DAILY JOURNAL CORP
Form 10-Q
February 11, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2018

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 0-14665

DAILY JOURNAL CORPORATION

(Exact name of registrant as specified in its charter)

South Carolina	95-4133299
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

915 East First Street

Los Angeles, California	90012-4050
(Address of principal executive offices)	(Zip code)

(213) 229-5300

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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 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 such files).

Yes: X No:

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

Large Accelerated Filer:	Accelerated Filer: X
Non-accelerated Filer:	Smaller Reporting Company:
	Emerging Growth Company:

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

Class	Outstanding at January 31, 2019
Common Stock, par value $ .01 per share	1,380,746 shares

DAILY JOURNAL CORPORATION

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PART I

Item 1. FINANCIAL STATEMENTS

DAILY JOURNAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	December 31 2018	September 30 2018
ASSETS		
Current assets		
Cash and cash equivalents	$6,691,000	$9,301,000
Marketable securities at fair value	183,656,000	212,296,000
Accounts receivable, less allowance for doubtful accounts of $200,000	7,033,000	4,803,000
Inventories	55,000	46,000
Prepaid expenses and other current assets	491,000	512,000
Income tax receivable	58,000	270,000
Total current assets	197,984,000	227,228,000
Property, plant and equipment, at cost		
Land, buildings and improvements	16,472,000	16,422,000
Furniture, office equipment and computer software	2,911,000	2,877,000
Machinery and equipment	1,749,000	1,749,000
	21,132,000	21,048,000
Less accumulated depreciation	(9,981,000)	(9,828,000)
	11,151,000	11,220,000
Goodwill	13,400,000	13,400,000
Deferred income taxes - Federal	9,753,000	9,269,000
Deferred income taxes - State	2,828,000	2,881,000
	$235,116,000	$263,998,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$4,036,000	$2,820,000
Accrued liabilities	3,804,000	4,402,000
Note payable collateralized by real estate	123,000	121,000
Deferred subscriptions	2,947,000	3,174,000
Deferred installation contracts	2,442,000	2,554,000
Deferred maintenance agreements and others	14,624,000	14,186,000
Total current liabilities	27,976,000	27,257,000
Long term liabilities		

Investment margin account borrowings	29,493,000	29,493,000
Note payable collateralized by real estate	1,804,000	1,835,000
Deferred maintenance agreements	106,000	176,000
Accrued liabilities	180,000	170,000
Deferred income taxes	34,174,000	42,151,000
Total long term liabilities	65,757,000	73,825,000
Commitments and contingencies (Notes 9 and 10)	---	---
Shareholders' equity		
Preferred stock, $.01 par value, 5,000,000 shares authorized and no shares issued	---	---
Common stock, $.01 par value, 5,000,000 shares authorized; 1,805,053 shares issued, including 424,307 treasury shares, at December 31, 2018 and September 30, 2018	14,000	14,000
Additional paid-in capital	1,755,000	1,755,000
Retained earnings	139,614,000	45,361,000
Accumulated other comprehensive income	---	115,786,000
Total shareholders' equity	141,383,000	162,916,000
	$235,116,000	$263,998,000

See accompanying Notes to Consolidated Financial Statements

DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(Unaudited)

	Three months ended December 31 2018		2017	
Revenues				
Advertising	$	2,192,000	$	2,116,000
Circulation		1,338,000		1,363,000
Advertising service fees and other		669,000		602,000
Licensing and maintenance fees		4,790,000		4,350,000
Consulting fees		541,000		995,000
Other public service fees		898,000		826,000
		10,428,000		10,252,000
Costs and expenses				
Salaries and employee benefits		8,655,000		8,197,000
Outside services		945,000		1,039,000
Postage and delivery expenses		204,000		217,000
Newsprint and printing expenses		176,000		212,000
Depreciation and amortization		153,000		1,218,000
Other general and administrative expenses		2,816,000		2,814,000
		12,949,000		13,697,000
Loss from operations		(2,521,000)		(3,445,000)
Other income (expense)				
Dividends and interest income		1,530,000		1,483,000
Other income and capital gains		10,000		11,000
		(28,640,000)		---

Net unrealized losses on investments						
Interest expense on note payable collateralized by real estate		(23,000	)		(24,000	)
Interest expense on margin loans		(206,000	)		(136,000	)
Loss before income taxes		(29,850,000	)		(2,111,000	)
Benefit from income taxes		8,317,000			16,850,000	
Net (loss) income	$	(21,533,000	)	$	14,739,000	
Weighted average number of common shares outstanding - basic and diluted		1,380,746			1,380,746	
Basic and diluted net (loss) income per share	$	(15.60	)	$	10.67	
Comprehensive (loss) income						
Net (loss) income	$	(21,533,000	)	$	14,739,000	
Net increase in unrealized appreciation of marketable securities (net of taxes)		---			12,118,000	
	$	(21,533,000	)	$	26,857,000	

See accompanying Notes to Consolidated Financial Statements.

