Dolan Media CO
Form 10-Q
November 13, 2007

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended: September 30, 2007

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: 001-33603

Dolan Media Company

(Exact name of registrant as specified in its charter)

Delaware	**43-2004527**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

706 Second Avenue South
Suite 1200
Minneapolis, Minnesota 55402
(Address, including zip code of registrant s principal executive offices)
(612) 317-9420
(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 þ No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

As of November 12, 2007, there were 25,088,117 outstanding shares of Common Stock, par value $.001, of the registrant.

DOLAN MEDIA COMPANY
QUARTER ENDED SEPTEMBER 30, 2007
INDEX

Table of Contents

PART I FINANCIAL INFORMATION
ITEM 1. Financial Statements

Dolan Media Company
Unaudited Condensed Consolidated Balance Sheets
(In thousands, except per share data)

	September 30, 2007	December 31, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 4,041	$ 786
Accounts receivable (net of allowances for doubtful accounts of $1,117, and $1,014 as of September 30, 2007 and December 31, 2006, respectively)	19,383	15,679
Prepaid expenses and other current assets	2,302	2,187
Deferred income taxes	152	152
Total current assets	25,878	18,804
Investments	18,322	18,065
Property and equipment, net	11,589	8,230
Finite-life intangible assets, net	77,531	65,881
Goodwill	79,030	72,690
Other assets	1,960	2,449
Total assets	$ 214,310	$ 186,119
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities		
Current portion of long-term debt	$ 5,076	$ 7,031
Accounts payable	6,208	4,438
Accrued compensation	3,364	3,526
Accrued liabilities	2,937	1,448
Due to sellers of acquired businesses	600	600
Deferred revenue	10,927	10,752
Total current liabilities	29,112	27,795
Long-term debt, less current portion	48,130	72,760
Deferred income taxes	4,034	4,034
Deferred revenue and other liabilities	2,600	1,829
Series C mandatorily redeemable, convertible, participating preferred stock, $0.001 par value; authorized: 40,000 shares; issued and outstanding: 0 shares as of September 30, 2007 and 38,132 shares as of December 31, 2006		73,292
Series B mandatorily redeemable, nonconvertible preferred stock, $0.001 par value; authorized: 40,000 shares; issued and outstanding: 0 shares as of September 30, 2007 and December 31, 2006		
Series A mandatorily redeemable, nonconvertible preferred stock, $.001 par value; authorized 550,000 shares; issued and outstanding: 0 shares as of		35,037

September 30, 2007 and 287,000 shares as of December 31, 2006				
Total liabilities		83,876		214,747
Minority interest in consolidated subsidiary		4,661		247
Commitments and contingencies (Notes 4 and 5)				
Stockholders equity (deficit)				
Common stock, $0.001 par value; authorized: 70,000,000 shares; issued and outstanding: 25,088,804 shares as of September 30, 2007 and 9,324,000* shares as of December 31, 2006		25		1
Additional paid-in capital		212,086		303
Accumulated deficit		(86,338)		(29,179)
Total stockholders equity (deficit)		125,773		(28,875)
Total liabilities and stockholders equity (deficit)	$	214,310	$	186,119

* Adjusted to reflect a 9 for 1 stock split as described in Note 8.

See Notes to Unaudited Condensed Consolidated Financial Statements

1

Table of Contents

Dolan Media Company
Unaudited Condensed Consolidated Statements of Operations
(In thousands, except per share data)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Revenues				
Business Information	$ 20,962	$ 17,810	$ 62,030	$ 54,465
Professional Services	17,362	10,970	49,044	24,934
Total revenues	38,324	28,780	111,074	79,399
Operating expenses				
Direct operating: Business Information	7,363	6,473	21,140	19,613
Direct operating: Professional Services	5,332	3,217	15,737	7,799
Selling, general and administrative	15,860	10,892	45,443	31,821
Amortization	1,871	1,315	5,585	3,601
Depreciation	1,206	634	2,851	1,728
Total operating expenses	31,632	22,531	90,756	64,562
Equity in earnings of Detroit Legal News Publishing, LLC, net of amortization of $364 and $347 for the three months ended September 30, 2007 and 2006, respectively, and $1,082 and $1,156 for the nine months ended September 30, 2007 and 2006, respectively	1,611	791	3,856	1,782
Operating income	8,303	7,040	24,174	16,619
Non-operating expense				
Non-cash interest expense related to redeemable preferred stock	(9,872)	(10,019)	(66,132)	(23,470)
Interest expense, net	(3,190)	(2,404)	(6,618)	(4,868)
Other expense	(8)	(6)	(21)	(26)
Total non-operating expense	(13,070)	(12,429)	(72,771)	(28,364)
Loss from operations before income taxes and minority interest	(4,767)	(5,389)	(48,597)	(11,745)
Income tax expense	(1,657)	(1,484)	(5,764)	(3,992)
Minority interest in net income of subsidiary	(1,091)	(649)	(2,798)	(1,238)
Net loss	$ (7,515)	$ (7,522)	$ (57,159)	$ (16,975)
Net loss per share:*				
Basic and diluted	$ (0.38)	$ (0.81)	$ (4.46)	$ (1.84)

