



## **Morningstar Annual Report 2017**

**Form 10-K (NASDAQ:MORN)**

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2016**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 000-51280

**MORNINGSTAR, INC.**

(Exact Name of Registrant as Specified in its Charter)

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**Illinois**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**36-3297908**  
(I.R.S. Employer  
Identification Number)

**22 West Washington Street  
Chicago, Illinois  
60602**  
(Address of Principal Executive Offices)

**(312) 696-6000**  
(Registrant's Telephone Number, Including Area Code)  
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, no par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of shares of common stock held by non-affiliates of the Registrant as of June 30, 2016 was \$1.5 billion. As of February 17, 2017, there were 42,930,200 shares of the Registrant's common stock, no par value, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain parts of the Registrant's Definitive Proxy Statement for the 2017 Annual Meeting of Shareholders are incorporated into Part III of this Form 10-K.

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## Part I

### Item 1. Business

#### Overview

Morningstar is a leading provider of independent investment research in North America, Europe, Australia, and Asia. Our mission is to create great products that help investors reach their financial goals. We offer an extensive line of data, software, research, and investment management offerings for financial advisors, asset managers, retirement plan providers and sponsors, and individual investors. We currently serve approximately 250,000 financial advisors, 1,400 asset management firms, 27 retirement plan providers, 300,000 retirement plan sponsors, and 10.9 million individual investors. We also provide data on the private capital markets to approximately 2,000 institutional clients.

Our data and research are core assets that we seek to leverage to build Morningstar's long-term value. Morningstar provides extensive data and research insights on a wide range of investment offerings, including managed investment products, publicly listed companies, private capital markets, and real-time global market data.

Our data and proprietary analytical tools such as the Morningstar Rating for mutual funds, which rates past performance based on risk- and cost-adjusted returns, and the Morningstar Style Box, which provides a visual summary of a mutual fund's underlying investment style, have become important tools that millions of investors and advisors use in making investment decisions. We've created other tools, such as the Ownership Zone, Sector Delta, and Market Barometer, which allow investors to see how different investments work together to form a portfolio and to track its progress. Our popular Portfolio X-Ray tool helps investors evaluate their portfolios and get a clear view of their underlying holdings.

We've been providing independent analyst research on mutual funds and other investment vehicles since the mid-1980s. We use this analyst research to provide a qualitative, forward-looking Morningstar Analyst Rating for funds. We now provide research reports and Morningstar Analyst Ratings for approximately 4,100 funds globally, including active, passive, multi-asset, ETF, and closed-end fund strategies. We also offer qualitative research and ratings on alternative funds, state-sponsored college savings plan portfolios, and target-date funds. During 2016, we began providing qualitative analyst ratings on ETFs and qualitative coverage of separately managed accounts.

In 2016, we introduced the new Morningstar Sustainability Rating for funds, which helps investors evaluate funds based on environmental, social, and governance (ESG) factors. Morningstar now provides Sustainability Ratings for approximately 34,000 mutual funds and ETFs, encompassing \$27 trillion in assets under management, or more than half of fund assets globally.

As part of our research efforts on individual stocks, we popularized the concepts of economic moat, a measure of competitive advantage originally developed by Warren Buffett, and margin of safety, which reflects the size of the discount in a stock's price relative to its estimated value. The Morningstar Rating for stocks is based on the stock's current price relative to our analyst-generated fair value estimates, as well as the company's level of business risk and economic moat. Our analysts cover approximately 1,500 stocks using a consistent, proprietary methodology that focuses on fundamental analysis, competitive advantage assessment, and intrinsic value estimation.

In addition to our analyst-driven coverage, we provide quantitative ratings and reports for approximately 42,000 companies globally. These equity ratings draw on the fundamental research of our equity analyst team and provide a forward-looking statistical view of the valuation, competitive advantage, and level of uncertainty for stocks that are often under-followed by other research firms.

Through our Morningstar Credit Ratings, LLC subsidiary, which is a Nationally Recognized Statistical Rating Organization (NRSRO), we provide new issue and surveillance ratings and analysis for commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS), and other types of asset-backed securities. In 2016, the Securities and Exchanges Commission (SEC) authorized Morningstar Credit Ratings to rate corporate issuers and financial institutions under its NRSRO registration.

