DAILY JOURNAL CORP
Form 10-Q
August 08, 2018

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 June 30, 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<br>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 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, 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 July 31, 2018 |
| --- | --- |
| Common Stock, par value $ .01 per share | 1,380,746 shares |

1

DAILY JOURNAL CORPORATION

INDEX

PART I

Item 1. FINANCIAL STATEMENTS

DAILY JOURNAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited)

| | June 30 2018 | September 30 2017 |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | $4,974,000 | $3,384,000 |
| Marketable securities at fair value, including common stocks of $207,499,000 at June 30, 2018, and common stocks of $220,973,000 and bonds of $8,292,000 at September 30, 2017 | 207,499,000 | 229,265,000 |
| Accounts receivable, less allowance for doubtful accounts of $200,000 at June 30, 2018 and September 30, 2017 | 8,312,000 | 5,358,000 |
| Inventories | 53,000 | 40,000 |
| Prepaid expenses and other current assets | 487,000 | 798,000 |
| Income tax receivable | 1,508,000 | 909,000 |
| Total current assets | 222,833,000 | 239,754,000 |
| | | |
| Property, plant and equipment, at cost | | |
| Land, buildings and improvements | 16,409,000 | 16,396,000 |
| Furniture, office equipment and computer software | 2,858,000 | 2,724,000 |
| Machinery and equipment | 1,818,000 | 1,799,000 |
| | 21,085,000 | 20,919,000 |
| Less accumulated depreciation | (9,721,000 ) | (9,292,000 ) |
| | 11,364,000 | 11,627,000 |
| Intangibles, net | 499,000 | 3,058,000 |
| Goodwill | 13,400,000 | 13,400,000 |
| Deferred income taxes - Federal | 7,717,000 | 10,652,000 |
| Deferred income taxes - State | 2,355,000 | 2,217,000 |
| | $258,168,000 | $280,708,000 |
| | | |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current liabilities | | |
| Accounts payable | $3,616,000 | $3,049,000 |
| Accrued liabilities | 3,473,000 | 3,112,000 |
| Note payable collateralized by real estate | 119,000 | 115,000 |
| Deferred subscriptions | 3,237,000 | 3,284,000 |
| Deferred installation contracts | 3,710,000 | 5,072,000 |

| | | |
|---|---|---|
| Deferred maintenance agreements and others | 11,157,000 | 9,442,000 |
| Total current liabilities | 25,312,000 | 24,074,000 |
| | | |
| Long term liabilities | | |
| Investment margin account borrowings | 29,493,000 | 29,493,000 |
| Note payable collateralized by real estate | 1,866,000 | 1,956,000 |
| Deferred maintenance agreements | 312,000 | 759,000 |
| Accrued liabilities | 135,000 | 135,000 |
| Deferred income taxes | 39,683,000 | 64,550,000 |
| Total long term liabilities | 71,489,000 | 96,893,000 |
| | | |
| Commitments and contingencies (Notes 10 and 11) | --- | --- |
| | | |
| 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 June 30, 2018 and September 30, 2017 | 14,000 | 14,000 |
| Additional paid-in capital | 1,755,000 | 1,755,000 |
| Retained earnings | 50,695,000 | 57,150,000 |
| Accumulated other comprehensive income | 108,903,000 | 100,822,000 |
| Total shareholders' equity | 161,367,000 | 159,741,000 |
| | $258,168,000 | $280,708,000 |

