based assets, including software and a database which has more than 20 years of comprehensive fundamental data on virtually all publicly listed companies in the United States, Canada, the United Kingdom, and Ireland, of $6,070,000 that will be amortized over a weighted average period of 10 years; and trade names of $900,000 that will be amortized over three years.

The deferred tax liability of $2,920,000 results primarily because the amortization expense related to certain intangible assets is not deductible for income tax purposes.

If this acquisition had occurred as of January 1, 2007 and 2008, our results of operations would not have been significantly different from the amounts reported for the three and nine months ended September 30, 2007 and 2008, respectively.

Acquisition of the mutual fund data business from Standard & Poor s

In March 2007, we acquired the mutual fund data business from Standard & Poor s for $57,983,000 in cash including post-closing adjustments and transaction costs directly related to the acquisition, less acquired cash. Approximately 80% of this business is generated outside the United States. We began including the financial results of this acquisition in our Consolidated Financial Statements on March 16, 2007.

The following table summarizes our allocation of the purchase price to the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

($000)

Cash	$	2,974
Accounts receivable		7,529
Other current assets		1,849
Fixed assets		126
Intangible assets		34,080
Goodwill		36,851
Deferred revenue		(16,450)
Accrued liabilities		(4,246)
Deferred tax liabilities		(1,626)
Other non-current liabilities		(130)
Total purchase price	$	60,957

The allocation includes $34,080,000 of acquired intangible assets. These assets include customer-related assets of $13,040,000 that will be amortized over a weighted average period of 10 years; technology-based assets, including software and a database covering managed investment vehicles, including mutual funds, exchange-traded funds, hedge funds, and offshore funds, of $20,580,000 that will be amortized over a weighted average period of nine years; and a non-compete agreement of $460,000 that will be amortized over five years.

The deferred tax liability of $1,626,000 results primarily because the amortization expense related to certain of these intangible assets is not deductible for income tax purposes.

Table of Contents

Based on the purchase price allocation, we recorded $36,851,000 of goodwill. The goodwill we recorded is not considered deductible for income tax purposes. SFAS No. 109, *Accounting for Income Taxes*, prohibits recognition of a deferred tax asset or liability for temporary differences in goodwill if goodwill is not amortizable and deductible for tax purposes.

In the third quarter of 2008, we recorded an income tax benefit of $820,000 related to this acquisition with a corresponding reduction to goodwill.

The purchase price allocation includes a liability of $1,685,000 for severance and lease termination costs. Substantially all of these liabilities were paid as of September 30, 2008.

If this acquisition had occurred as of January 1, 2007, our results of operations would not have been significantly different from the amounts reported for the nine months ended September 30, 2007.

Goodwill

The following table shows the changes in our goodwill balances from January 1, 2007 to September 30, 2008:

		($000)
Balance as of January 1, 2007	$	86,680
Acquisition of the mutual fund data business acquired from Standard & Poor s		37,180
Acquisition of the minority interest in Morningstar Europe NV		1,000
Other, primarily currency translation		3,281
Balance as of December 31, 2007		128,141
Acquisition of the Hemscott data, media, and investor relations Web site businesses		36,817
Acquisition of Financial Computer Support, Inc.		3,306
Adjustment to the goodwill of the mutual fund data business acquired from Standard & Poor s		(329)
Other, primarily currency translation		(1,788)
Balance as of September 30, 2008	$	166,147

We did not record any impairment losses in the quarter or year-to-date periods ended September 30, 2008 or 2007, respectively.

The following table summarizes our intangible assets:

	As of September 30, 2008				As of December 31, 2007			
($000)	**Gross**	**Accumulated Amortization**	**Net**	**Weighted Average**	**Gross**	**Accumulated Amortization**	**Net**	**Weighted Average**

							Useful Life (years)						**Useful Life (years)**
Intellectual property	$	27,366	$	(7,898)	$	19,468	10	$	26,956	$	(5,542)	$	21,414	10
Customer-related assets		69,162		(16,032)		53,130	10		58,721		(10,354)		48,367	10
Supplier relationships		240		(45)		195	20		240		(36)		204	20
Technology-based assets		35,937		(8,431)		27,506	9		30,059		(4,881)		25,178	9
Non-competition agreement		810		(333)		477	5		810		(206)		604	5
Intangible assets related to the FCSI acquisition		2,435				2,435	10							
Total intangible assets	$	135,950	$	(32,739)	$	103,211	9	$	116,786	$	(21,019)	$	95,767	10

We amortize intangible assets using the straight-line method over their expected economic useful lives. Amortization expense was $12,065,000 and $9,487,000 for the nine months ended September 30, 2008 and 2007, respectively.

As of September 30, 2008, we estimate that aggregate amortization expense for intangible assets will be $15,937,000 in 2008; $15,749,000 in 2009; $14,261,000 in 2010; $12,810,000 in 2011; $12,152,000 in 2012; and $10,741,000 in 2013. Our estimates of future amortization expense for intangible assets may be affected by changes to the preliminary purchase price allocations associated with our recent acquisitions.

Table of Contents

Income per Share

The numerator for both basic and diluted income per share is net income. The denominator for basic income per share is the weighted average number of common shares outstanding during the period. For diluted income per share, the denominator includes the dilutive effect of outstanding employee stock options and restricted stock units using the treasury method. The following table shows how we reconcile our net income and the number of shares used in computing basic and diluted income per share:

(in thousands, except per share amounts)	Three Months Ended September 30 2008	2007	Nine Months Ended September 30 2008	2007
Basic income per share:				
Net income	$ 22,187	$ 19,853	$ 73,262	$ 53,912
Weighted average common shares outstanding	46,499	43,393	45,883	42,889
Basic net income per share	$ 0.48	$ 0.46	$ 1.60	$ 1.26
Diluted income per share:				
Net income	$ 22,187	$ 19,853	$ 73,262	$ 53,912
Weighted average common shares outstanding	46,499	43,393	45,.883	42,889
Net effect of dilutive stock options and restricted stock units	2,922	4,839	3,338	5,030
Weighted average common shares outstanding for computing diluted income per share	49,421	48,232	49,221	47,919
Diluted net income per share	$ 0.45	$ 0.41	$ 1.49	$ 1.13

5. Segment and Geographical Area Information

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

- *Individual segment.* Our Individual segment focuses on products and services for individual investors. The largest product in this segment based on revenue is our U.S.-based Web site, Morningstar.com, which includes both paid Premium Membership service and sales of Internet advertising space. As a result of the Hemscott acquisition in the first quarter of 2008, this segment also includes revenue from the Hemscott Premium and Premium Plus subscription-based services and sales of Internet advertising space on Hemscott.com.

Our Individual segment also includes Morningstar Equity Research, which we distribute through several channels. We distribute our equity research through six major banks to meet the requirements for independent research under the Global Analyst Research Settlement, as well as to several other companies that purchase our research for their own use or provide our research to their affiliated financial advisors or to individual investors. In addition, investors can access our equity research through our Premium Membership offering on Morningstar.com.

We also offer a variety of print and online publications about investing, including several newsletters and books.