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In our investment management business, we've developed in-depth advice on asset allocation, portfolio construction, and security selection to meet the needs of investors and professionals looking for integrated portfolio solutions. We've published research on "Gamma," an innovative measure that quantifies how much additional retirement income investors can generate by making better financial planning decisions. We use the concept of human capital—or potential future earning ability—to provide a more complete picture of an investor's financial worth and optimize a portfolio's asset mix.

We believe investors rely on these tools because they offer a useful framework for comparing potential investments and making decisions. Our independence and our history of innovation make us a trusted resource for investors.

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## Strategy and Key Objectives

Our strategy is to widen our economic moat, or sustainable competitive advantage, and build shareholder value by focusing on our three key objectives, which we describe in more detail below. Our investment data, research, and ratings are at the heart of our strategy, allowing us to help investors achieve better investment outcomes whether they make their own investment decisions or outsource management of their portfolios.

### *1. Produce the most effective investment data, research, and ratings to help investors reach their financial goals.*

We believe our leadership position in independent investment research offers a competitive advantage that would be difficult for competitors to replicate. Our goal is to leverage our proprietary research and intellectual property to help investors with both decision support (via Morningstar Direct) and outsourced investment management (via our investment management business).

We're focusing our research efforts on several different areas, as described below.

- *Manager research (including mutual funds, ETFs, separate accounts, and other vehicles)*

Our goal for manager research is to leverage our leadership position to reach additional customers globally. In contrast to most other companies, we also integrate manager research with our software, which we believe is another competitive advantage.

As of December 31, 2016, we had 120 manager research analysts, including teams in North America, Europe, Australia, and Asia.

- *Equity research*

Our equity research complements our approach to manager research, where we focus on analyzing the individual stocks that make up each fund's portfolio. As of December 31, 2016, we had more than 100 equity analysts globally, making us one of the largest providers of independent equity research. We believe our analysts' long-term approach, deep industry knowledge, and focus on sustainable competitive advantage are important factors that set us apart and help investors achieve better investment outcomes.

- *Credit ratings*

Morningstar Credit Ratings, LLC, our credit ratings subsidiary, is a Nationally Recognized Statistical Rating Organization (NRSRO) that has historically focused on structured finance. As mentioned above, the SEC recently approved an expansion of the NRSRO license for Morningstar Credit Ratings to cover credit ratings for corporate issuers and financial institutions. Our goal is to bring transparency, unique perspectives, and superior client service to investors across the fixed-income markets.

- *Portfolio advice methodologies (including our research on Gamma and the Total Wealth Approach)*

Over the past several years, we've developed new research tools that provide a more holistic approach to investing and asset allocation. Whereas traditional asset allocation methodologies focus solely on financial assets (such as stocks and bonds), we've developed methodologies that provide a more complete view of all sources of wealth, including financial capital, human capital, housing assets, and retirement and pension benefits.

### *2. Develop Morningstar Direct as our flagship decision support platform.*

In 2015, we began rolling out the next-generation version of Morningstar Direct, our institutional investment research platform.

The new software is designed to be more intuitive, elegant, and easy-to-use. It provides a more consistent, cohesive experience with a strong emphasis on Morningstar's proprietary research and tools. We also improved the underlying technology, including a more streamlined development process for commonly used Morningstar capabilities such as portfolio management tools.

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The new software is fully web-based, which eliminates the need for desktop software installations and allows immediate access to new features. It allows us to innovate more rapidly and more easily configure our software solutions to meet client needs. It also addresses the growing need for mobile-optimized capabilities to extend the desktop experience onto mobile devices.

Over the past several years, we've started migrating many of our core software capabilities to Morningstar Direct, which will serve as our main platform for clients looking for information to support the investment decisions they make on their own or validate investment recommendations from another party. We're also continuing to expand the user base for Morningstar Direct by enhancing capabilities for our existing asset management clients and adding workflows for new types of clients, such as financial advisors.

