INFORMATION HOLDINGS INC
Form 10-Q
May 10, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2004

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 No. 1-14371

INFORMATION HOLDINGS INC.

(Exact name of Registrant as specified in its charter)

Delaware	**06-1518007**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2777 Summer Street, Suite 602	
Stamford, Connecticut	**06905**
(Address of principal executive offices)	(Zip Code)

(203) 961-9106
(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. ý Yes o No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act) ý Yes o No

As of May 4, 2004, there were 20,895,692 shares of the Company s common stock, par value $0.01 per share, outstanding.

INFORMATION HOLDINGS INC.

Form 10-Q for the Quarter Ended March 31, 2004

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INFORMATION HOLDINGS INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	March 31, 2004 (Unaudited)	December 31, 2003
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 52,959	$ 39,693
Short-term investments	7,027	12,271
Restricted cash	3,000	3,000
Accounts receivable *(net of allowance for doubtful accounts of $694 and $693, respectively)*	38,878	37,650
Prepaid expenses and other current assets	4,049	5,669
Income taxes receivable		11,899
Deferred income taxes	2,001	2,001
Total current assets	107,914	112,183
Investments	88,843	83,207
Property and equipment, net	4,100	4,281
Identified intangible assets, net	69,224	70,248
Goodwill	99,808	100,871
Other assets	4,546	3,880
TOTAL	$ 374,435	$ 374,670
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 33,083	$ 32,073
Accrued expenses	12,651	18,124
Deferred revenue	26,930	25,753
Total current liabilities	72,664	75,950
Long-term deferred income taxes	16,114	16,307
Total liabilities	88,778	92,257
STOCKHOLDERS EQUITY:		
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued	$	$
Common stock, $.01 par value; authorized 50,000,000 shares; issued 21,894,079 and 21,882,604 shares, respectively; outstanding 20,886,879 and 20,875,404 shares, respectively	219	219
Additional paid-in capital	248,208	247,964
Retained earnings	41,535	38,304

Treasury stock, at cost, 1,007,200 shares, in both periods		(14,723)		(14,723)
Accumulated other comprehensive income		10,418		10,649
Total stockholders equity		285,657		282,413
TOTAL	$	374,435	$	374,670

See notes to unaudited consolidated financial statements.

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INFORMATION HOLDINGS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Revenues	$ 24,600	$ 19,657
Cost of sales	6,511	6,368
Gross profit	18,089	13,289
Operating expenses:		
Selling, general and administrative	11,040	8,857
Depreciation and amortization	3,037	2,709
Total operating expenses	14,077	11,566
Income from operations	4,012	1,723
Other income (expense):		
Interest income	841	188
Interest expense	(1)	(56)
Early termination of credit agreement		(575)
Other income, net	303	
Income from continuing operations before income taxes	5,155	1,280
Provision for income taxes	1,819	397
Income from continuing operations	3,336	883
(Loss) income from operations of discontinued segment, net of income taxes	(105)	211

Net income	$ 3,231	$ 1,094
Net income (loss) per basic and diluted common share:		
Continuing operations	$ 0.16	$ 0.04
Discontinued operations	(0.01)	0.01
Net income	$ 0.15	$ 0.05
Weighted average number of common shares outstanding		
Basic	20,885	21,437
Diluted	20,991	21,471

See notes to unaudited consolidated financial statements.

INFORMATION HOLDINGS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,231	$ 1,094
Loss (income) from discontinued operations	105	(211)
Income from continuing operations	3,336	883
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	994	1,008
Amortization of other intangible assets	2,043	1,701
Gain on sale of assets	(426)	
Change in deferred income taxes	(339)	(387)
Termination of credit facility		494
Net amortization of premiums on investments available for sale	599	
Other	334	59
Changes in operating assets and liabilities:		
Increase in accounts receivable, net	(1,380)	(1,831)
Decrease in prepaid and other current assets	467	128
(Decrease) increase in accounts payable and accrued expenses	(3,509)	88
Income tax benefit from stock options exercised	10	21
Net change in income taxes (receivable) payable	12,382	(1,713)
Increase in deferred revenue	987	2,366
Net change in other assets and liabilities	(35)	9
Net Cash Provided by Continuing Operations	15,463	2,826
Net Cash Provided by Discontinued Operations		1,648
Net Cash Provided by Operating Activities	15,463	4,474
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(484)	(428)
Proceeds from maturities of investments held to maturity		4,795
Purchases of investments available for sale	(43,403)	
Proceeds from sales and maturities of investments available for sale	42,412	
Net proceeds on sale of assets	480	
Transaction costs, net of proceeds from sale of discontinued operations	(220)	