- *Advisor segment.* Our Advisor segment focuses on products and services for financial advisors. Key products in this segment based on revenue are Morningstar Advisor Workstation and Morningstar Principia. Advisor Workstation is a Web-based investment planning system that provides financial advisors with a comprehensive set of tools for conducting their core business. 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 and planning software for financial advisors. In addition, we offer Morningstar Managed Portfolios, a fee-based discretionary asset management service that includes a series of mutual fund and exchange-traded fund portfolios tailored to meet a range of investment time horizons and risk levels that financial advisors can use for their clients taxable and tax-deferred accounts; and Financial Communications, which includes investment conferences, Web sites, magazines, and presentation materials for financial advisors. Beginning in September 2008, our Advisor segment also includes the operations of FCSI, a leading provider of practice management software for independent advisors.

- *Institutional segment.* Our Institutional segment focuses on products and services for institutions, including banks, insurance companies, mutual fund companies, brokerage firms, media companies, and retirement plan providers and sponsors. Key products and services in this segment based on revenue are Investment Consulting, which focuses on investment monitoring and asset allocation for funds of funds, including mutual funds and variable annuities; Licensed Data, a set of investment data spanning 10 core databases, available through electronic data feeds; Morningstar Direct, a Web-based institutional research platform that provides advanced research and tools on the complete range of securities in Morningstar s global database; Retirement Advice, including the Morningstar Retirement Manager and Advice by Ibbotson platforms; and Licensed Tools and Content, a set of online tools and editorial content designed for institutions to use in their Web sites and software.

Table of Contents

With the January 2008 Hemscott acquisition, our Licensed Data offerings include Hemscott Data, which has more than 20 years of comprehensive fundamental data on virtually all publicly listed companies in the United States, Canada, the United Kingdom, and Ireland. Other products that have been added to this segment include Hemscott Guru, a leading online research tool that contains financial data and directors biographies on more than 2,500 UK-quoted companies and 400,000 private companies; Hemscott Adviser Rankings Guide, a comprehensive listing of more than 1,800 leading providers of professional services to all UK- and Irish-registered companies listed on the London Stock Exchange; and Hemscott IR, a pioneer in best-practice online investor relations and corporate communications services in the United Kingdom.

We measure the operating results of these segments based on operating income (loss), including an allocation of corporate costs. We include intersegment revenue and expenses in segment information. We sell services and products between segments at predetermined rates primarily based on cost. The recovery of intersegment cost is shown as Intersegment revenue.

Our segment accounting policies are the same as those described in Note 2 to our Consolidated Financial Statements included in our Annual Report on Form 10-K as of December 31, 2007, except for the capitalization and amortization of internal product development costs and amortization of intangible assets. We exclude these items from our operating segment results to provide our chief operating decision maker with a better indication of each segment s ability to generate cash flow. This information is one of the criteria used by our chief operating decision maker in determining how to allocate resources to each segment. We include the capitalization and amortization of internal product development costs, the amortization of intangible assets, and the elimination of intersegment revenue and expense, in the Corporate Items and Eliminations category to arrive at the consolidated financial information. Our segment disclosures include the business segment information provided to our chief operating decision maker on a recurring basis. Therefore, we do not present balance sheet information, including goodwill or other intangibles, by segment.

Table of Contents

The following tables show selected segment data for the three and nine months ended September 30, 2008 and 2007:

Three months ended September 30, 2008

($000)	Individual	Advisor	Institutional	Corporate Items & Eliminations	Total
Revenue:					
External customers	$ 25,434	$ 32,353	$ 67,718	$	$ 125,505
Intersegment	1,179	49	1,230	(2,458)	
Total revenue	26,613	32,402	68,948	(2,458)	125,505
Operating expense, excluding stock-based compensation expense, depreciation, and amortization	18,984	22,111	43,620	(2,470)	82,245
Stock-based compensation expense	583	834	1,401		2,818
Depreciation and amortization	435	616	1,223	3,992	6,266
Operating income (loss)	$ 6,611	$ 8,841	$ 22,704	$ (3,980)	$ 34,176
Capital expenditures	$ 1,814	$ 2,561	$ 6,706	$ 855	$ 11,936
U.S. revenue					$ 94,924
Non-U.S. revenue					$ 30,581

Three months ended September 30, 2007

($000)	Individual	Advisor	Institutional	Corporate Items & Eliminations	Total
Revenue:					
External customers	$ 22,605	$ 29,295	$ 59,959	$	$ 111,859
Intersegment	1,062	41	886	(1,989)	
Total revenue	23,667	29,336	60,845	(1,989)	111,859
Operating expense, excluding stock-based compensation expense, depreciation, and amortization	16,624	19,404	38,098	(1,971)	72,155
Stock-based compensation expense	492	792	1,313		2,597
Depreciation and amortization	364	472	758	4,068	5,662
Operating income (loss)	$ 6,187	$ 8,668	$ 20,676	$ (4,086)	$ 31,445
Capital expenditures	$ 275	$ 734	$ 1,081	$ 1,376	$ 3,466
U.S. revenue					$ 87,006
Non-U.S. revenue					$ 24,853

Table of Contents

Nine months ended September 30, 2008

($000)	Individual	Advisor	Institutional	Corporate Items & Eliminations	Total
Revenue:					
External customers	$ 78,392	$ 96,872	207,922	$	$ 383,186
Intersegment	3,727	86	3,796	(7,609)	
Total revenue	82,119	96,958	211,718	(7,609)	383,186
Operating expense, excluding stock-based compensation expense, depreciation, and amortization	58,093	64,375	130,649	(7,592)	245,525
Stock-based compensation expense	1,677	2,563	4,291		8,531
Depreciation and amortization	1,306	1,693	3,495	12,205	18,699
Operating income (loss)	$ 21,043	$ 28,327	73,283	$ (12,222)	$ 110,431
Capital expenditures	$ 5,832	$ 7,266	$ 14,262	$ 1,930	$ 29,290
U.S. revenue					$ 289,621
Non-U.S. revenue					$ 93,565

	Sept. 30, 2008
U.S. long-lived assets	$ 40,476
Non-U.S. long-lived assets	$ 11,815

Nine months ended September 30, 2007

($000)	Individual	Advisor	Institutional	Corporate Items & Eliminations	Total
Revenue:					
External customers	$ 68,611	$ 85,356	$ 163,024	$	$ 316,991
Intersegment	3,286	166	2,727	(6,179)	
Total revenue	71,897	85,522	165,751	(6,179)	316,991
Operating expense, excluding stock-based compensation expense, depreciation, and amortization	51,129	58,063	105,981	(6,077)	209,096
Stock-based compensation expense	1,628	2,483	4,023		8,134
Depreciation and amortization	1,160	1,418	2,280	10,985	15,843
Operating income (loss)	$ 17,980	$ 23,558	$ 53,467	$ (11,087)	$ 83,918
Capital expenditures	$ 604	$ 2,514	$ 3,249	$ 2,987	$ 9,354
U.S. revenue					$ 253,405
Non-U.S. revenue					$ 63,586

	Sept. 30, 2007
U.S. long-lived assets	$ 9,745
Non-U.S. long-lived assets	$ 9,164

Table of Contents

6. Investments

We monitor the concentration, diversification, maturity, and liquidity of our investment portfolio, which is primarily invested in fixed-income securities. We classify our investment portfolio as follows:

($000)		September 30 2008		December 31 2007
Available-for-sale	$	68,967	$	91,546
Held-to-maturity		3,416		3,428
Trading securities		3,622		4,038
Total	$	76,005	$	99,012

Held-to-maturity investments include a $2,500,000 certificate of deposit held as collateral against two bank guarantees for our office space lease in Australia.