### *3. Build world-class investment management solutions based on our proprietary research.*

We leverage our innovative, proprietary research by building world-class investment management solutions that help investors achieve better outcomes. Our goal is to connect our existing capabilities to create holistic solutions that help financial advisors, asset managers, and individual investors with portfolio construction, monitoring, security selection, and implementation.

Our investment management solutions include Morningstar Managed Portfolios, which had \$29.8 billion in assets under advisement as of December 31, 2016, and Workplace Solutions (formerly Retirement Solutions), which had a total of \$104.4 billion in assets under management and advisement.

We also expect to expand the investment management solutions we offer through our index business. We currently offer more than 350 investment indexes that can be used for both benchmarking and product creation.

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## **Major Customer Groups**

Given the core capabilities discussed above, we're focusing on five primary customer groups:

- Advisor (including independent financial advisors as well as those affiliated with broker-dealers or other intermediaries);
  - Asset management (including fund companies, insurance companies, and other companies that build and manage portfolios of securities for their clients);
  - Workplace/retirement (including retirement plan providers and plan sponsors);
  - Individual investor; and
  - Private/institutional investor.
-

### *Advisor*

Financial advisors work with individual investors to help them reach their financial goals. This customer group includes independent advisors at registered investment advisor (RIA) firms, advisors affiliated with independent broker-dealers, dually registered advisors, and “captive” advisors who are employees of a broker-dealer. Captive broker-dealers include wirehouses, regional broker-dealers, and banks. In total, Cerulli Associates estimates there were approximately 310,000 financial advisors in the United States as of the end of 2016.

We believe our deep understanding of individual investors’ needs allows us to work with advisors to help them make more efficient use of their time and deliver better investment outcomes for their clients. Our advisor solutions also draw on Morningstar’s proprietary investment research methodologies and research insights.

We sell our advisor-related solutions both directly to independent financial advisors and through enterprise licenses, which allow financial advisors associated with the licensing firm to use our products.

We’re expanding the range of services we offer to help financial advisors with all aspects of their daily workflow needs, including investment decision-making, portfolio construction, client monitoring and reporting, practice management, portfolio rebalancing that connects with custodial and trading interfaces, and financial planning. Because advisors are increasingly outsourcing investment management, we’re continuing to enhance Morningstar Managed Portfolios to help advisors save time and reduce compliance risk.

Our main products for financial advisors are Morningstar Advisor Workstation (including Morningstar Office) and Morningstar Managed Portfolios.

### *Asset management*

Asset management firms manage and distribute investment portfolios. We estimate that there are more than 3,000 asset management firms globally, ranging from large, global firms to firms with small fund lineups and operations in a single market or region. The asset management customer group includes individuals involved in sales, marketing, product development, and distribution, as well as investment management (often referred to as the “buy side”), which includes portfolio management and research.

Our asset management offerings help companies connect with their clients because of Morningstar’s strong brand presence with both financial advisors and individual investors. We offer a global reach and have earned investors’ trust in our unbiased approach, investor-centric mission, and thought leadership.

Our goal is to expand our reach with asset management clients and individuals at these firms who employ Morningstar’s research offerings to help them achieve better results for their clients. We also plan to leverage our proprietary research and data to continue developing differentiated software and data offerings.

The key products we offer for asset management firms include Morningstar Direct, Morningstar Data, and Morningstar Indexes. For the buy side, key products include Morningstar Research, Morningstar Credit Ratings, Morningstar Data, and Morningstar Direct.

### *Workplace/retirement*

In the workplace (also known as retirement) market, millions of investors are now charged with planning for their own retirement, mainly through self-directed retirement plans such as 401(k) plans in the United States. Assets in 401(k) plans totaled an estimated \$4.6 trillion as of December 31, 2016, based on data from Cerulli Associates. In the wake of the financial crisis of 2008 and 2009, we believe individual investors, financial advisors, employers, and government organizations have all become more aware of the need for advice and guidance that helps individuals build assets for retirement and beyond.

Our retirement offerings help retirement plan participants of all ages plan and invest for retirement. We offer these services both through retirement plan providers (typically third-party asset management companies that provide administrative and record-keeping services) and directly to plan sponsors (employers that offer retirement plans to their employees).