DEX MEDIA INC
Form 10-Q
May 05, 2005

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 March 31, 2005

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: 001-32249

Dex Media, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**14-1855759**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

198 Inverness Drive West
Englewood, Colorado
80112
(Address of principal executive offices)
(303) 784-2900
(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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of May 3, 2005, there were 150,416,418 shares of the registrant s Common Stock, par value $0.01 per share, outstanding.

TABLE OF CONTENTS

Table of Contents

PART I.
FINANCIAL INFORMATION

Item I. ***Financial Statements***

DEX MEDIA, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)
(Unaudited)

	As of March 31, 2005	As of December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 409	$ 9,234
Accounts receivable, net	92,950	104,232
Deferred directory costs	296,296	291,237
Current deferred income taxes	27,871	13,438
Other current assets	19,457	13,102
Total current assets	436,983	431,243
Property, plant and equipment, net	103,742	101,471
Goodwill	3,081,446	3,081,446
Intangible assets, net	2,947,233	3,033,659
Deferred income taxes	59,919	85,149
Deferred financing costs	132,008	142,182
Other assets	3,456	2,815
Total Assets	$ 6,764,787	$ 6,877,965
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 45,067	$ 48,410
Employee compensation	23,043	36,432
Common stock dividend payable	13,547	13,528
Deferred revenue and customer deposits	206,910	207,655
Accrued interest payable	77,177	63,202
Current portion of long-term debt	221,720	189,534
Other accrued liabilities	21,769	18,563
Total current liabilities	609,233	577,324
Long-term debt	5,386,609	5,537,848
Post-retirement and other post-employment benefit obligations	84,239	81,095
Other liabilities	196	1,163
Total Liabilities	6,080,277	6,197,430

Commitments and contingencies (Note 10)		
Stockholders Equity:		
Series A Junior Participating Preferred Stock, $0.01 par value, 200,000 shares authorized		
Common stock, $0.01 par value, 700 million shares authorized, 150,381,098 and 150,281,662 shares issued and outstanding at March 31, 2005 and December 31, 2004, respectively	1,504	1,503
Additional paid-in capital	820,938	833,736
Accumulated deficit	(138,724)	(153,916)
Accumulated other comprehensive income (loss)	792	(788)
Total Stockholders Equity	684,510	680,535
Total Liabilities and Stockholders Equity	$ 6,764,787	$ 6,877,965

See accompanying notes to condensed consolidated financial statements.

Table of Contents

DEX MEDIA, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share data)
(Unaudited)

	Three Months Ended March 31,	
	2005	**2004**
Revenue	$ 411,660	$ 388,177
Operating expenses:		
Cost of revenue	123,425	118,192
General and administrative expense	43,532	40,931
Bad debt expense	10,397	12,420
Depreciation and amortization expense	6,783	6,330
Amortization of intangibles	86,426	103,110
Total operating expenses	270,563	280,983
Operating income	141,097	107,194
Other (income) expense:		
Interest income	(304)	(257)
Interest expense	116,287	124,625
Other expense, net	122	33
Income (loss) before income taxes	24,992	(17,207)
Income tax provision (benefit)	9,800	(6,666)
Net income (loss)	$ 15,192	$ (10,541)
Basic and diluted income (loss) per common share	$ 0.10	$ (0.10)

See accompanying notes to condensed consolidated financial statements.

3

Table of Contents

DEX MEDIA, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Three Months Ended March 31,	
	2005	**2004**
Operating activities:		
Net income (loss)	$ 15,192	$ (10,541)
Adjustments to net income (loss):		
Bad debt expense	10,397	12,420
Depreciation and amortization expense	6,783	6,330
Amortization of intangibles	86,426	103,110
Amortization of deferred financing costs	10,432	18,216
Accretion on discount notes	11,735	8,502
Stock-based compensation expense	495	
Loss on disposition of assets	122	
Deferred tax provision (benefit)	9,800	(6,666)
Changes in operating assets and liabilities:		
Accounts receivable	885	(9,849)
Deferred directory costs	(5,059)	(27,284)
Other current assets	(5,913)	3,590
Other long-term assets	174	421
Accounts payable and other liabilities	(13,013)	(15,907)
Accrued interest	13,975	6,746
Deferred revenue and customer deposits	(745)	38,081
Other long-term liabilities	(159)	
Employee benefit plan obligations	3,144	3,050
Cash provided by operating activities	144,671	130,219
Investing activities:		
Expenditures for property, plant and equipment	(4,353)	(9,255)
Capitalized software development costs	(4,823)	(18,002)
Working capital adjustment related to the acquisition of Dex West		5,251
Cash used for investing activities	(9,176)	(22,006)
Financing activities:		
Proceeds from borrowings on revolving credit facilities	6,000	25,000
Repayments of borrowings on revolving credit facilities	(1,000)	(25,000)
Proceeds from issuance of long-term debt		250,476
Payments on long-term debt	(135,788)	(105,000)
Exercise of employee stock options	252	4,337
Payment of financing costs	(258)	(2,316)
Contribution by stockholders		1,439