7. Investments In Unconsolidated Entities

Our investments in unconsolidated entities consist primarily of the following:

Morningstar Japan K.K. Morningstar Japan K.K. (MJKK) develops and markets products and services customized for the Japanese market. MJKK s shares are traded on the Osaka Stock Exchange, Hercules Market, using the ticker 4765. As of September 30, 2008, we owned approximately 34% of MJKK. We account for our investment in MJKK using the equity method. The book value of our investment in MJKK totaled $17,851,000 and $17,522,000 as of September 30, 2008 and December 31, 2007, respectively. The market value of our investment in MJKK was approximately Japanese Yen 3.0 billion (approximately U.S. $28,593,000) as of September 30, 2008 and Japanese Yen 5.4 billion (approximately U.S. $48,007,000) as of December 31, 2007.

Morningstar Korea, Ltd. Morningstar Korea provides financial information and services for investors in South Korea. Our ownership interest and profit- and loss-sharing interest in Morningstar Korea was 40% as of September 30, 2008 and December 31, 2007. We account for this investment using the equity method. Our investment totaled $1,520,000 and $1,512,000 as of September 30, 2008 and December 31, 2007, respectively.

Other Investments in Unconsolidated Entities. As of September 30, 2008 and December 31, 2007, the book value of our other investments in unconsolidated entities totaled $959,000 and $821,000, respectively, and consist primarily of our investments in Morningstar Danmark A/S (Morningstar Denmark) and Morningstar Sweden AB (Morningstar

Sweden). Morningstar Denmark and Morningstar Sweden develop and market products and services customized for their respective markets. Our ownership interest in both Morningstar Denmark and Morningstar Sweden was approximately 25% as of September 30, 2008 and December 31, 2007. We account for our investments in Morningstar Denmark and Morningstar Sweden using the equity method.

The following table shows condensed combined financial information, a portion of which is unaudited, for our investments in unconsolidated entities.

	Three months ended September 30		Nine months ended September 30	
($000)	**2008**	**2007**	**2008**	**2007**
Revenue	$ 9,290	$ 13,999	$ 40,074	$ 33,402
Operating income	$ 1,363	$ 1,343	$ 4,769	$ 5,413
Net income	$ 937	$ 868	$ 3,490	$ 3,309

Table of Contents

8. Stock-Based Compensation

Stock-Based Compensation Plans

In November 2004, we adopted the 2004 Stock Incentive Plan. The 2004 Stock Incentive Plan provides for grants of options, stock appreciation rights, restricted stock, restricted stock units, and performance shares. All of our employees are eligible for awards under the 2004 Stock Incentive Plan. Our non-employee directors are also eligible for awards under the 2004 Stock Incentive Plan. Joe Mansueto, our chairman and chief executive officer, does not participate in the 2004 Stock Incentive Plan or prior plans (as defined below).

Since the adoption of the 2004 Stock Incentive Plan, we have granted stock options and, beginning in 2006, restricted stock units. Stock options granted under the 2004 Stock Incentive Plan generally vest ratably over a four-year period and expire 10 years after the date of grant. Almost all of the options granted under the 2004 Stock Incentive Plan have a premium feature in which the exercise price increases over the term of the option at a rate equal to the 10-year Treasury bond yield as of the date of grant. Restricted stock units represent the right to receive a share of Morningstar common stock when that unit vests. Restricted stock units granted under the 2004 Stock Incentive Plan generally vest ratably over a four-year period. At the time of grant, employees may elect to defer receipt of the Morningstar common stock issued upon vesting of the restricted stock unit. As of September 30, 2008, we had 2,524,594 shares available for future grants under our 2004 Stock Incentive Plan compared with 2,657,982 as of December 31, 2007.

Prior to November 2004, we granted stock options under various plans, including the 1993 Stock Option Plan (the 1993 Plan), the 2000 Morningstar Stock Option Plan (the 2000 Plan), and the 2001 Morningstar Stock Option Plan (the 2001 Plan). Options granted under the 1993 Plan, the 2000 Plan, and the 2001 Plan generally vested over a four-year period. As a result, all of the options related to these three plans are vested. Because the options granted under all three plans expire 10 years after the date of grant, some of these options remain outstanding. The 2004 Stock Incentive Plan amends and restates the 1993 Plan, the 2000 Plan, and the 2001 Plan (collectively, the Prior Plans). Under the 2004 Stock Incentive Plan, we will not grant any additional options under any of the Prior Plans, and any shares subject to an award under any of the Prior Plans that are forfeited, canceled, settled, or otherwise terminated without a distribution of shares, or withheld by us in connection with the exercise of options or in payment of any required income tax withholding, will not be available for awards under the 2004 Stock Incentive Plan.

In February 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 Don Phillips, an officer of Morningstar. Under these agreements, we granted Don 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. These options are fully vested and expire in February 2009. As of September 30, 2008, there were 59,076 options remaining to be exercised, compared with 217,286 as of December 31, 2007.

Accounting for Stock-Based Compensation Awards

In accordance with SFAS No. 123 (R), *Stock Based Compensation*, we estimate forfeitures of all employee stock-based awards and recognize compensation cost only for those awards expected to vest. We determine forfeiture rates based on historical experience. Estimated forfeitures are adjusted to actual forfeiture experience as needed. Because our largest annual equity grants typically have vesting dates in the second quarter, we adjusted the stock-based compensation expense to reflect those awards that ultimately vested. As a result, in the second quarter of

2008 and 2007, we recorded approximately $210,000 and $720,000, respectively, of additional stock-based compensation expense as a result of adjusting from the estimated forfeitures to actual forfeiture experience for certain of our employee stock option and restricted stock unit grants. In addition, we reduced our estimate of the forfeiture rate that will be applied to awards not yet vested.

The following table summarizes stock-based compensation expense:

	Three months ended September 30		Nine months ended September 30	
($000)	**2008**	**2007**	**2008**	**2007**
Stock-based compensation expense	$ 2,818	$ 2,597	$ 8,531	$ 8,134

We recorded deferred tax benefits related to stock-based compensation expense of $697,000 and $927,000 for the three months ended September 30, 2008 and 2007, respectively, and $2,701,000 and $2,947,000 for the nine months ended September 30, 2008 and 2007, respectively.

Table of Contents

Restricted Stock Units

We measure the fair value of our restricted stock units on the date of grant based on the market price of the underlying common stock as of the close of trading on the day prior to grant. We amortize that value to stock-based compensation expense, net of estimated forfeitures, ratably over the vesting period. The total grant date fair value of restricted stock units granted in the first nine months of 2008 was approximately $12,653,000. As of September 30, 2008, the total amount of unrecognized stock-based compensation expense related to restricted stock units was approximately $22,165,000. We expect to recognize this expense over an average period of approximately 35 months.