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DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS’ EQUITY

(Unaudited)

	Common Stock Share	Common Stock Amount	Treasury Stock Share	Treasury Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at September 30, 2018	1,805,053	$18,000	(424,307)	$(4,000)	$1,755,000	$45,361,000	$115,786,000	$162,916,000
Adoption of new accounting pronouncement	---	---	---	---	---	115,786,000	(115,786,000)	---
Net loss	---	---	---	---	---	(21,533,000)	---	(21,533,000)
Balance at December 31, 2018	1,805,053	$18,000	(424,307)	$(4,000)	$1,755,000	$139,614,000	$---	$141,383,000
Balance at September 30, 2017	1,805,053	$18,000	(424,307)	$(4,000)	$1,755,000	$57,150,000	$100,822,000	$159,741,000
Net income	---	---	---	---	---	14,739,000	---	14,739,000
Unrealized gains on investments, net	---	---	---	---	---	---	12,118,000	12,118,000
Balance at December 31, 2017	1,805,053	$18,000	(424,307)	$(4,000)	$1,755,000	$71,889,000	$112,940,000	$186,598,000

See accompanying Notes to Consolidated Financial Statements

DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three months ended December 31	
	2018	2017
Cash flows from operating activities		
Net (loss) income	$(21,533,000)	$14,739,000
Adjustments to reconcile net (loss) income to net cash used in operations		
Depreciation and amortization	153,000	1,218,000
Net unrealized losses on investments	28,640,000	---
Deferred income taxes	(8,408,000)	(16,778,000)
Discounts earned on bonds	---	(1,000)
Changes in operating assets and liabilities		
(Increase) decrease in current assets		
Accounts receivable, net	(2,230,000)	1,166,000
Inventories	(9,000)	---
Prepaid expenses and other assets	21,000	157,000
Income tax receivable	212,000	(78,000)
Increase (decrease) in liabilities		
Accounts payable	1,216,000	(98,000)
Accrued liabilities	(588,000)	(701,000)
Deferred subscriptions	(227,000)	(149,000)
Deferred maintenance agreements and others	368,000	419,000
Deferred installation contracts	(112,000)	(708,000)
Net cash used in operating activities	(2,497,000)	(814,000)
Cash flows from investing activities		
Purchases of property, plant and equipment	(84,000)	(34,000)
Net cash used in investing activities	(84,000)	(34,000)
Cash flows from financing activities		
Payment of real estate loan principal	(29,000)	(28,000)
Net cash used in financing activities	(29,000)	(28,000)
Decrease in cash and cash equivalents	(2,610,000)	(876,000)
Cash and cash equivalents		
Beginning of period	9,301,000	3,384,000
End of period	$6,691,000	$2,508,000

Interest paid during period	$152,000	$169,000
Net income taxes (refunded) paid during period	$(121,000)	$6,000

See accompanying Notes to Consolidated Financial Statements.

DAILY JOURNAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - The Corporation and Operations

Daily Journal Corporation (the “Company”) publishes newspapers and web sites covering California and Arizona and produces several specialized information services. It also serves as a newspaper representative specializing in public notice advertising. This is sometimes referred to as the Company’s Traditional Business”.

Journal Technologies, Inc. (“Journal Technologies”), a wholly-owned subsidiary, supplies case management software systems and related products to courts, prosecutor and public defender offices, probation departments and other justice agencies, including administrative law organizations, city and county governments and bar associations. These organizations use the Journal Technologies family of products to help manage cases and information electronically, to interface with other critical justice partners and to extend electronic services to the public, including efiling and a website to pay traffic citations online, and bar members. These products are licensed to more than 500 organizations in 42 states and internationally.

Essentially all of the Company’s operations are based in California, Arizona, Colorado and Utah.

