Houghton Mifflin Harcourt Co
Form 10-Q
May 08, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

OR

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

Commission file number 001-36166

Houghton Mifflin Harcourt Company

(Exact name of registrant as specified in its charter)

Delaware	**27-1566372**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

222 Berkeley Street

Boston, MA 02116

(617) 351-5000

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

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 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.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x	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 number of shares of common stock, par value $0.01 per share, outstanding as of April 30, 2014 was 139,994,391.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained herein include forward-looking statements, which involve risks and uncertainties. These forward-looking statements can be identified by the use of forward-looking terminology, including the terms believes, estimates, projects, anticipates, expects, could, intends, may, will or should, forecast, intend, target or, in each case, their negative, or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. They include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies, the industry in which we operate and potential business decisions. We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors, and, of course, it is impossible for us to anticipate all factors that could affect our actual results. All forward-looking statements are based upon information available to us on the date of this report.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. We caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and the development of the industry in which we operate may differ materially from those made in or suggested by the forward-looking statements contained herein. In addition, even if our results of operations, financial condition and liquidity and the development of the industry in which we operate are consistent with the forward looking statements contained herein, those results or developments may not be indicative of results or developments in subsequent periods.

Important factors that could cause our results to vary from expectations include, but are not limited to: changes in state and local education funding and/or related programs, legislation and procurement processes; adverse or worsening economic trends or the continuation of current economic conditions; changes in consumer demand for, and acceptance of, our products; changes in competitive factors; offerings by technology companies that compete with our products; industry cycles and trends; conditions and/or changes in the publishing industry; changes or the loss of our key third-party print vendors; restrictions under agreements governing our outstanding indebtedness; changes in laws or regulations governing our business and operations; changes or failures in the information technology systems we use; demographic trends; uncertainty surrounding our ability to enforce our intellectual property rights; inability to retain management or hire employees; impact of potential impairment of goodwill and other intangibles in a challenging economy; decline or volatility of our stock price regardless of our operating performance; and other factors discussed in the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2013. In light of these risks, uncertainties and assumptions, the forward-looking events described herein may not occur.

We undertake no obligation, and do not expect, to publicly update or publicly revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law. All subsequent written and oral forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained herein.

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PART 1 FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (Unaudited)

Houghton Mifflin Harcourt Company

Consolidated Balance Sheets (Unaudited)

(in thousands of dollars, except share information)	March 31, 2014	December 31, 2013
Assets		
Current assets		
Cash and cash equivalents	$ 167,763	$ 313,628
Short-term investments	100,561	111,721
Accounts receivable, net of allowance for bad debts and book returns of $36.2 million and $40.6 million, respectively	260,247	318,101
Inventories	208,831	182,194
Deferred income taxes	29,402	29,842
Prepaid expenses and other assets	17,155	16,130
Total current assets	783,959	971,616
Property, plant, and equipment, net	135,522	140,848
Pre-publication costs, net	267,473	269,488
Royalty advances to authors, net of allowance of $44.7 million and $41.2 million, respectively	51,489	46,881
Goodwill	531,786	531,786
Other intangible assets, net	886,298	919,994
Other assets	26,109	29,773
Total assets	$ 2,682,636	$ 2,910,386
Liabilities and Stockholders Equity		
Current liabilities		
Current portion of long-term debt	$ 2,500	$ 2,500
Accounts payable	67,562	105,012
Royalties payable	50,403	65,387
Salaries, wages, and commissions payable	18,405	29,945
Deferred revenue	105,277	107,905
Interest payable	48	55
Severance and other charges	7,232	8,184
Accrued postretirement benefits	2,141	2,141
Other liabilities	28,923	32,002
Total current liabilities	282,491	353,131
Long-term debt	242,500	243,125
Royalties payable		1,520

Long-term deferred revenue	182,443	189,258
Accrued pension benefits	21,904	24,405
Accrued postretirement benefits	23,420	23,860
Deferred income taxes	117,506	116,999
Other liabilities	106,188	107,812
Total liabilities	976,452	1,060,110
Commitments and contingencies (Note 11)		
Stockholders equity		
Preferred stock, $0.01 par value: 20,000,000 shares authorized; no shares issued and outstanding at March 31, 2014 and December 31, 2013		
Common stock, $0.01 par value: 380,000,000 shares authorized; 140,076,413 and 140,044,400 shares issued at March 31, 2014 and December 31, 2013, respectively; 139,994,391 and 139,962,378 shares outstanding at March 31, 2014 and December 31, 2013, respectively	1,400	1,400
Treasury stock, 82,022 shares as of March 31, 2014 and December 31, 2013		
Capital in excess of par value	4,752,620	4,750,589
Accumulated deficit	(3,034,757)	(2,888,422)
Accumulated other comprehensive income (loss)	(13,079)	(13,291)
Total stockholders equity	1,706,184	1,850,276
Total liabilities and stockholders equity	$ 2,682,636	$ 2,910,386

The accompanying notes are an integral part of these consolidated financial statements.