The following table summarizes restricted stock unit activity in the first nine months of 2008:

Restricted Stock Units (RSUs)	**Unvested**	**Vested but Deferred**	**Total**		**Weighted Average Grant Date Fair Value**
Restricted Stock Units December 31, 2007	414,282	6,621	420,903	$	48.41
Granted	180,231		180,231	$	70.21
Vested	(88,288)		(88,288)	$	47.40
Vested but deferred	(15,394)	15,394		$	
Forfeited	(19,854)		(19,854)	$	49.78
Restricted Stock Units September 30, 2008	470,977	22,015	492,992	$	56.32

Stock Options

The following tables summarize stock option activity in the first nine months of 2008 for our various stock option grants. The first table includes activity for options granted at an exercise price below the fair value per share of our common stock on the grant date; the second table includes activity for all other option grants.

	Nine months ended September 30, 2008		
Options Granted At an Exercise Price Below the Fair Value Per Share on the Grant Date	**Underlying Shares**		**Weighted Average Exercise Price**
Options outstanding December 31, 2007	2,068,590	$	12.84
Canceled	(7,565)	$	15.92
Exercised	(500,304)	$	10.41
Options outstanding September 30, 2008	1,560,721	$	13.90
Options exercisable September 30, 2008	1,534,021	$	13.84

All Other Option Grants, Excluding Activity Shown Above	Nine months ended September 30, 2008 Underlying Shares	Weighted Average Exercise Price
Options outstanding December 31, 2007	4,377,089	$ 13.61
Canceled	(20,338)	$ 21.61
Exercised	(1,289,579)	$ 10.78
Options outstanding September 30, 2008	3,067,172	$ 14.92
Options exercisable September 30, 2008	2,838,068	$ 14.21

The total intrinsic value (difference between the market value of our stock on the date of exercise and the exercise price of the option) of options exercised in the nine months ended September 30, 2008 and 2007 was $100,196,000 and $55,701,000, respectively.

Table of Contents

The table below shows additional information for options outstanding and options exercisable as of September 30, 2008:

	Options Outstanding				Options Exercisable			
Range of Exercise Prices	**Outstanding Shares**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Aggregate Intrinsic Value ($000)**	**Exercisable Shares**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Aggregate Intrinsic Value ($000)**
$ 2.77	109,137	0.31	$ 2.77	$ 5,752	108,934	0.31	$ 2.77	$ 5,741
$ 8.57 - $14.70	3,028,267	2.34	$ 12.34	130,603	3,027,635	2.34	$ 12.34	130,575
$ 17.19 - $38.98	1,490,489	6.47	$ 19.96	52,931	1,235,520	6.42	$ 19.31	44,678
$ 2.77 - $38.98	4,627,893	3.62	$ 14.57	$ 189,286	4,372,089	3.44	$ 14.07	$ 180,994
Vested or Expected to Vest								
$2.77 - $38.98	4,603,918	3.60	$ 14.53	$ 188,505				

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing stock price of $55.47 on September 30, 2008, which would have been received by the option holders had all option holders exercised their options as of that date.

As of September 30, 2008, the total amount of unrecognized stock-based compensation expense related to non-vested stock options was approximately $1,533,000. We expect to recognize this expense over a weighted average period of approximately eight months.

9. Related Party Transactions

In 1989, under our 1989 Nonqualified Stock Option Plan (the 1989 Plan), we granted 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, to Don Phillips, an officer of Morningstar. These options were not exercised and expired in February 1999. In February 1999, in conjunction with the expiration of options granted under the 1989 Plan, we entered into a Deferred Compensation Agreement (the Agreement) with Don. Under the terms of the Agreement, on any date that Don exercises the right to purchase shares under the 1999 Plan, we shall pay to him $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 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.

In May 2006, Don Phillips entered into a Rule 10b5-1 sales plan contemplating the sale of shares to be acquired through stock option exercises. Upon exercise of these stock options, we will make payments to him, as prescribed by the Agreement. In the first nine months of 2008, Don exercised 158,210 options, of which 72,710 were sold under his 10b5-1 plan. As of September 30, 2008 and December 31, 2007, our Condensed Consolidated Balance Sheets include a liability of $159,000 and $585,000, respectively, for the Agreement. The liability is classified as Other current liabilities. The reduction in the liability since December 31, 2007 reflects amounts paid to Don in the first nine months of 2008 in accordance with the Agreement.

10. Income Taxes

The following table shows our effective tax rate for the three and nine months ended September 30, 2008 and 2007:

	Three months ended September 30		Nine months ended September 30	
($000)	**2008**	**2007**	**2008**	**2007**
Income before income taxes and equity in net income of unconsolidated entities	$ 35,466	$ 33,665	$ 114,324	$ 89,019
Equity in net income of unconsolidated entities	268	417	1,065	1,409
Total	$ 35,734	$ 34,082	$ 115,389	$ 90,428
Income tax expense	$ 13,547	$ 14,229	$ 42,127	$ 36,516
Effective income tax expense rate	37.9%	41.7%	36.5%	40.4%

Our effective tax rate declined by 3.8 percentage points in the third quarter of 2008 and declined 3.9 percentage points for the nine months ended September 30, 2008 compared with the prior-year periods. The decrease in the 2008 effective tax rate primarily reflects a reduction in our U.S. state tax rate related to a 2007 change in state tax law. The favorable, but variable, benefit from incentive stock-option transactions also contributed to the lower tax rate compared against the same periods in 2007, but to a greater extent in the year-to-date period.

We conduct business globally and as a result, we file income tax returns in U.S. Federal, state, local, and foreign jurisdictions. In the normal course of business we are subject to examination by tax authorities throughout the world. The open tax years for our U.S. Federal tax return include the years 2005 to the present. Most of our state tax returns have open tax years from 2004 to the present. In non-U.S. jurisdictions, the statute of limitations generally extends to years prior to 2003. There were no significant changes to uncertain tax positions in the first nine months of 2008 as a result of lapses of statutes of limitation or audit activity.

Table of Contents

We are currently under audit by various state and local tax authorities in the United States. We are also under audit by the tax authorities in certain non-U.S. jurisdictions. It is likely that the examination phase of some of these state, local, and non-U.S. audits will conclude in 2008. It is not possible to estimate the impact of current audits on previously recorded unrecognized tax benefits.

As of December 31, 2007 we had approximately $7,195,000 of gross unrecognized tax benefits, of which $4,741,000, if recognized, would result in a reduction of our effective income tax rate, and $2,383,000 of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of the deduction. In the first nine months of 2008 we reduced the unrecognized tax benefit by $2,383,000 and recorded a corresponding decrease to our deferred tax assets as a result of a resolution concerning the timing of the deduction. Because of the impact of deferred tax accounting, other than interest and penalties, this liability did not affect our 2008 effective tax rate. Adjustments recorded to other unrecognized tax benefits in the first nine months of 2008 were not material.

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

11. Contingencies

Morningstar Associates, LLC Subpoenas from Securities and Exchange Commission, New York Attorney General s Office, and the Department of Labor

Securities and Exchange Commission

In February 2005, Morningstar Associates, LLC, a wholly owned subsidiary of Morningstar, Inc., received a request from the SEC for the voluntary production of documents relating to the investment consulting services the company offers to retirement plan providers, including fund lineup recommendations for retirement plan sponsors. In July 2005, the SEC issued a subpoena to Morningstar Associates that was virtually identical to its February 2005 request.