Capitalized software development cost		(808)		(89)
Capitalized internal-use software		(117)		(159)
Net Cash (Used in) Provided by Continuing Operations		(2,140)		4,119
Net Cash Used in Discontinued Operations				(818)
Net Cash (Used in) Provided by Investing Activities		(2,140)		3,301
CASH FLOWS FROM FINANCING ACTIVITIES:				
Common stock issued from stock options exercised		234		157
Principal payments on capital leases		(37)		(35)
Net Cash Provided by Continuing Operations		197		122
Net Cash Used in Discontinued Operations				(97)
Net Cash Provided by Financing Activities		197		25
EFFECT OF EXCHANGE RATES ON CASH		(254)		264
NET INCREASE IN CASH AND EQUIVALENTS		13,266		8,064
CASH AND EQUIVALENTS, BEGINNING OF PERIOD		39,693		53,910
CASH AND EQUIVALENTS, END OF PERIOD	$	52,959	$	61,974

See notes to unaudited consolidated financial statements.

INFORMATION HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

A. BASIS OF PRESENTATION

The consolidated balance sheet of Information Holdings Inc. (IHI, or the Company) at December 31, 2003 has been derived from IHI s Annual Report on Form 10-K for the year then ended. All other consolidated financial statements contained herein have been prepared by IHI and are unaudited. These consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2003 and the notes thereto contained in IHI s Annual Report on Form 10-K.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X, and do not include all information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. However, in the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of IHI as of March 31, 2004, and the consolidated results of operations and cash flows for the periods presented herein. Operating results for the three months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ended December 31, 2004.

The consolidated financial statements include the accounts of IHI and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

During 2003, the Company sold substantially all of the assets and certain liabilities of its wholly owned subsidiaries Transcender LLC and CRC Press and Subsidiaries (See Note D *Discontinued Operations*). Accordingly, for financial statement purposes, the assets, liabilities, results of operations and cash flows of these components have been segregated from those of continuing operations and are presented in the Company s consolidated financial statements as discontinued operations for all periods presented herein.

B. ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company grants stock options for a fixed number of shares to employees and non-employee directors with an exercise price equal to the fair value of the shares at the date of grant. The Company accounts for its stock option grants under the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* which utilizes the intrinsic value method. Since stock options are granted by the Company with exercise prices equal to the market price of the underlying stock at the date of grant, no compensation expense has been recognized in the Company s Consolidated Statements of Operations.

Had compensation cost for the Company s stock option plan been recognized based upon the estimated fair value of the options at the dates of grant consistent with the requirements of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, the Company s net income and earnings per share would have been the pro forma amounts indicated below:

(In thousands, except per share data):	Three Months Ended March 31, 2004		2003	
Net income as reported	$	3,231	$	1,094
Deduct: Total stock-based employee expense determined under fair value based method for all awards, net of related tax effects		620		888
Pro forma net income	$	2,611	$	206
Earnings per common share:				
Basic as reported	$	0.15	$	0.05
Basic pro forma	$	0.13	$	0.01
Diluted as reported	$	0.15	$	0.05
Diluted pro forma	$	0.12	$	0.01

The effects on pro forma net income and earnings per share of expensing the estimated fair value of stock options are not necessarily representative of the effects on reported net income for future years due to such factors as the vesting period of the stock options and the potential for issuance of additional stock options in future years. For purposes of pro forma disclosure, the estimated fair value of options granted is amortized to expense over the option vesting period.

