Morningstar Corporate Actions Methodology for Venture Capital-Backed Private Companies

Morningstar Inc.
Jan 2026

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https://indexes.morningstar.com/

Introduction

This document outlines the corporate action policy that is used in the maintenance of Morningstar's venture capital-backed private company indexes.

Cash Distributions

Cash Dividend or Ordinary Cash Dividend

This is a distribution of a portion of a company's earnings to its shareholders at regular intervals, typically on a quarterly, semiannual, or annual basis, and quoted in per share amounts. Typically, privately held companies do not pay out regular dividends. So, private equity index calculation is not impacted by ordinary dividends.

In an index comprising both public and private equity securities, the treatment of ordinary dividend distributions by public companies may differ. In some cases, dividends paid by public companies are reinvested on a pro rata basis across all index constituents, including private companies. In other cases, reinvestment is limited to public company constituents only.

Please refer to the Corporate Actions section of the index rulebook to confirm which methodology applies.

Mergers and Acquisitions

In a merger, two or more companies join to form a new entity. This is generally done by a mutual agreement or through a tender offer that can be structured in a wide variety of ways that involve cash, stock, or a combination of both. In an acquisition, a company buys most or all of the target company and assumes controlling interest. The acquisition could be funded through cash, stock, or a combination of both. In a reverse merger, a private company acquires a public company. Any type of merger or acquisition will result in changes in the financing/backing status of the target company, making them ineligible for inclusion in Morningstar venture capital-backed private company indexes. Companies that have completed a merger or acquisition are dropped from the index within two days of the last update date[1] of the deal, at the valuation determined by Morningstar's venture capital pricing methodology.

If a merged or acquired company has been removed from the index but become eligible again due to a new qualifying funding round, it will be included as of the next effective reconstitution date.

[1] Last update date is the date when the information on the deal is captured by Pitchbook.

Bankruptcy and Financial Distress

Bankrupt securities are ineligible. When a company undergoes bankruptcy, or goes out of business, it is removed from the index at zero price within two days of the last update date[2] of the bankruptcy.

If a bankrupt company has been removed from the index but become eligible again due to a new qualifying funding round, it will be included as of the next effective reconstitution date.

Listings

A private security gets listed when it is made available on a tradeable exchange through an IPO. When a constituent undergoes an IPO, it is held in the index portfolio for 180 days to reflect the typical period when early investors begin to unwind positions, though timing can vary by investor. Listed securities are dropped at their public market capitalization.

If a listed company has been removed from the index but become eligible again due to a new qualifying funding round, it will be included as of the next effective reconstitution date.

Buyouts

If a company undergoes a buyout, leveraged buyout, or an investor buyout by management, its financing/backing status changes, thereby making it ineligible for inclusion in Morningstar venture capital-backed private company indexes. Companies that are bought out are dropped from the index within two days of the last update date[1] of the deal, at the valuation determined by Morningstar's venture capital pricing methodology.

If a bought-out company has been removed from the index but become eligible again due to a new qualifying funding round, it will be included as of the next effective reconstitution date.

Stock Splits

A stock split is a corporate action where the company divides the existing number of shares into multiple new shares. The shares are distributed on a pro-rata basis based on the shares held by the existing shareholders. The price per share is simultaneously reduced by the same factor, such that a stock split should not result in a change to a company's market capitalization. Stock splits are quoted in the ratio of new shares received/old shares held.

The index shares increase, and the price of the stock decreases as determined by the stock-split ratio, while the market value of the security in the index remains the same before and after the stock split.

Reverse Stock Splits

A reverse stock split is a corporate action where the company consolidates the existing number of shares into fewer shares. This is also known as a stock consolidation, stock merge, or stock rollback.

The index shares decrease while the price of the security increases as determined by the reverse stock-split ratio. The market value of the security in the index remains the same before and after reverse stock split.

About Morningstar Indexes

Morningstar Indexes was built to keep up with the evolving needs of investors—and to be a leading-edge advocate for them. Our rich heritage as a transparent, investor-focused leader in data and research uniquely equips us to support individuals, institutions, wealth managers and advisors in navigating investment opportunities across major asset classes, styles and strategies. From traditional benchmarks and unique IP-driven indexes, to index design, calculation and distribution services, our solutions span an investment landscape as diverse as investors themselves.

Please visit indexes.morningstar.com for more information.

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