Weighted average shares outstanding:*				
Basic and diluted	19,675,101	9,336,131	12,812,282	9,230,373

* Adjusted to reflect a 9 for 1 stock split as described in Note 8.

See Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents

Dolan Media Company
Unaudited Condensed Consolidated Statements of Cash Flows
(In thousands)

	Nine Months Ended September 30, 2007	2006
Cash flows from operating activities		
Net loss	$ (57,159)	$ (16,975)
Distributions received from Detroit Legal News Publishing, LLC	4,200	2,800
Minority interest distributions paid	(1,814)	(1,015)
Non-cash operating activities:		
Amortization	5,585	3,601
Depreciation	2,851	1,728
Stock-based compensation expense	564	
Deferred income taxes		112
Change in value of interest rate swap and accretion of interest on note payable	698	234
Equity in earnings of Detroit Legal News Publishing, LLC	(3,856)	(1,782)
Minority interest	2,798	1,238
Non-cash interest related to redeemable preferred stock	66,611	23,570
Amortization of debt issuance cost	696	613
Changes in operating assets and liabilities, net of effects of business acquisitions:		
Accounts receivable	(3,705)	(615)
Prepaid expenses and other current assets	(707)	(124)
Other assets	28	(231)
Accounts payable and accrued liabilities	4,313	2,002
Deferred revenue	(767)	(305)
Net cash provided by operating activities	20,336	14,851
Cash flows from investing activities		
Acquisitions and investments	(17,335)	(42,262)
Capital expenditures	(5,724)	(1,598)
Other	130	40
Net cash used in investing activities	(22,929)	(43,820)
Cash flows from financing activities		
Net payments on senior revolving note		(13,500)
Proceeds from borrowings on senior term notes	10,000	56,350
Payments on senior long-term debt	(39,750)	(4,500)
Proceeds from initial public offering, net of underwriting discount	141,593	
Redemption of preferred stock	(101,089)	
Payments of offering costs	(3,985)	
Payments of deferred financing costs	(891)	(777)
Other	(30)	(69)
Net cash provided by financing activities	5,848	37,504

Net increase in cash and cash equivalents	3,255	8,535
Cash and cash equivalents at beginning of period	786	2,348
Cash and cash equivalents at end of period	$ 4,041	$ 10,883

See Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents

Dolan Media Company
Condensed Consolidated Statements of Stockholders Equity (Deficit)
Year Ended December 31, 2006 and
Nine Months Ended September 30, 2007
(unaudited)
(In thousands, except share data)

	Common Stock		Additional Paid-In	Accumulated	
	Shares*	Amount	Capital	Deficit	Total
Balance (deficit) at December 31, 2006	9,324,000	$ 1	$ 303	$ (29,179)	$ (28,875)
Net loss				(57,159)	(57,159)
Stock based compensation expense			564		564
Preferred stock series C conversion	5,093,155	5	73,844		73,849
Initial public offering proceeds, net of underwriting discount and offering costs	10,500,000	11	137,383		137,394
Issuance of restricted stock, net of forfeitures	171,649				
Other		8	(8)		
Balance (deficit) at September 30, 2007	25,088,804	$ 25	$ 212,086	$ (86,338)	$ 125,773

* Adjusted to reflect a 9 for 1 stock split as described in Note 8.

See Notes to Unaudited Consolidated Financial Statements

4

Table of Contents

Dolan Media Company

Notes to Unaudited Condensed Consolidated Financial Statements

Note 1. Significant Accounting Policies

Basis of Presentation: The unaudited condensed consolidated financial statements of Dolan Media Company have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to these rules and regulations. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and related notes for the year ended December 31, 2006 included in the Company s prospectus filed on August 2, 2007 with the Securities and Exchange Commission pursuant to Rule 424(b)(4) of the Securities Act of 1933, as amended.

In the opinion of management, these unaudited condensed consolidated financial statements reflect all adjustments necessary for a fair presentation of the Company s interim financial results. All such adjustments are of a normal and recurring nature. The results of operations for any interim period are not necessarily indicative of results for the full calendar year.