The Company estimates the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model (the Black-Scholes Model) using certain assumptions. These assumptions are evaluated and revised, as necessary, to reflect market conditions and the Company s experience. The Black-Scholes Model was developed for use in estimating the value of traded options that have no vesting restrictions and are fully transferable. Because the Company s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the estimate, in management s opinion, the existing Black-Scholes Model does not provide a reliable measure of the fair value of the Company s employee stock options.

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C. ACQUISITIONS

On December 1, 2003, the Company acquired the issued share capital (the Shares) of CDC Solutions Limited (CDC), a private company based in the United Kingdom for cash consideration of approximately $26,287,000 (Cash Consideration). CDC is a leading provider of life science regulatory intelligence and publishing solutions. The Cash Consideration includes approximately $22,126,000 of initial consideration, approximately $3,836,000 currently held in escrow for estimated guaranteed earnouts as defined and calculated in accordance with the underlying Share Purchase Agreement (SPA), and approximately $325,000 of closing costs associated with the transaction.

In the first quarter of 2004 the Company received a valuation of the fair value of the identified intangible assets and their estimated useful lives which range from four to ten years. The purchase price of CDC was accordingly adjusted to reflect acquired identified intangible assets of $4,810,000, and the related deferred tax liability recorded as a result of the gross up of acquired intangible assets was adjusted to $1,443,000 based on the valuation. In addition, during the quarter certain other adjustments to the purchase price were recorded to reduce net tangible liabilities acquired to $8,000. Accordingly, non-deductible goodwill was adjusted to $22,928,000.

Concurrent with the acquisition, the Company documented a plan to integrate the CDC business with its Liquent business. The integration plan included the elimination of certain duplicate positions within the acquired operation and the abandonment of certain property no longer needed. Approximately $765,000 of costs related to severance and remaining lease costs at CDC were accrued for in purchase accounting as of the acquisition date, including an adjustment recorded in the first quarter of approximately $96,000 due to increased severance at CDC. As of March 31, 2004, the Company paid $406,000 of severance and $57,000 of lease costs against the liability. For the year ended December 31, 2003, severance and integration costs of $749,000 had been charged to expense at Liquent related to the CDC integration. The remaining liability at December 31, 2003 related to these costs was $606,000. During the first quarter of 2004, Liquent charged additional severance costs related to the CDC integration of approximately $108,000 to Selling, general and administrative expense. The Company paid $198,000 of severance costs and $124,000 of lease costs during the first quarter of 2004. The balance of the severance costs are expected to be paid by the third quarter of 2004 and the lease costs over the life of the lease, which terminates October 2005.

Pursuant to the SPA, the sellers are also entitled to future consideration potential dependent on the future operating results of Liquent and CDC on a combined basis through December 31, 2006. Based on calculations outlined in the SPA, the Company has recorded additional further consideration costs related to the combined business as of December 31, 2003 of approximately $1,200,000, which are expected to be paid during the second quarter of 2004.

Earnout Consideration (as defined in the SPA) is to be calculated by March 31, 2007 based on formulas related to revenues and EBITDA (earnings before interest, taxes, depreciation and amortization) of the combined Liquent-CDC business for the three-year period ending December 31, 2006 (the Earnout Period). Amounts due for the Earnout Consideration, if any, will be paid during the second quarter of 2007, unless the provisions related to a change in control discussed below come into effect. Earnout Consideration will become due if the combined business has greater than 10% annual compound revenue growth during the Earnout Period, or if EBITDA exceeds $15,000,000 for either the year ending December 31, 2006 or on average for the three years of the Earnout Period. The Earnout Consideration is subject to a maximum of 10,000,000 and could be as low as zero. The Company currently believes that Earnout Consideration could reasonably range from $6 million to $10 million.