Subsequently, the SEC focused on disclosure relating to an optional service offered to retirement plan sponsors (employers) that select 401(k) plan services from ING, one of Morningstar Associates clients. In response to the SEC investigation, ING and Morningstar Associates revised certain documents for plan sponsors to further clarify the roles of ING and Morningstar Associates in providing that service. The revisions also help reinforce that Morningstar Associates makes its selections only from funds available within ING s various retirement products.

In January 2007, the SEC notified Morningstar Associates that it ended its investigation, with no enforcement action, fines, or penalties.

New York Attorney General s Office

In December 2004, Morningstar Associates received a subpoena from the New York Attorney General s office seeking information and documents related to an investigation the New York Attorney General s office is conducting. The request is similar in scope to the SEC subpoena described above. Morningstar Associates has provided the requested information and documents.

In January 2007, Morningstar Associates received a Notice of Proposed Litigation from the New York Attorney General s office. The Notice centers on the same issues that became the focus of the SEC investigation described above. The Notice gave Morningstar Associates the opportunity to explain why the New York Attorney General s office should not institute proceedings. Morningstar Associates promptly submitted its explanation and has cooperated fully with the New York Attorney General s office.

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

United States Department of Labor

In May 2005, Morningstar Associates received a subpoena from the United States Department of Labor, seeking information and documents related to an investigation the Department of Labor is conducting. The Department of Labor subpoena is substantially similar in scope to the SEC and New York Attorney General subpoenas.

Table of Contents

In January 2007, the Department of Labor issued a request for additional documents pursuant to the May 2005 subpoena, including documents and information regarding Morningstar Associates retirement advice products for plan participants. Morningstar Associates continues to cooperate fully with the Department of Labor.

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

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.

12. Recently Issued Accounting Pronouncements

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of SFAS No. 133*. The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity s financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. To date, we have not engaged in currency or other hedging activities, and we do not currently have any positions in derivative instruments. Therefore, we do not expect the adoption of SFAS No. 161 will have any impact on our Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations.* SFAS No. 141(R) modifies the financial accounting and reporting of business combinations. SFAS No. 141(R) requires the acquirer to recognize and measure the fair value of the acquired operation as a whole, and the assets acquired and liabilities assumed at their full fair values as of the date control is obtained, regardless of the percentage ownership in the acquired operation or how the acquisition was achieved. SFAS No. 141(R) is effective for business combination transactions with acquisition dates on or after the first annual reporting period beginning on or after December 15, 2008. SFAS No. 141(R) is required to be adopted concurrently with SFAS No. 160, *Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* . SFAS No. 141(R) requires prospective application and prohibits earlier application. We are in the process of determining the effect the adoption of SFAS No. 141(R) will have on our Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 160, *Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51.* SFAS No. 160 amends the financial accounting and reporting of noncontrolling (or minority) interests in consolidated financial statements. SFAS No. 160 is required to be adopted concurrently with SFAS No. 141(R) and is effective for the first annual reporting period beginning on or after December 15, 2008. Earlier application is prohibited. We are in the process of determining the effect the adoption of SFAS No. 160 will have on our Consolidated Financial Statements.

13. Subsequent Event

In October 2008, we acquired Fundamental Data Limited, a leading provider of data on closed-end funds in the United Kingdom, for 11 million pounds sterling, or approximately U.S. $19 million, subject to post-closing adjustments.

Fundamental Data covers all UK- and U.S.-domiciled closed-end funds as well as offshore and local closed-end funds worldwide. Clients include major investment banks, stockbrokers, fund management groups, private client advisers, accountancy firms, wealth managers, and other professionals. Fundamental Data currently provides data on more than 1,500 closed-end funds and has more than 3,000 data points for each fund. Fundamental Data s flagship product is FundWeb, an online subscription service allowing its clients access to its comprehensive database. Fundamental Data also provides data feeds, Web site feeds, and report outsourcing services including production of fund fact sheets. It also offers an online database of publicly issued documents relating to closed-end funds.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion included in this section, as well as other sections of this Quarterly Report on Form 10-Q, contains forward-looking statements as that term is used in the Private Securities Litigation Reform Act of 1995. These statements are based on our current expectations about future events or future financial performance. Forward-looking statements by their nature address matters that are, to different degrees, uncertain, and often contain words such as may, could, expect, intend, plan, seek, anticipate, believe, estimate, predict, potential, or continue. These statements involve known and unknown risks and uncertainties that may cause the events we discuss not to occur or to differ significantly from what we expect. For us, these risks and uncertainties include, among others, general industry conditions and competition, including the current global financial crisis that began in 2007; the impact of market volatility on revenue from asset-based fees; damage to our reputation resulting from claims made about possible conflicts of interest; liability for any losses that result from an actual or claimed breach of our fiduciary duties; financial services industry consolidation; a prolonged outage of our database and network facilities; challenges faced by our non-U.S. operations; and the availability of free or low-cost investment information.

A more complete description of these risks and uncertainties can be found in Part II, Item 1A. Risk Factors in this Quarterly Report on Form 10-Q as well as our other filings with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2007. If any of these risks and uncertainties materialize, our actual future results may vary significantly from what we expected. We do not undertake to update our forward-looking statements as a result of new information or future events.

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

Understanding our Company

Our Business

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

We emphasize a decentralized approach to running our business to empower our managers and to create a culture of responsibility and accountability. We operate our decentralized business structure in 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.

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

- Enhance our position in each of our three operating segments by focusing on our three major Internet-based platforms;
- Become a global leader in funds-of-funds investment management;
- Expand the range of services we offer investors, financial advisors, and institutional clients; and
- Expand our international brand presence, products, and services.

Industry Overview

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

The third quarter of 2008 was a time of significant market volatility and uncertainty, which worsened during the quarter and into the fourth quarter. The ongoing financial crisis accelerated during the quarter as high-profile investment bank Lehman Brothers went into bankruptcy, mortgage lenders Fannie Mae and Freddie Mac were taken over by the U.S. government, insurance firms such as AIG received large cash infusions from the U.S. government, and lawmakers and regulators considered a $700 billion rescue package proposed by Treasury officials. Other large investment banks underwent significant changes as Bank of America purchased Merrill Lynch and Morgan Stanley and Goldman Sachs chose to obtain bank charters, which subjects them to strict banking regulations.

In response to these events, the U.S. equity market lost about 10% of its value during the quarter as measured by Morningstar s U.S. Market Index, a broad market benchmark. Many global markets also lost ground during the quarter, and bond markets also experienced volatility because of widening credit spreads as well as fears of inflation. Problems in the credit markets had widespread effects even on traditional safe havens such as money market funds and high-grade commercial paper. As the third quarter progressed, market volatility and uncertainty became increasingly severe.

Table of Contents

The recent market upheaval triggered the largest wave of monthly net redemptions in the history of the mutual fund industry. In September 2008, according to Morningstar s data, investors pulled an estimated $47.5 billion out of long-term mutual funds. Investor concern about the deepening financial crisis and a money market fund dropping below a $1 net asset value contributed to the outflows. International stock funds and U.S. stock funds each had about $19 billion in net redemptions in September. Most other asset classes, including balanced funds, taxable bond funds, and municipal bond funds, also experienced net outflows. In contrast to previous market declines, when investors sold off stock funds and reallocated assets to bond funds, many investors have pulled their money out of mutual funds altogether. Because of these redemptions as well as the impact of market losses, total U.S. mutual fund assets declined to $10.6 trillion as of September 30, 2008, down from $11.7 trillion as of June 30, 2008 based on data from the Investment Company Institute (ICI).