The accompanying unaudited condensed consolidated interim financial statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates in the Preparation of Financial Statements: 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 amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates. The Company believes the critical accounting policies that require the most significant assumptions and judgments in the preparation of its consolidated financial statements are: purchase accounting; valuation of the Company s equity securities; accounting for and analysis of potential impairment of goodwill; other intangible assets and other long-lived assets; accounting for share-based compensation; income tax accounting; and allowances for doubtful accounts.

Recently Issued Accounting Standards: On February 15, 2007, the Financial Accounting Standards Board, or the FASB, issued *SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities*. Under this standard, the Company may elect to report financial instruments and certain other items at fair value on a contract-by-contract basis with changes in value reported in earnings. This election is irrevocable. SFAS 159 provides an opportunity to mitigate volatility in reported earnings that is caused by measuring hedged assets and liabilities that were previously required to use a different accounting method than the related hedging contracts when the complex provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, are not met. SFAS 159 is effective for years beginning after November 15, 2007. The Company is currently evaluating the potential impact of adopting this standard.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for the Company beginning January 1, 2008. The Company is currently assessing the potential impact that the adoption of SFAS 157 will have, if any, on the Company s financial statements.

Dolan Media Company
Notes to Unaudited Condensed Consolidated Financial Statements

Recently Adopted Accounting Pronouncement: The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB *Statement No. 109*, commonly referred to as FIN 48, on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no adjustment in the liability for unrecognized income tax benefits. At the adoption date of January 1, 2007, the Company had $153,000 of unrecognized income tax benefits. All of the unrecognized income tax benefits, if recognized, would favorably affect its effective income tax rate in future periods. There were no material adjustments for the unrecognized income tax benefits in the three and nine months ended September 30, 2007.

The Company is subject to United States federal income tax, as well as income tax of multiple state jurisdictions. Currently, no federal or state jurisdiction is examining the Company s income tax returns. The Company has used net operating losses from tax years ended 2000 through 2006. As a result, the Company s federal income tax returns for those tax years are open to examination for an additional three year period, beginning with the tax year immediately following the tax year in which the Company fully used the net operating loss from such prior tax year. In states where the Company s operations have generated net operating losses, its state returns will be open for examination for a similar three year period.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. Upon adoption of FIN 48, the Company had $36,000 of accrued interest related to uncertain tax positions.

The Company does not anticipate any significant increases or decreases in unrecognized tax benefits within twelve months of adoption of FIN 48. Insignificant amounts of interest expense will continue to accrue.

Note 2. Accounts Receivable

Accounts receivable are carried at original invoice amount less an estimate made for doubtful accounts. The Company reviews a customer s credit history before extending credit and establishes an allowance for doubtful accounts based on factors surrounding the credit risk of specific customers, historic trends and other information.

Activity in the allowance for doubtful accounts was as follows (*in thousands*):

	Beginning Balance	Acquisitions	Provision (Reduction) for Doubtful Accounts	(Write offs) Recoveries	Ending Balance
For the nine months ended September 30, 2007	$1,014	$	$ 506	$(403)	$ 1,117
For the nine months ended September 30, 2006	$1,175	$	$ (112)	$(171)	$ 892

Note 3. Basic and Diluted Loss Per Share

Basic per share amounts are computed, generally, by dividing net income (loss) by the weighted-average number of common shares outstanding. The Company believes that the series C preferred stock (which was redeemed in connection with the Company s initial public offering) was a participating security because the holders of the convertible preferred stock participated in any dividends paid on the Company s common stock on an as converted basis. Consequently, the two-class method of income

Dolan Media Company
Notes to Unaudited Condensed Consolidated Financial Statements

allocation was used in determining net income (loss), except during periods of net losses. Under this method, net income (loss) was allocated on a pro rata basis to the common and Series C preferred stock to the extent that each class may share in income for the period had it been distributed. Diluted per share amounts assumed the conversion, exercise, or issuance of all potential common stock instruments (see Note 12 for information on stock options) unless their effect was anti-dilutive, thereby reducing the loss per share or increasing the income per share.