In the event of a sale of all or substantially all of the share capital of the Company or the combined Liquent-CDC business during the Earnout Period, the sellers have the right, but not an obligation, to elect a payout of the Earnout Consideration. The payout of the Earnout Consideration in the event of a sale varies depending on the year of such sale and the operating performance of the combined business through the date of sale. The range of payout is zero to 5,000,000 if a sale occurs in 2004, zero to 7,500,000 if a sale occurs in 2005 and zero to 10,000,000 if a sale occurs in 2006.

The CDC acquisition has been accounted for using the purchase method of accounting and, accordingly, the results of its operations have been included in the Company s results of operations from its date of acquisition.

The following unaudited pro forma information presents the results of operations of the Company as if the 2003 acquisition of CDC had taken place on January 1, 2003:

(In thousands, except per share data)		**Three Months Ended March 31, 2003**
Revenues	$	22,364
Net loss	$	(3)
Basic loss per common share	$	(0.00)
Diluted loss per common share	$	(0.00)

These pro forma results of operations have been prepared for comparative purposes only and do not purport to be indicative of the operating results that would have occurred had the acquisition been consummated as of the above date, nor are they necessarily indicative of future operating results.

D. DISCONTINUED OPERATIONS

On December 22, 2003, the Company entered into an Asset Purchase Agreement (the APA) to sell substantially all of the assets and certain liabilities of Transcender LLC (Transcender) to Self Test Software, Inc., a subsidiary of Kaplan, Inc. (the Transcender Buyer). The transaction was completed on December 31, 2003. The Company received net proceeds of $9.7 million, representing the cash consideration for the assets sold of $10.3 million including an adjustment made in the first quarter of 2004 based on the closing balance sheet of Transcender in accordance with the APA less deal related expenses. During the first quarter of 2004, the Company recorded a loss on sale of $0.1 million, net of income tax benefits, within discontinued operations primarily related to severance costs for employees terminated on March 31, 2004. Prior to sale, Transcender was included as part of the software segment (See Note F *Segment Information*).

Pursuant to an Interim Transition Services Agreement (the TSA) between the Company and the Transcender Buyer, the Company has agreed to act as a service provider to the Transcender Buyer for the period from December 31, 2003 to May 31, 2004 (the Transition Period). The TSA requires the Company to retain all employees of Transcender through March 31, 2004 and certain employees through May 31, 2004. The Transcender Buyer is reimbursing the Company in full for all employee costs and incidental expenses during the Transition Period. The Company is responsible to pay severance costs to any employee that is not offered employment or does not accept employment with the Transcender Buyer. As of March 31, 2004, the Company has accrued severance and related costs of approximately $0.3 million, including approximately $0.1 million, net of income taxes, charged to discontinued operations in the first quarter of 2004. The Company estimates that it will incur nominal additional severance and related costs in the second quarter of 2004. The Transcender Buyer reimbursed the Company in full for all real estate costs through March 31, 2004 and is reimbursing the Company for a portion of real estate costs from April 1, 2004 through May 31, 2004. Future rental payments under the Transcender leases approximate $2.7 million. The Company is actively seeking to sublet the Transcender real estate and may generate sublease income in the future to offset a portion of the lease commitment. During the second quarter of 2004, the Company expects to record a charge in discontinued operations related to the remaining lease commitments less estimated sublease income.

On February 27, 2003, the Company entered into a definitive purchase agreement (the Purchase Agreement) to sell substantially all of the assets and certain liabilities of its wholly owned subsidiaries CRC Press LLC (CRC Press), CRC Press (U.K.) LLC and Parthenon Publishing Group, Inc. (together, CRC), to CRC Press I LLC and Routledge No. 2 Limited, both wholly owned subsidiaries of Taylor & Francis Group plc. The transaction was completed on April 8, 2003. The Company received net proceeds of approximately $90 million, representing the cash consideration for the assets sold less deal related expenses and an adjustment made based on the closing balance sheet of CRC in accordance with the Purchase Agreement. On April 8, 2004 the Company received $3.0 million of proceeds previously held in escrow related to representations and warranties contained in the Purchase Agreement. CRC comprised the entirety of the Company s former scientific and technology information (STI) segment. Subsequent to the date of sale, the Company no longer has operations in the STI segment (See Note F *Segment Information*).