Asset flows to alternative asset classes also suffered net outflows during the quarter. Based on data from Hedge Fund Research, hedge funds had $31 billion in net outflows during the quarter, compared with net inflows of $12.5 billion in the second quarter. Assets in exchange-traded funds (ETFs) totaled $580 billion as of September 30, 2008, about on par with $578 billion as of June 30, 2008, based on data from the ICI.

The environment for online advertising has been mixed. Earlier in the year, growth rates generally remained strong as advertisers continued to shift spending from traditional media to the Internet. Industry publication eMarketer currently projects that total online ad spending will reach $24.9 billion in 2008, which is below its previous forecast but still an increase of 17% over 2007. More recently, however, some companies in the financial services industry have said that they may cut advertising spending because of the weak market environment. Based on data from Nielsen/Net Ratings, aggregate page views and unique users to financial and investment sites both increased in the third quarter of 2008 compared with the same period in 2007, although the number of pages viewed per visit declined by about 2%. We believe this indicates that while some investors may be disengaged because of the market downturn, many people are still interested in investment-related content.

Overall, we believe the disruption in the financial markets continues to cause widespread investor uncertainty, and the market downturn has also created some spending cutbacks among asset management firms and other financial services companies.

The financial crisis has had two main effects on our business: lengthening the sales cycle and increasing pressure on renewal pricing. Most of the impact to date has been on new business, where we ve been seeing longer sales cycles, tightening budgets, and more review by senior management at client organizations.

On the positive side, many of our contracts have multiyear terms, and we believe the services we provide are fairly entrenched within many areas of our clients organizations. At the same time, our renewal rates have remained strong (though with some pressure on pricing) and cancellations have not significantly increased.

Industry consolidation in the financial services sector has also been an ongoing trend. When our clients are acquired, the impact on us may be positive, negative, or neutral. We may lose business following an acquisition of one of our clients, but we also often have opportunities to continue providing services or expand our business with the new parent organization. We are actively monitoring business conditions for all of our major clients and continuing to work closely with them to align our products and services to meet their needs.

Overall, we remain cautious because of the difficult and uncertain market environment. However, we re investing in our business and managing it for the long term. We re also looking for business opportunities that may emerge from the current crisis.

Three and Nine Months Ended September 30, 2008 vs. Three and Nine Months Ended September 30, 2007

Consolidated Results

Key Metrics ($000)	Three Months Ended September 30 2008	2007	Change	Nine Months Ended September 30 2008	2007	Change
Revenue	$ 125,505	$ 111,859	12.2%	$ 383,186	$ 316,991	20.9%
Operating income	34,176	31,445	8.7%	110,431	83,918	31.6%
Operating margin	27.2%	28.1%	(0.9)pp	28.8%	26.5%	2.3pp
Cash used for investing activities	(28,235)	(49,552)	(43.0)%	(61,339)	(108,529)	(43.5)%
Cash provided by financing activities	9,388	12,154	(22.8)%	39,322	24,851	58.2%
Cash provided by operating activities	$ 49,245	$ 28,380	73.5%	$ 98,364	$ 72,876	35.0%
Capital expenditures	(11,936)	(3,466)	244.4%	(29,290)	(9,354)	213.1%
Free cash flow	$ 37,309	$ 24,914	49.8%	$ 69,074	$ 63,522	8.7%

NMF not meaningful

pp percentage points

Table of Contents

We define free cash flow as cash provided by or used for operating activities less capital expenditures. We present free cash flow solely as supplemental disclosure to help investors better understand how much cash is available after we spend money to operate our business. Our management team uses free cash flow to evaluate the performance of our business. Free cash flow is not a measure of performance set forth under U.S. Generally Accepted Accounting Principles (GAAP). Also, the free cash flow definition we use may not be comparable to similarly titled measures used by other companies.

Third-Quarter Highlights

- Revenue increased 12.2%. Because of the difficult market environment, our 8% organic revenue growth (which we define as consolidated revenue excluding acquisitions and the impact of foreign currency translations) was slower compared with past levels and third-quarter revenue declined by 5.1% compared with the second quarter of 2008.

- Revenue from acquisitions, primarily Hemscott, contributed 4.2 percentage points to third-quarter revenue growth.

- The largest contributors to organic revenue growth this quarter were Licensed Data and our three major Internet-based platforms: Morningstar Advisor Workstation, Morningstar Direct, and Morningstar.com.

- International revenue grew about 23% and acquisitions accounted for about one-half of the growth in international revenue. The percentage of revenue from outside the United States reached 24%, up from 22% in the third quarter of 2007.

- Operating margin declined modestly to 27.2% in 2008 compared with 28.1% in 2007.

- Free cash flow increased by approximately $12.4 million to $37.3 million, reflecting a $20.9 million increase in cash provided by operating activities and a $8.5 million increase in capital expenditures related to our new corporate office.

Consolidated Revenue

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

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

	Revenue from Acquisitions	
Acquisition	**Three Months Ended September 30, 2008**	**Nine Months Ended September 30, 2008**
Mutual fund data business acquired from Standard & Poor s		January 1 through March 15, 2008
Hemscott data, media, and investor relations Web site businesses	July 1 through September 30, 2008	January 9 through September 30, 2008
Financial Computer Support, Inc. (FSCI) practice management software for independent advisors	September 2 through September 30, 2008	September 2 through September 30, 2008

In the third quarter of 2008, our consolidated revenue increased 12.2% to $125.5 million. Revenue for the first nine months of the year increased 20.9% to $383.2 million. Acquisitions contributed $4.7 million to our consolidated revenue in the third quarter of 2008 and $20.7 million in the nine months ended September 30, 2008. Foreign currency translations also had a positive but much smaller impact on revenue. Because of continued market weakness and economic uncertainty, organic revenue increased at a lower rate than in the past.

Third-quarter revenue declined $6.7 million, or 5.1%, compared with the second quarter of 2008, primarily because of lower revenue from Investment Consulting and online advertising revenue from Morningstar.com. In addition, we hold our annual investment conference in the second quarter, and revenue from this event does not recur in other quarters.

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

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

Table of Contents

($000)	Three Months Ended September 30 2008	2007	Change	Nine Months Ended September 30 2008	2007	Change
Consolidated revenue	$ 125,505	$ 111,859	12.2%	$ 383,186	$ 316,991	20.9%
Less: acquisitions	(4,732)		NMF	(20,706)		NMF
Less: impact of foreign currency translations	(271)		NMF	(5,637)		NMF
Consolidated revenue excluding acquisitions and foreign currency translations	$ 120,502	$ 111,859	7.7%	$ 356,843	$ 316,991	12.6%

The Institutional segment, which makes up more than half of consolidated revenue, remained the largest contributor to revenue growth in the third quarter and nine-month periods. Institutional segment revenue increased $8.1 million, or 13.3%, in the third quarter of 2008, and $46.0 million, or 27.7%, in the first nine months of 2008. Acquisitions contributed approximately $4.1 million to Institutional segment revenue in the third quarter and $17.8 million in the first nine months. Advisor segment revenue increased $3.1 million, or 10.5%, in the third quarter and $11.4 million, or 13.4%, in the first nine months of 2008. Acquisitions contributed approximately $0.2 million to Advisor segment revenue in the third quarter and $1.3 million for the year-to-date period. Individual segment revenue increased $2.9 million, or 12.4%, in the third quarter and $10.2 million, or 14.2%, in the first nine months of the year. Acquisitions contributed $0.4 million and $1.6 million of revenue to the Individual segment in the third quarter and year-to-date periods, respectively.