Distributions to stockholders				(250,476)
Common stock dividends paid		(13,526)		
Cash used for financing activities		(144,320)		(101,540)
Cash and cash equivalents:				
(Decrease) increase		(8,825)		6,673
Beginning balance		9,234		7,416
Ending balance	$	409	$	14,089
Supplemental cash flow disclosures:				
Interest paid	$	75,498	$	91,189

See accompanying notes to condensed consolidated financial statements.

Table of Contents

DEX MEDIA, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

(a) The Company

Dex Media, Inc. (Dex Media or the Company) is the indirect parent of Dex Media East LLC (Dex Media East) and Dex Media West LLC (Dex Media West). Dex Media East operates the directory business in Colorado, Iowa, Minnesota, Nebraska, New Mexico, North Dakota and South Dakota (collectively, the Dex East States). Dex Media West operates the directory business in Arizona, Idaho, Montana, Oregon, Utah, Washington and Wyoming (collectively, the Dex West States).

The directory business was acquired from Qwest Dex, Inc. (Qwest Dex) in a two phase purchase between Dex Holdings LLC (Dex Holdings), the former parent of Dex Media, and Qwest Dex. Dex Holdings and Dex Media were formed by the private equity firms of The Carlyle Group and Welsh, Carson, Anderson & Stowe (WCAS) (collectively, the Sponsors).

In the first phase of the purchase, which was consummated on November 8, 2002, Dex Holdings assigned its right to purchase the directory business of Qwest Dex in the Dex East States (Dex East) to the Company (the Dex East Acquisition). In the second phase of the purchase, which was consummated on September 9, 2003, Dex Holdings assigned its right to purchase the directory business of Qwest Dex in the Dex West States (Dex West) to the Company (the Dex West Acquisition). Dex Holdings was dissolved effective January 1, 2005.

(b) Operations

The Company is the exclusive official directory publisher for Qwest Corporation, the local exchange carrier of Qwest Communications International Inc. (Qwest), in the Dex East States and the Dex West States (collectively, the Dex States). As a result, the Company is the largest telephone directory publisher of white and yellow pages directories to businesses and residents in the Dex States. The Company provides directory, Internet and direct marketing solutions to local and national advertisers. Virtually all of the Company s revenue is derived from the sale of advertising in its various directories. Published directories are distributed to residents and businesses in the Dex States through third-party vendors. The Company operates as a single segment.

(c) Dex Media s Initial Public Offering

Effective July 21, 2004, the Company consummated its initial public offering of common stock (the IPO). The Company issued 19,736,842 shares of common stock at an IPO price of $19.00 per share for net proceeds of $354.0 million. A portion of the net proceeds was used to redeem all of the Company s outstanding 5% Series A Preferred Stock, including accrued and unpaid dividends, for $128.5 million and to pay fees and expenses related to the IPO. On August 26, 2004, the remainder of net proceeds related to the IPO was used to redeem $183.8 million of Dex Media East s senior subordinated notes at a redemption price of 112.125% along with the accrued and unpaid interest and $18.2 million of Dex Media West s senior subordinated notes at a redemption price of 109.875% along with the accrued and unpaid interest. Also in connection with the IPO, the Company paid $10.0 million to each of the Sponsors to eliminate the $4.0 million aggregate annual advisory fees payable under Dex Media East s and Dex Media West s management consulting agreements. Immediately prior to the IPO, the Company effected a 10-for-1 common stock split. The share and per share data for the three months ended March 31, 2004 have been adjusted to reflect the effects of the stock split.