Summary operating results for the discontinued operations follow:

	Three Months Ended March 31,	
(In thousands)	**2004**	**2003**
Revenues	$	$ 13,356
Income from discontinued operations before income taxes		379
Provision for income taxes on discontinued operations		168
Loss on sale of discontinued operations, net of income taxes	(105)	
(Loss) income from discontinued operations, net of income taxes	$ (105)	$ 211

E. EARNINGS (LOSS) PER SHARE

The following table sets forth the denominators used in computing basic and diluted earnings (loss) per common share for the periods indicated:

	Three Month Ended March 31,	
(In thousands)	**2004**	**2003**
Weighted average common shares outstanding:		
Basic	20,885	21,437
Net effect of dilutive stock options based on the treasury stock method	106	34
Diluted	20,991	21,471

For the three months ended March 31, 2004 and 2003, 474,703 and 1,129,225 stock options, respectively, were excluded from the computation of diluted earnings per common share due to their antidilutive effect.

F. SEGMENT INFORMATION

Operating segments are defined as components of an enterprise for which separate financial information is available and regularly reviewed by the Company s senior management. The Company evaluates performance based on EBITDA of the respective business units.

The Company has two reportable segments contributing to its results from continuing operations: data and software. The data segment, which includes MicroPatent, Master Data Center (MDC) and IDRAC, provides a broad array of databases, information products and complementary services for intellectual property and regulatory professionals. The software segment is comprised solely of Liquent, a leading provider of life science regulatory intelligence and publishing solutions. The CDC operations are being integrated with the Company s Liquent unit and are included in the software segment for reporting purposes. Other includes unallocated corporate items. Corporate assets consist principally of cash and cash equivalents and investments.

The following tables set forth the information for the Company s reportable segments of continuing operations for the periods indicated (in thousands):

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
REVENUES FROM EXTERNAL CUSTOMERS:		
Data	$ 15,552	$ 13,815
Software (1)	9,048	5,842
	$ 24,600	$ 19,657
EBITDA:		
Data	$ 6,779	$ 5,551
Software (1)	2,087	341
Other	(1,439)	(1,999)
	$ 7,427	$ 3,893
INCOME (LOSS) FROM OPERATIONS:		
Data	$ 4,077	$ 3,469
Software (1)	1,257	(302)
Other	(1,322)	(1,444)
	$ 4,012	$ 1,723

(1) Results include operations of CDC from the date of the acquisition December 1, 2003 only (See Note C - *Acquisitions*).

The Company evaluates the performance of its segments based primarily on revenues and EBITDA. The Company believes that EBITDA is the most useful measure of business unit earnings because it more closely approximates the cash generating ability of each business compared to income (loss) from operations. Income (loss) from operations includes charges for depreciation and amortization, the majority of which relate to amortization of intangible assets. The Company generally does not incur capital expenditures to replace intangible assets within existing operations.

A reconciliation of EBITDA to income from continuing operations is as follows (in thousands):

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
EBITDA	$ 7,427	$ 3,893
Depreciation and amortization (1)	(3,112)	(2,745)
Interest income, net	840	132
Income from continuing operations before income taxes	$ 5,155	$ 1,280

Provision for income taxes		1,819		397
Income from continuing operations	$	3,336	$	883

(1) Depreciation and amortization includes $75,000 and $36,000 of amortization of capitalized software, classified as Cost of sales for the three months ended March 31, 2004 and 2003, respectively.

G. COMPREHENSIVE INCOME

Comprehensive income is comprised of net income and other comprehensive income. Accumulated other comprehensive income includes foreign currency translation adjustments and unrealized gains and losses, net of the related tax effect, on available-for-sale securities and on derivative instruments designated and qualifying as cash flow hedges. The following table is a reconciliation of the Company s net income to comprehensive income (in thousands):

	Three Months Ended March 31,	
	2004	**2003**
Net income	$ 3,231	$ 1,094
Other comprehensive income:		
Change in net unrealized gains and losses on available-for-sale investments		