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Houghton Mifflin Harcourt Company

Consolidated Statements of Operations (Unaudited)

(in thousands of dollars, except share and per share data)	**Three Months Ended March 31, 2014**	**2013**
Net sales	$ 153,933	$ 166,594
Costs and expenses		
Cost of sales, excluding pre-publication and publishing rights amortization	92,648	87,060
Publishing rights amortization	30,751	39,450
Pre-publication amortization	28,974	26,157
Cost of sales	152,373	152,667
Selling and administrative	137,010	130,236
Other intangible asset amortization	2,945	10,752
Severance and other charges	1,757	1,928
Operating loss	(140,152)	(128,989)
Other income (expense)		
Interest expense	(4,297)	(5,907)
Change in fair value of derivative instruments	(103)	(530)
Loss before taxes	(144,552)	(135,426)
Income tax expense	1,783	1,955
Net loss	$ (146,335)	$ (137,381)
Net loss per share attributable to common stockholders, basic and diluted	$ (1.05)	$ (0.98)
Weighted average shares outstanding, basic and diluted	139,982,297	139,917,978

The accompanying notes are an integral part of these consolidated financial statements.

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Houghton Mifflin Harcourt Company

Consolidated Statements of Comprehensive (Loss) Income (Unaudited)

(in thousands of dollars)	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Net loss	$ (146,335)	$ (137,381)
Other comprehensive income (loss)		
Foreign currency translation adjustments	203	(743)
Unrealized gain (loss) on short-term investments, net of tax	9	(15)
Other comprehensive income (loss), net of taxes	212	(758)
Comprehensive loss	$ (146,123)	$ (138,139)

The accompanying notes are an integral part of these consolidated financial statements.

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Houghton Mifflin Harcourt Company

Consolidated Statements of Cash Flows (Unaudited)

(in thousands of dollars)	**Three Months Ended March 31, 2014**	**2013**
Cash flows from operating activities		
Net loss	$ (146,335)	$ (137,381)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities		
Depreciation and amortization expense	79,909	90,700
Amortization of deferred financing costs	1,188	1,217
Deferred income taxes	947	1,285
Noncash stock-based compensation expense	2,397	1,586
Change in fair value of derivative instruments	103	530
Changes in operating assets and liabilities, net of acquisitions		
Accounts receivable	57,854	49,125
Inventories	(26,637)	(38,589)
Accounts payable and accrued expenses	(34,269)	(17,342)
Royalties, net	(21,112)	(17,795)
Deferred revenue	(9,443)	(24,970)
Interest payable	(7)	57
Severance and other charges	(1,769)	(1,407)
Accrued pension and postretirement benefits	(2,941)	(3,342)
Other, net	(2,429)	(2,036)
Net cash (used in) provided by operating activities	(102,544)	(98,362)
Cash flows from investing activities		
Proceeds from sale of short-term investments	19,000	42,250
Purchases of short-term investments	(8,053)	(36,053)
Additions to pre-publication costs	(38,283)	(31,995)
Additions to property, plant, and equipment	(14,994)	(15,399)
Net cash (used in) provided by investing activities	(42,330)	(41,197)
Cash flows from financing activities		
Payments of long-term debt	(625)	(625)
Income tax withholding payments associated with restricted stock units vesting	(366)	
Net cash (used in) provided by financing activities	(991)	(625)
Net (decrease) increase in cash and cash equivalents	(145,865)	(140,184)
Cash and cash equivalents		
Beginning of period	313,628	329,078
Net (decrease) increase in cash and cash equivalents	(145,865)	(140,184)

End of period	$	167,763	$	188,894
Supplementary disclosure of cash flow information				
Pre-publication costs included in accounts payable (non cash)	$	13,176	$	17,691
Property, plant, and equipment included in accounts payable (non cash)		3,136		2,368
Property, plant, and equipment acquired under capital leases (non cash)		4,272		4,641

The accompanying notes are an integral part of these consolidated financial statements.

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Houghton Mifflin Harcourt Company

Notes to Consolidated Financial Statements (Unaudited)

(in thousands of dollars, except share and per share information)

1. Basis of Presentation

Houghton Mifflin Harcourt Company, formerly known as HMH Holdings (Delaware), Inc. (HMH , Houghton Mifflin Harcourt , we , us , our , or the Company), is a leading global provider of education solutions, delivering content, technology, services and media to over 50 million students in over 150 countries worldwide. We deliver our offerings to both educational institutions and consumers around the world. We believe our long-standing reputation and well-known brands enable us to capitalize on consumer and digital trends in the education market through our existing and developing channels. Furthermore, since 1832, we have published trade and reference materials, including adult and children s fiction and non-fiction books that have won industry awards such as the Pulitzer Prize, Newbery and Caldecott medals and National Book Award, all of which are generally known.