The table below presents our consolidated revenue by segment for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30 2008		2007		Nine Months Ended September 30 2008		2007	
Revenue by Segment ($000)	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Individual	$ 26,613	21.2%	$ 23,667	21.2%	$ 82,119	21.4%	$ 71,897	22.7%
Advisor	32,402	25.8	29,336	26.2	96,958	25.3	85,522	27.0
Institutional	68,948	54.9	60,845	54.4	211,718	55.3	165,751	52.3
Elimination of intersegment revenue	(2,458)	(1.9)	(1,989)	(1.8)	(7,609)	(2.0)	(6,179)	(2.0)
Consolidated revenue	$ 125,505	100.0%	$ 111,859	100.0%	$ 383,186	100.0%	$ 316,991	100.0%

On a product level, Licensed Data and our three major Internet-based platforms Morningstar Advisor Workstation, Morningstar Direct, and Morningstar.com were the largest contributors to organic revenue growth in the third quarter, and were also major contributors to revenue growth for the nine-month period. Licensed Data was a leading contributor to the organic growth in the quarter, as demand for data feeds and other services remained strong. Total licenses for Morningstar Advisor Workstation in the United States were up 9.2% as of September 30, 2008. The year-over-year growth in licenses also reflects the ongoing positive impact of renewals signed in 2007 for expanded functionality and additional users.

Investment Consulting slowed in the third quarter, but was the third-largest driver behind organic revenue growth for the nine-month period. Much of our Investment Consulting business focuses on asset allocation services that we provide for funds of funds, where we typically act as a portfolio consultant or portfolio construction manager. Assets under advisement decreased about 7% year over year and declined about 14% compared with the second quarter of 2008. Changes in the value of assets under advisement can come from two primary sources: gains or losses related to overall trends in market performance, and net inflows or outflows caused when investors or institutions add to or redeem shares from these portfolios. The market has fallen about 20% over the past year, through September 30, 2008, and our assets under advisement declined about 7%. Because we derive 15% of our revenue from basis points tied to assets under management, our Investment Consulting business restrained our growth during the quarter.

During the second quarter of 2008, an Investment Consulting client informed us that it was not planning to renew its contract in October 2008. This contract represented about $11.3 million, or 2%, of consolidated revenue during the last 12 months. Because this client began moving assets out of some portfolios on which we provide advisory services during the third quarter, assets in some areas of our consulting business declined more than the market.

Revenue from international operations increased as a percentage of total revenue for both periods, although more so for the year-to-date period. The fund data business acquired from Standard & Poor s and the Hemscott data business both have extensive operations outside the United States. Revenue from international operations grew $5.7 million, or 23.0%, to $30.6 million in the third quarter of 2008, with acquisitions contributing $3.1 million of the increase. In the year-to-date period, revenue from international operations increased $30.0 million, or 47.1%, to $93.6 million, with acquisitions contributing $15.5 million of the increase.

Table of Contents

Foreign currency translations also had a favorable impact on international revenue, particularly for the year-to-date period. Excluding the impact of acquisitions and foreign currency translations, revenue in our non-U.S. operations grew approximately 9.6% and 13.9%, respectively, in the quarter and year-to-date periods. While foreign currency translations have had a favorable impact on 2008 revenue to date, the future impact may be favorable or unfavorable, depending on which direction rates move.

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

	Three Months Ended September 30			Nine Months Ended September 30		
($000)	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
International revenue	$ 30,581	$ 24,853	23.0%	$ 93,565	$ 63,586	47.1%
Less: acquisitions	(3,082)		NMF	(15,481)		NMF
Less: impact of foreign currency translations	(271)		NMF	(5,637)		NMF
International revenue excluding acquisitions and foreign currency translations	$ 27,228	$ 24,853	9.6%	$ 72,447	$ 63,586	13.9%

We present international organic revenue because we believe this non-GAAP financial measure helps investors better compare period-to-period results. International organic revenue should not be considered an alternative to any measure of performance as promulgated under GAAP.

Consolidated Operating Expense

	Three Months Ended September 30			Nine Months Ended September 30		
($000)	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Operating expense	$ 91,329	$ 80,414	13.6%	$ 272,755	$ 233,073	17.0%
% of revenue	72.8%	71.9%	0.9pp	71.2%	73.5%	(2.3)pp

In the third quarter of 2008, our consolidated operating expense rose at a slightly higher rate than revenue, increasing $10.9 million, or 13.6%. For the first nine months of 2008, operating expense was up $39.7 million, or 17.0%.

Compensation-related expense, excluding bonuses, accounted for the majority of the increase in both periods, mainly because of a 34% increase in worldwide headcount and higher sales commission expense. Lower bonus expense partially offset the increase in these costs. We had approximately 2,250 employees worldwide as of September 30, 2008, compared with 1,680 as of September 30, 2007. We added approximately 290 employees as a result of acquisitions, primarily from Hemscott in the UK, and approximately 160 employees for our development center in China. In addition, we hired 50 employees in the third quarter for the Morningstar Development Program, a two-year rotational training program for entry-level college graduates.

Bonus expense recorded in the third quarter of 2008 declined by $0.9 million, and increased $0.8 million in the year-to-date period. Changes in the size of our bonus pool are based on full-year operating income growth relative to the previous year. The size of the bonus pool varies each year and we review it and update it quarterly.

Other factors contributing to the increase in operating expense in the quarter include higher lease expense for our new headquarters and other global offices. Currently we are recording lease expense for the new headquarters we expect to move into later this year as well as lease expense for our current headquarters. These expense increases were partially offset by lower legal and professional fees. In the third quarter of 2007, we recorded $0.9 million in expense related to the settlement of litigation in Australia. In addition, we had about $1.8 million in product implementation expense for Advice by Ibbotson in the first nine months of 2007 that did not recur in 2008.

As a percentage of revenue, operating expense increased by 0.9 percentage points in the third quarter of 2008 as operating costs in most categories increased at a slightly faster pace compared with revenue growth. In the first nine months of 2008, operating expense as a percentage of revenue declined by 2.3 percentage points partly because of lower bonus expense and legal expense as a percentage of revenue, as well as the decline in product implementation expense associated with the Advice by Ibbotson service, all offset by higher lease expense as a percentage of revenue.

Cost of Goods Sold

	Three Months Ended September 30			Nine Months Ended September 30		
($000)	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Cost of goods sold	$ 32,828	$ 28,674	14.5%	$ 98,930	$ 83,549	18.4%
% of revenue	26.2%	25.6%	0.6pp	25.8%	26.4%	(0.6)pp
Gross profit	$ 92,677	$ 83,185	11.4%	$ 284,256	$ 233,442	21.8%
Gross margin	73.8%	74.4%	(0.6)pp	74.2%	73.6%	0.6pp

Table of Contents

Cost of goods sold is our largest category of operating expense, accounting for more than one-third of our total operating expense in both 2008 and 2007. Our business relies heavily on human capital, and cost of goods sold includes the compensation expense for employees who produce our products and services.