2. Basis of Presentation

(a) General

The accompanying condensed consolidated interim financial statements are unaudited. In compliance with the instructions of the Securities and Exchange Commission (SEC) for interim financial statements,

DEX MEDIA, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. In management s opinion, the condensed consolidated financial statements reflect all adjustments (which consist of normal recurring adjustments) necessary to fairly present the condensed consolidated statements of financial position as of March 31, 2005 and December 31, 2004 and the condensed consolidated statements of operations and cash flows for the three months ended March 31, 2005 and 2004. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company as of December 31, 2004 and 2003 and for the years ended December 31, 2004 and 2003, and for the periods from November 9 to December 31, 2002 and from January 1 to November 8, 2002, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the SEC. The condensed consolidated statements of operations for the three months ended March 31, 2005 are not necessarily indicative of the results expected for the full year. The accompanying condensed consolidated balance sheets as of March 31, 2005 and December 31, 2004, and the condensed consolidated statements of operations and cash flows for the three months ended March 31, 2005 and 2004 reflect the consolidated financial position, results of operations and cash flows of the Company, which includes its wholly-owned subsidiaries. The accompanying condensed consolidated statements of operations for the three months ended March 31, 2004 include all material adjustments required under purchase accounting related to the Dex West Acquisition subsequent to September 9, 2003.

(b) Reclassifications

Certain prior period amounts have been reclassified to conform to the 2005 presentation.

3. Summary of Significant Accounting Policies

(a) Principles of Consolidation

The condensed consolidated financial statements of the Company include the results of operations, financial position, and cash flows of Dex Media and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

(b) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts and disclosures reported in these condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

(c) Revenue Recognition

The sale of advertising in printed directories published by the Company is the primary source of revenue. The Company recognizes revenue ratably over the life of each directory using the deferral and amortization method of accounting, with revenue recognition commencing in the month of delivery.

The Company publishes white and yellow pages directories with primarily 12-month lives. From time to time, the Company may choose to change the publication dates of certain directories in order to more efficiently manage work and customer flow. The lives of the affected directories are expected to be 12 months thereafter. Such publication date changes do not have a significant impact on the Company s recognized revenue as the Company s sales contracts generally allow for the billing of additional monthly charges in the case of directories with extended lives. During the three months ended March 31, 2005 and 2004, the Company published 73 and 74 directories, respectively.

Table of Contents

DEX MEDIA, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company enters into transactions such as exclusivity arrangements, sponsorships, and other media access transactions, where the Company s products and services are promoted by a third party and, in exchange, the Company carries the party s advertisement. The Company accounts for these transactions in accordance with Emerging Issues Task Force (EITF) Issue No. 99-17 *Accounting for Advertising Barter Transactions.* Revenue and expense related to such transactions are included in the condensed consolidated statements of operations consistent with reasonably similar items sold or purchased for cash. Such barter transactions were not significant to the Company s financial results for the three months ended March 31, 2005 and 2004.

In certain cases, the Company enters into agreements with customers that involve the delivery of more than one product or service. Revenue for such arrangements is allocated in accordance with EITF Issue No. 00-21 *Revenue Arrangements with Multiple Deliverables.*

(d) Cost of Revenue

The Company accounts for cost of revenue under the deferral and amortization method of accounting. Accordingly, the Company s cost of revenue recognized in a reporting period consists of: (i) costs incurred in that period and recognized in that period, principally sales salaries and wages; (ii) costs incurred in a prior period, a portion of which is amortized and recognized in the current period; and (iii) costs incurred in the current period, a portion of which is amortized and recognized in that period and the balance of which is deferred until future periods. Consequently, there will be a difference between the cost of revenue recognized in any given period and the costs incurred in the given period.

Costs incurred in the current period and subject to deferral include direct costs associated with the publication of directories, including sales commissions, paper, printing, transportation, distribution and pre-press production and employee and systems support costs relating to each of the foregoing. Sales commissions include commissions paid to employees for sales to local advertisers and to third-party certified marketing representatives which act as the Company s channel to national advertisers. All deferred costs related to the sales and production of directories are recognized ratably over the life of each directory under the deferral and amortization method of accounting, with cost recognition commencing in the month of delivery. From time to time, the Company has changed the publication dates of certain directories to more efficiently manage work and customer flow. In such cases, the estimated life of the related unamortized deferred cost of revenue is revised to amortize such cost over the new remaining estimated life. Changes in directory publication dates typically do not result in any additional direct incurred costs.