Note 2 - Basis of Presentation

In the opinion of the Company, the accompanying interim unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of its financial position as of December 31, 2018, and its results of operations and cash flows for the three-month periods ended December 31, 2018 and 2017. The results of operations for the three months ended December 31, 2018 are not necessarily indicative of the results to be expected for the full year.

The consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. 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 such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2018.

Certain reclassifications of previously reported amounts have been made to conform to the current year’s presentation.

Note 3 - Accounting Standards Adopted in Fiscal 2019 and Recent Accounting Pronouncements

Accounting Standards Adopted in Fiscal 2019

On October 1, 2018, the Company adopted Accounting Standards Update (“ASU”) No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU requires an entity that holds financial assets or owes financial liabilities to, among other things, measure equity investments at fair value and recognize unrealized gains (losses) through net income (loss). Accordingly, the Company’s net loss of $21,533,000 for the three month ended December 31, 2018, included net unrealized losses on investments of $28,640,000. For the prior year’s period, the Company recorded net unrealized gains for its available-for-sale marketable securities in other comprehensive income. In addition, ASU 2016-01 prohibits the restatement of prior year financial statements but requires that the Company reclassify net after-tax unrealized gains on investments of $115,786,000 on adoption day from “accumulated other comprehensive income” to “retained earnings”, both of which are listed under the “Shareholders’ equity” section of the Company’s Consolidated Balance Sheets. This represented an increase to retained earnings and a decrease to accumulated other comprehensive income.

Other Recent Accounting Pronouncements

The Company will continue to evaluate the other new accounting pronouncements as detailed in its Annual Report on Form 10-K for the year ended September 30, 2018.

Note 4 – Revenue Recognition

The Company recognizes revenues in accordance with the provisions of ASU No. 2014-09, *Revenue from Contracts with Customers (ASC Topic 606)*, which it adopted effective October 1, 2017, using the modified retrospective method.

For the Company's Traditional Business, proceeds from the sale of subscriptions for newspapers, court rule books and other publications and other services are recorded as deferred revenue and are included in earned revenue only when the services are provided, generally over the subscription term. Advertising revenues are recognized when advertisements are published and are net of agency commissions.

Journal Technologies contracts may include several products and services, which are generally distinct and include separate transaction pricing and performance obligations. Most are one-transaction contracts. These current subscription-type contract revenues include (i) implementation consulting fees to configure the system to go-live, (ii) subscription software license, maintenance (including updates and upgrades) and support fees, and (iii) third-party hosting fees when used. Revenues for consulting are recognized at point of delivery (go-live) upon completion of services, and subscription and advertising revenues are recognized ratably (using the output method based on time-elapsed) after the go-live. These contracts include assurance warranty provisions for limited periods and do not include financing terms. For some contracts, the Company acts as a principal with respect to certain services, such as data conversion, interfaces and hosting that are provided by third-parties, and recognizes such revenues on a gross basis. For legacy contracts with perpetual license arrangements, licenses and consulting services are recognized at point of delivery (go-live), and maintenance revenues are recognized ratably after the go-live. Other public service fees are earned and recognized as revenues when the Company processes credit card payments on behalf of the courts via its websites through which the public can efile cases and pay traffic citations and other fees.

The adoption of ASC 606 also requires the capitalization of certain costs of obtaining contracts, specifically sales commissions, which are to be amortized over the expected term of the contracts. For its software contracts, the Company incurs an immaterial amount of sales commission costs which have no significant impact on the Company's financial condition and results of operations. In addition, the Company's implementation and fulfillment costs do not meet all criteria required for capitalization.

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Since the Company recognizes revenues when it can invoice the customer pursuant to the contract for the value of completed performance, as a practical expedient and because reliable estimates cannot be made, it has elected not to include the transaction price allocated to unsatisfied performance obligations. Also, as a practical expedient, the Company has elected not to include its evaluation of variable consideration of certain usage-based public service fees that are included in some contracts. Furthermore, there are no fulfillment costs to be capitalized for the software contracts because these costs do not generate or enhance resources that will be used in satisfying future performance obligations.

Note 5 - Basic and Diluted Income Per Share

The Company does not have any common stock equivalents, and therefore basic and diluted income (loss) per share are the same.

Note 6 - Investments in Marketable Securities

All investments are classified as “Current assets” because they are available for sale at any time. These “available-for-sale” marketable securities are stated at fair value. The Company uses quoted prices in active markets for identical assets (consistent with the Level 1 definition in the fair value hierarchy) to measure the fair value of its investments on a recurring basis pursuant to ASC 820, *Fair Value Measurement*.