The consolidated financial statements of HMH include the accounts of all of our wholly-owned subsidiaries as of March 31, 2014 and December 31, 2013 and the three month periods ended March 31, 2014 and March 31, 2013.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Certain information and note disclosures normally included in our annual financial statements prepared in accordance with GAAP have been condensed or omitted consistent with Article 10 of Regulation S-X. In the opinion of management, our unaudited consolidated financial statements and accompanying notes include all adjustments (consisting of normal recurring adjustments) considered necessary by management to fairly state the results of operations, financial position and cash flows for the interim periods presented. Interim results of operations are not necessarily indicative of the results for the full year or for any future period. These financial statements should be read in conjunction with the annual financial statements and the notes thereto also included herein.

During the first quarter of 2014, we recorded an out of period correction of approximately $1.1 million reducing net sales and increasing deferred revenue that should have been deferred previously. In addition, during the first quarter of 2014, we recorded approximately $3.5 million of incremental expense, primarily commissions, related to the prior year. These out of period corrections had no impact on our debt covenant compliance. Management believes these out of period corrections are not material to the current period financial statements or any previously issued financial statements and does not expect them to be material for the full fiscal year 2014. Additionally, we revised previously reported balance sheet amounts to severance and other charges of $7.3 million, which has been reclassified as long term and to current deferred revenue of $5.2 million which has also been reclassified as long term. The revision was not material to the reported consolidated balance sheet for any previously filed periods.

Seasonality and Comparability

Our net sales, operating profit and operating cash flows are impacted by the inherent seasonality of the academic calendar. Consequently, the performance of our businesses may not be comparable quarter to consecutive quarter and should be considered on the basis of results for the whole year or by comparing results in a quarter with results in the same quarter for the previous year.

Schools make most of their purchases in the second and third quarters of the calendar year in preparation for the beginning of the school year. Thus, over the past three years, approximately 67% of consolidated net sales have historically been realized in the second and third quarters. Sales of K-12 instructional materials and customized testing products are also cyclical, with some years offering more sales opportunities than others. The amount of funding available at the state level for educational materials also has a significant effect on year-to-year net sales. Although the loss of a single customer would not have a material adverse effect on our business, schedules of school adoptions and market acceptance of our products can materially affect year-to-year net sales performance.

2. Significant Accounting Policies and Estimates

Our financial results are affected by the selection and application of accounting policies and methods. There were no material changes in the three months ended March 31, 2014 to the application of significant accounting policies and estimates as described in our audited financial statements for the year ended December 31, 2013.

3. Recent Accounting Pronouncements

Recent accounting pronouncements, not included below, are not expected to have a material impact on our consolidated financial position and results of operations.

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In July 2013, the Financial Accounting Standards Board (FASB) issued new accounting guidance on the presentation of unrecognized tax benefits. This new guidance requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists, with limited exceptions. This new guidance is effective for the periods beginning after December 15, 2013, and should be applied prospectively with retroactive application permitted. Our adoption of the guidance did not impact our consolidated financial statements.

In February 2013, the FASB issued guidance requiring disclosure of amounts reclassified out of accumulated other comprehensive income (loss) by component. The amendment also requires entities to present significant amounts by the respective line items of net income (loss), either on the face of the income statement or in the notes to the financial statements for amounts required to be reclassified out of accumulated other comprehensive income (loss) in their entirety in the same reporting period. For other amounts that are not required to be reclassified to net income (loss) in their entirety, a cross-reference is required to other disclosures that provide additional details about those amounts. This guidance was effective prospectively for annual and interim periods beginning January 1, 2013 and is related to presentation only. Our adoption of the guidance did not impact our consolidated financial statements.

4. Inventories

Inventories consisted of the following:

	March 31, 2014	December 31, 2013
Finished goods	$ 201,067	$ 177,017
Raw materials	7,764	5,177
Inventory	$ 208,831	$ 182,194

5. Goodwill and Other Intangible Assets

Goodwill and other intangible assets consisted of the following:

	March 31, 2014		December 31, 2013	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Goodwill	$ 531,786	$	$ 531,786	$
Trademarks and tradenames	440,005		440,005	
Publishing rights	1,180,000	(814,688)	1,180,000	(783,937)
Customer related and other	283,172	(202,191)	283,172	(199,246)
	$ 2,434,963	$ (1,016,879)	$ 2,434,963	$ (983,183)

Amortization expense for publishing rights and customer related and other intangibles were $33.7 million and $50.2 million for the three months ended March 31, 2014 and 2013, respectively.

6. Debt