(e) Stock-Based Compensation

The Company accounts for the Stock Option Plan of Dex Media, Inc. and the Dex Media, Inc. 2004 Incentive Award Plan, as more fully discussed in Note 8(e), under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related Interpretations. Had the Company accounted for employee stock option grants under the minimum value method for options issued prior to becoming a publicly traded company and the fair value method after becoming a publicly traded company, both of which are prescribed by Statement of Financial

Table of Contents

DEX MEDIA, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounting Standard (SFAS) No. 123, *Accounting for Stock-Based Compensation,* the pro forma results of the Company would have been as follows (in thousands, except per share data):

	Three Months Ended March 31,	
	2005	**2004**
Net Income (Loss)		
As reported	$ 15,192	$ (10,541)
Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects	274	22
Deduct: Stock-based employee compensation expense determined under minimum value or fair value based method, as applicable, for all awards, net of related tax effects	(443)	(132)
Pro forma	$ 15,023	$ (10,651)
Basic and diluted income (loss) per common share		
As reported	$ 0.10	$ (0.10)
Pro forma	0.10	(0.10)

(f) Income Tax Provision

The Company files a consolidated Federal income tax return and combined or consolidated state income tax returns, where permitted. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recorded to reflect the future tax consequences of temporary differences between the financial reporting bases of assets and liabilities and their tax bases at each year end. Deferred tax assets and liabilities are measured using the enacted income tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. Deferred tax assets and liabilities are adjusted for future income tax rate changes in the year the changes are enacted. Deferred tax assets are recognized for operating loss and tax credit carryforwards if management believes, based upon existing evidence, that it is more likely than not that the carryforwards will be utilized. All deferred tax assets are reviewed for realizability and valuation allowances are recorded if it is more likely than not that the deferred tax assets will not be realized.

(g) New Accounting Standards

On March 29, 2005, the SEC released Staff Accounting Bulletin (SAB) No. 107. SAB No. 107 provides an interpretation of SFAS No. 123R and its interaction with certain SEC rules and regulations and provides the SEC s views regarding the valuation of share-based payment arrangements for public companies. The SAB provides guidance with regard to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R and disclosures in Management s Discussion and Analysis subsequent to the adoption of SFAS No. 123R. Based upon the options outstanding as of March 31, 2005, the Company has determined that the adoption of SAB 107 will not have a material impact on the Company s results of operations.

On April 14, 2005, the SEC announced the adoption of a new rule that amends the compliance dates for SFAS No. 123R. Under SFAS No. 123R, registrants would have been required to implement the standard as of the beginning of the first interim or annual period that begins after June 15, 2005. The SEC s new rule requires companies to implement SFAS No. 123R at the beginning of their first fiscal year beginning on or after June 15, 2005, instead of the first reporting period that begins after June 15, 2005. This means that the

8

Table of Contents

DEX MEDIA, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

financial statements of the Company must comply with SFAS No. 123R beginning with the interim financial statements for the first quarter of 2006. The SEC s new rule does not change the accounting required by SFAS No. 123R; it changes only the dates for compliance with the standard.

4. Goodwill and Intangible Assets

During the three months ended March 31, 2005 goodwill was not impaired or otherwise adjusted.

The gross carrying amount and accumulated amortization of other intangible assets and their estimated useful lives are as follows (dollars in thousands):

	As of March 31, 2005			
Intangible Assets	**Gross Carrying Value**	**Accumulated Amortization**	**Net Book Value**	**Life**
Customer relationships local	$ 1,787,000	$ (603,971)	$ 1,183,029	20 years(1)
Customer relationships national	493,000	(124,176)	368,824	25 years(1)
Non-compete/ publishing agreements	610,000	(29,348)	580,652	39-40 years
Dex Trademark	696,000		696,000	Indefinite
Qwest Dex Trademark agreement	133,000	(56,749)	76,251	4-5 years
Advertising agreement	49,000	(6,523)	42,477	14-15 years
Totals	$ 3,768,000	$ (820,767)		