As of December 31, 2018, there were net unrealized gains of $129,767,000 with these investments. With the adoption of ASU No. 2016-01, Subtopic 825-10, as stated in Note 3, the Company recorded and included in its net loss the net unrealized losses on investments of $28,640,000 for the three months ended December 31, 2018. At September 30, 2018, net unrealized gains of $158,407,000 were recorded before taxes of $42,151,000 in the accumulated other comprehensive income in the accompanying Consolidated Balance Sheets. Most of the unrealized gains were in the common stocks of three U.S. financial institutions and one foreign manufacturer.

Investments in equity securities as of December 31, 2018 and September 30, 2018 are summarized below.

Investments in Financial Instruments

	December 31, 2018			September 30, 2018		
	Aggregate fair value	Amortized/ Adjusted cost basis	Pretax net unrealized gains	Aggregate fair value	Amortized/ Adjusted cost basis	Pretax net unrealized gains
Marketable securities	$183,656,000	$53,889,000	$129,767,000	$212,296,000	$53,889,000	$158,407,000

As of December 31, 2018, the Company performed an evaluation for an equity security with a fair value below cost to determine if the unrealized loss was other-than-temporary. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer and the Company’s ability and intent to hold the security until fair value recovers. The assessment of the ability and intent to hold this security to recovery focuses on liquidity needs, asset/liability management objectives and security portfolio objectives. Based on the result of the evaluation, the Company concluded that as of December 31, 2018, the unrealized loss related to an equity security it owns was temporary.

Note 7 – Goodwill

The Company accounts for goodwill in accordance with Accounting Standards Codification (ASC) 350, *Intangibles — Goodwill and Other*. Goodwill, which is not amortized for financial statement purposes, is amortized over a 15-year period for tax purposes, but evaluated for impairment annually, or whenever events or changes in circumstances indicate that the value may not be recoverable. Considered factors for potential goodwill impairment evaluation with respect to Journal Technologies include, among other things, the current year's business profitability before intangible amortization, fluctuations of revenues, changes in the marketplace, the status of deferred installation contracts and new business.

In addition, ASU 2011-08, *Intangible – Goodwill and Others -- Testing Goodwill for Impairment*, allows for the option of performing a qualitative assessment before calculating the fair value of a reporting unit. If it is determined based on qualitative factors that there is no impairment to goodwill, then the fair value of a reporting unit is not needed. If a quantitative analysis is required and the unit's carrying amount exceeds its fair value, then the second step is performed to measure the amount of potential impairment. The Company's annual goodwill impairment analysis in fiscal 2018 did not result in an impairment charge based on the qualitative assessment. There was no indicator of impairment during the three-month periods ended December 31, 2018 and 2017.

Note 8 - Income Taxes

For the three months ended December 31, 2018, the Company recorded an income tax benefit of $8,317,000 on a pretax loss of $29,850,000. This was the net result of applying the effective tax rate anticipated for fiscal 2019 to the pretax loss for the three months ended December 31, 2018. The effective tax rate was greater than the statutory rate primarily due to state tax benefits.

During the prior fiscal year, the December 2017 Tax Cuts and Jobs Act reduced the maximum corporate income tax rate from 35% to 21%. The impact to the Company's financial statements was as follows: (i) fiscal 2018 income tax expense or benefit was calculated using a blended rate of 24.28% pursuant to IRC Section 15, (ii) deferred tax expense included a discrete net tax benefit of approximately $16 million resulting from a revaluation of deferred tax assets and liabilities to the expected tax rate that will be applied when temporary differences are expected to reverse, (iii) items that were expected to reverse during fiscal 2018 were valued at the blended rate of 24.28% while temporary differences that will reverse after fiscal 2018 were valued at the 21% rate, and (iv) approximately $20 million of the revaluation of deferred taxes related to items that were initially recorded as accumulated other comprehensive income. This revaluation of approximately $20 million was recorded as a component of income tax expense or benefit in continuing operations. Consequently, on a pretax loss of $2,111,000 for the three months ended December 31, 2017, the Company recorded an income tax benefit of $16,850,000. The income tax benefit was also the result of applying the effective tax rate anticipated for fiscal 2018 to the pretax loss for the three-month period ended December 31, 2017. The effective tax rate (before the discrete item discussed above) was greater than the statutory rate primarily due to the dividends received deduction which increases the loss for tax purposes.