The following table computes basic and diluted net loss per share (*in thousands, except per share amounts*):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Net loss	$ (7,515)	$ (7,522)	$ (57,159)	(16,975)
Basic:				
Weighted average common shares outstanding	19,777	9,336	12,847	9,230
Weighted average common shares of unvested restricted stock	(102)		(35)	
Weighted average common shares equivalents of convertible preferred stock				
Shares used in the computation of basic net loss per share	19,675	9,336	12,812	9,230
Net loss per share basic	$ (0.38)	$ (0.81)	$ (4.46)	$ (1.84)
Diluted:				
Shares used in the computation of basic net loss per share	19,675	9,336	12,812	9,230
Employee and non-employee director stock options				
Unvested restricted stock				
Shares used in the computation of diluted net loss per share	19,675	9,336	12,812	9,230
Net loss per share diluted	$ (0.38)	$ (0.81)	$ (4.46)	$ (1.84)

For the three and nine months ended September 30, 2007, options to purchase 147,000 and 0 weighted shares of common stock, respectively, were excluded from the computation because their effect would be anti-dilutive. In 2006, no anti-dilutive shares were excluded related to stock options as no stock options were outstanding in the three and nine months ended September 30, 2006.

Note 4. Acquisitions

Acquisitions have been accounted for under the purchase method of accounting, in accordance with SFAS No. 141, *Business Combinations*. Management is responsible for determining the fair value of the assets acquired and liabilities assumed at the acquisition date. The fair values of the assets acquired and liabilities assumed represent management s estimate of fair values. Valuations are determined through a combination of methods that include internal rate of return calculations, discounted cash flow models, outside valuations and appraisals and market conditions. The results of the acquisitions are included in the accompanying unaudited condensed consolidated statement of operations from the respective acquisition dates forward.

2007 Acquisitions:

Feiwell & Hannoy P.C.: On January 9, 2007, American Processing Company, or APC, a majority owned subsidiary of the Company, acquired the mortgage default processing service business of Feiwell & Hannoy P.C., an Indiana law firm, for the following consideration: (i) $13.0 million cash, (ii) a non-interest bearing note (discounted at 13%) with a face amount of $3.5 million payable in two equal annual installments of $1.75 million beginning on January 9, 2008, and (iii) a 4.5% membership interest in APC that had an estimated fair value on January 9, 2007 of $3.4 million. In addition, the Company incurred acquisition costs of approximately $626,000. The Company used a market approach to estimate

Table of Contents

Dolan Media Company
Notes to Unaudited Condensed Consolidated Financial Statements

the fair value of the APC membership interest issued to Feiwell & Hannoy. The results of Feiwell & Hannoy s mortgage default processing service operations are included in the Company s unaudited condensed consolidated financial statements beginning January 9, 2007. In connection with the acquisition of Feiwell & Hannoy, APC appointed the managing attorneys of Feiwell & Hannoy as vice presidents of APC. As a result of this acquisition, the Company s ownership interest in APC was diluted from 81% to 77.4%.

Of the $20.3 million of acquired intangibles, the Company has preliminarily allocated $15.3 million to a long-term service agreement, which is being amortized over 15 years, representing its initial contractual term. The Company preliminarily allocated the remaining $5.0 million of the purchase price to goodwill. The goodwill is tax deductible and was allocated to the Professional Services segment of the Company. The Company engaged an independent third-party valuation firm to assist it in estimating the fair value of the service agreement. The value of the service agreement was estimated using a discounted cash flow analysis (income approach) assuming a 4% revenue growth and a 24% discount rate. The Company paid a premium over the fair value of the net tangible and identified intangible assets acquired in connection with this acquisition (i.e., goodwill) because the acquired business is a complement to APC and the Company anticipated cost savings and revenue synergies through combined general and administrative and corporate functions. The Company does not believe that any of these considerations resulted in separately identifiable intangible assets.

In connection with this acquisition, APC amended and restated its operating agreement to allow Feiwell & Hannoy and the other minority interest holder of APC, Trott & Trott, PC, the individual right to require APC to purchase all or any portion of their respective membership interest for a purchase price equal to 6.25 times the trailing twelve month EBITDA of APC. Feiwell & Hannoy and Trott & Trott can each exercise this right for a period of six months after August 7, 2009. If Feiwell & Hannoy or Trott & Trott fail to exercise this right within the allowable time period, APC s obligation to purchase the membership interest of that minority interest holder terminates. The Company does not have the right to require APC to repurchase all or any portion of its membership interest in APC.

Venture Publications Inc.: On March 30, 2007, the Company purchased the publishing assets of Venture Publications, Inc. in Jackson, Mississippi, for $2.8 million plus acquisition costs of approximately $59,000. The Company may be obligated to make an additional payment of up to $600,000 provided certain revenue targets are met. The assets included the *Mississippi Business Journal* and its related publishing assets and an annual business trade show. These assets are a part of the Company s Business Information segment.

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