Cost of goods sold increased $4.2 million in the third quarter of 2008 and $15.4 million in the first nine months of 2008. Most of the increase was driven by higher compensation expense. However, in the first nine months this was partly offset by a reduction in product implementation expense. In 2007, we recorded outsourced product implementation expense associated with the Advice by Ibbotson service of $0.2 million in the third quarter and $1.8 million in the year-to-date period. These costs did not recur in 2008.

Because cost of goods sold increased slightly faster than the revenue growth, gross margin in the third quarter of 2008 was 73.8%, down slightly compared to the third quarter of 2007. The year-to-date gross margin improved to 74.2%, compared with 73.6% in the same period last year, essentially the result of the stronger business environment in the first half of 2008 when revenue growth outpaced operating expense growth.

Development Expense

	Three Months Ended September 30			Nine Months Ended September 30		
($000)	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Development expense	$ 10,271	$ 9,010	14.0%	$ 30,187	$ 26,199	15.2%
% of revenue	8.2%	8.1%	0.1pp	7.9%	8.3%	(0.4)pp

Development expense increased $1.3 million in the third quarter of 2008 and $4.0 million in the first nine months of 2008. This increase was driven mainly by higher compensation expense for both periods.

Sales and Marketing Expense

	Three Months Ended September 30			Nine Months Ended September 30		
($000)	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Sales and marketing expense	$ 19,457	$ 17,132	13.6%	$ 62,547	$ 50,332	24.3%
% of revenue	15.5%	15.3%	0.2pp	16.3%	15.9%	0.4pp

Sales and marketing expense increased $2.3 million in the third quarter of 2008 and $12.2 million in the first nine months of the year. Higher compensation expense and sales commission expense were the two main contributors to the increase in both periods. Marketing expense also rose because of marketing campaigns for certain products, as well as the Morningstar Investment Conference held in Europe during the second quarter. As a percentage of revenue, sales and marketing expense increased slightly in both the third quarter and year-to-date periods.

General and Administrative Expense

($000)	Three Months Ended September 30 2008	2007	Change	Nine Months Ended September 30 2008	2007	Change
General and administrative expense	$ 22,507	$ 19,936	12.9%	$ 62,392	$ 57,150	9.2%
% of revenue	17.9%	17.8%	0.1pp	16.3%	18.0%	(1.7)pp

General and administrative expense increased $2.6 million in the third quarter of 2008 and $5.2 million in the first nine months of 2008. In the third quarter and first nine months of 2008, lease costs grew because we recorded lease expense for our current headquarters as well as expense for the new headquarters building we expect to move into later this year. For both periods, compensation expense also increased, but was partially offset by the favorable impact of lower bonus expense in this cost category. The increase in office lease and compensation expense was offset by lower spending on legal and professional fees, in both the quarter and year-to-date periods. In the third quarter of 2007, we recorded $0.9 million in expense related to settling litigation in Australia.

As a percentage of revenue, general and administrative expense remained flat in the third quarter and declined 1.7 percentage points in the nine-month period. The drop in the nine-month period reflects the reduction in compensation expense, including bonus, and legal fees as a percentage of revenue.

Depreciation and Amortization Expense

($000)	Three Months Ended September 30 2008	2007	Change	Nine Months Ended September 30 2008	2007	Change
Depreciation expense	$ 2,314	$ 2,016	14.8%	$ 6,634	$ 6,356	4.4%
Amortization expense	3,952	3,646	8.4%	12,065	9,487	27.2%
Total depreciation and amortization expense	$ 6,266	$ 5,662	10.7%	$ 18,699	$ 15,843	18.0%
% of revenue	5.0%	5.1%	(0.1)pp	4.9%	5.0%	(0.1)pp

Table of Contents

Depreciation and amortization expense increased $0.6 million in the third quarter and $2.9 million in the first nine months of 2008. Amortization of intangible assets related to acquisitions increased substantially, particularly for the nine-month period because of the Hemscott acquisition, which was completed on January 9, 2008.

We expect that amortization of intangible assets will be an ongoing cost for the remaining life of the assets. As of September 30, 2008, we estimate that aggregate amortization expense for intangible assets will be $15.9 million in 2008. Our estimates of future amortization expense for intangible assets may be affected by changes to the preliminary purchase price allocations associated with our 2008 acquisitions.

Stock-Based Compensation Expense

	Three Months Ended September 30			Nine Months Ended September 30		
($000)	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Stock-based compensation expense	$ 2,818	$ 2,597	8.5%	$ 8,531	$ 8,134	4.9%
% of revenue	2.2%	2.3%	(0.1)pp	2.2%	2.6%	(0.4)pp

Stock-based compensation expense increased $0.2 million in the third quarter and $0.4 million in the first nine months of 2008.

Under Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), *Share Based Payment*, we record stock-based compensation cost only for those awards that ultimately vest. As a result, our stock-based compensation expense reflects an estimate of the expected forfeiture rate. We usually adjust our estimate of the forfeiture rate in the second quarter, which is when most of our larger equity grants typically vest. The adjustment recorded in the second quarter of 2008 was an expense of $0.2 million, compared with an adjustment of $0.7 million of expense recorded in the second quarter of 2007.

Based on grants made through September 30, 2008, we anticipate that stock-based compensation expense will be $11.3 million for the full-year 2008. This amount is subject to change based on additional equity grants or any change in our estimated forfeiture rate.

Bonus Expense

	Three Months Ended September 30			Nine Months Ended September 30		
($000)	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Bonus expense	$ 13,224	$ 14,086	(6.1)%	$ 37,943	$ 37,168	2.1%
% of revenue	10.5%	12.6%	(2.1)pp	9.9%	11.7%	(1.8)pp

The amount of bonus expense is not a fixed cost. Instead, changes in the size of our bonus pool are based on full-year operating income growth relative to the previous year, and the size of the bonus pool varies each year. We review and update growth estimates and the bonus pool size quarterly. In the third quarter, bonus expense declined about $0.9 million. As a result, bonus expense declined to 10.5% of revenue in the third quarter of 2008, compared with 12.6% in the same period in 2007. For the first nine months of 2008, bonus expense as a percentage of revenue was 9.9%, about 1.8 percentage points lower than the same period in 2007. We include bonus expense in each of our operating expense categories.

Consolidated Operating Income

($000)	Three Months Ended September 30 2008	2007	Change	Nine Months Ended September 30 2008	2007	Change
Operating income	$ 34,176	$ 31,445	8.7%	$ 110,431	$ 83,918	31.6%
% of revenue	27.2%	28.1%	(0.9)pp	28.8%	26.5%	2.3pp

Consolidated operating income increased $2.7 million in the third quarter of 2008 and $26.5 million in the first nine months of 2008. In the third quarter, the operating margin declined moderately as operating costs in most categories increased at a slightly faster pace than revenue growth. In the first nine months of 2008, operating margin increased by 2.3 percentage points partly because of lower bonus expense and legal expense as a percentage of revenue, as well as the $1.8 million decline in product implementation expense associated with the Advice by Ibbotson service. Higher lease expense as a percentage of revenue offset these operating margin benefits in the first nine months and also contributed to the lower operating margin in the third quarter.