The Company's effective tax rate was 28% for the three months ended December 31, 2018 as compared with 798% in the prior year period. The difference in the effective tax rate was primarily due to the effect of the tax cuts in the prior year period as discussed above.

The Company files consolidated federal income tax returns in the United States and with various state jurisdictions and is no longer subject to examinations for fiscal years before fiscal 2015 with regard to federal income taxes and fiscal 2013 for state income taxes.

Note 9 - Debt and Commitments

During fiscal 2013, the Company borrowed from its investment margin account the aggregate purchase price of $29.5 million for two acquisitions, in each case pledging its marketable securities as collateral. The interest rate for these investment margin account borrowings fluctuates based on the Federal Funds Rate plus 50 basis points with interest only payable monthly. The interest rate as of December 31, 2018 was 3%. These investment margin account borrowings do not mature.

In 2015, the Company purchased a 30,700 square foot office building constructed in 1998 on about 3.6 acres in Logan, Utah that had been previously leased by Journal Technologies. The Company paid $1.24 million and financed the balance with a real estate bank loan of $2.26 million which bears a fixed interest rate of 4.66% and is repayable in equal monthly installments of about $17,600 through 2030. This loan is secured by the Logan facility and can be paid off at any time without prepayment penalty. This real estate loan had a balance of approximately $1.93 million as of December 31, 2018.

The Company also owns its facilities in Los Angeles and leases space for its other offices under operating leases which expire at various dates through fiscal 2021. During fiscal 2014, the Company renewed its office lease for its San Francisco office for five years to end on October 31, 2019 with a current monthly rent of approximately $28,000 for about 6,200 square feet. Beginning in fiscal 2017, the Company leased approximately 9,800 square feet of office space (expiring in August 2020) in Englewood, Colorado, for a monthly rent of approximately $21,000.

The Company is responsible for a portion of maintenance, insurance and property tax expenses relating to the leased properties. Rental expenses were $258,000 for the three-month period ended December 31, 2018, as compared with $237,000 in the prior year period.

Note 10 - Contingencies

From time to time, the Company is subject to contingencies, including litigation, arising in the normal course of its business. While it is not possible to predict the results of such contingencies, management does not believe the ultimate outcome of these matters will have a material effect on the Company’s financial position or results of operations or cash flows.

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Note 11 - Operating Segments

The Company's reportable segments are: (i) the Traditional Business and (ii) Journal Technologies. All inter-segment transactions were eliminated. Summarized financial information regarding the Company's reportable segments is shown in the following table:

	Reportable Segments			
	Traditional Business	Journal Technologies	Corporate income and expenses	Total
Three months ended December 31, 2018				
Revenues				
Advertising	$2,192,000	$---	$---	$2,192,000
Circulation	1,338,000	---	---	1,338,000
Advertising service fees and other	669,000	---	---	669,000
Licensing and maintenance fees	---	4,790,000	---	4,790,000
Consulting fees	---	541,000	---	541,000
Other public service fees	---	898,000	---	898,000
Operating expenses	4,208,000	8,741,000	---	12,949,000
Loss from operations	(9,000)	(2,512,000)	---	(2,521,000)
Dividends and interest income	---	---	1,530,000	1,530,000
Other income	---	---	10,000	10,000
Net unrealized losses on investments	---	---	(28,640,000)	(28,640,000)
Interest expenses on note payable collateralized by real estate	(23,000)	---	---	(23,000)
Interest expenses on margin loans	---	---	(206,000)	(206,000)
Pretax (loss) income	(32,000)	(2,512,000)	(27,306,000)	(29,850,000)
Income tax benefit (expense)	80,000	585,000	7,652,000	8,317,000
Net income (loss)	48,000	(1,927,000)	(19,654,000)	(21,533,000)
Total assets	18,702,000	30,571,000	185,843,000	235,116,000
Capital expenditures	50,000	34,000	---	84,000

	Reportable Segments			
	Traditional Business	Journal Technologies	Corporate income and expenses	Total
Three months ended December 31, 2017				
Revenues				
Advertising	$2,116,000	$---	$ ---	$2,116,000

Circulation	1,363,000	---	---	1,363,000
Advertising service fees and other	602,000	---	---	602,000
Licensing and maintenance fees	---	4,350,000	---	4,350,000
Consulting fees	---			