See accompanying Notes to Consolidated Financial Statements

3

DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(Unaudited)

| | Three months ended June 30 | |
|---|---|---|
| | 2018 | 2017 |
| Revenues | | |
| Advertising | $2,375,000 | $2,400,000 |
| Circulation | 1,346,000 | 1,385,000 |
| Advertising service fees and other | 724,000 | 778,000 |
| Licensing and maintenance fees | 4,756,000 | 3,916,000 |
| Consulting fees | 940,000 | 869,000 |
| Other public service fees | 866,000 | 853,000 |
| | 11,007,000 | 10,201,000 |
| Costs and expenses | | |
| Salaries and employee benefits | 8,475,000 | 8,126,000 |
| Outside services | 1,012,000 | 1,116,000 |
| Postage and delivery expenses | 217,000 | 283,000 |
| Newsprint and printing expenses | 186,000 | 224,000 |
| Depreciation and amortization | 905,000 | 1,423,000 |
| Other general and administrative expenses | 2,921,000 | 2,662,000 |
| | 13,716,000 | 13,834,000 |
| Loss from operations | (2,709,000) | (3,633,000) |
| Other income (expense) | | |
| Dividends and interest income | 1,215,000 | 952,000 |
| Other income | 9,000 | 4,000 |
| Interest expense on note payable collateralized by real estate | (24,000) | (24,000) |
| Interest expense on margin loans | (173,000) | (115,000) |
| Loss before income taxes | (1,682,000) | (2,816,000) |
| Benefit from income taxes | 710,000 | 1,465,000 |
| Net loss | $(972,000) | $(1,351,000) |
| Weighted average number of common shares outstanding - basic and diluted | 1,380,746 | 1,380,746 |
| Basic and diluted net loss per share | $(0.70) | $(0.98) |
| Comprehensive (loss) income | | |
| Net loss | $(972,000) | $(1,351,000) |
| Net (decrease) increase in unrealized appreciation of marketable securities (net of taxes) | (7,613,000) | 4,258,000 |
| | $(8,585,000) | $2,907,000 |

See accompanying Notes to Consolidated Financial Statements.

DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

| | Nine months ended June 30 | |
|---|---|---|
| | 2018 | 2017 |
| Revenues | | |
| Advertising | $6,700,000 | $6,833,000 |
| Circulation | 4,065,000 | 4,258,000 |
| Advertising service fees and other | 1,985,000 | 2,111,000 |
| Licensing and maintenance fees | 13,087,000 | 11,764,000 |
| Consulting fees | 2,147,000 | 3,027,000 |
| Other public service fees | 2,613,000 | 2,477,000 |
| | 30,597,000 | 30,470,000 |
| Costs and expenses | | |
| Salaries and employee benefits | 25,227,000 | 23,864,000 |
| Outside services | 3,095,000 | 3,183,000 |
| Postage and delivery expenses | 650,000 | 846,000 |
| Newsprint and printing expenses | 589,000 | 663,000 |
| Depreciation and amortization | 3,022,000 | 4,204,000 |
| Other general and administrative expenses | 8,541,000 | 7,462,000 |
| | 41,124,000 | 40,222,000 |
| Loss from operations | (10,527,000) | (9,752,000) |
| Other income (expense) | | |
| Dividends and interest income | 3,722,000 | 3,491,000 |
| Gains on sales of bonds and capital asset | 3,182,000 | --- |
| Other income | 28,000 | 25,000 |
| Interest expense on note payable collateralized by real estate | (72,000) | (75,000) |
| Interest expense on margin loans | (458,000) | (290,000) |
| Reversal of accrued interest and penalty expense for uncertain and unrecognized tax benefits | --- | 743,000 |
| Loss before income taxes | (4,125,000) | (5,858,000) |
| Benefit from income taxes | 17,660,000 | 6,015,000 |
| Net income | $13,535,000 | $157,000 |
| Weighted average number of common shares outstanding - basic and diluted | 1,380,746 | 1,380,746 |
| Basic and diluted net income per share | $9.80 | $0.11 |
| Comprehensive income | | |
| Net income | $13,535,000 | $157,000 |

| | | |
|---|---|---|
| Net (decrease) increase in unrealized appreciation of marketable securities (net of taxes) | (9,356,000 ) | 23,915,000 |
| | $4,179,000 | $24,072,000 |

See accompanying Notes to Consolidated Financial Statements.

DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Nine months ended June 30 | |
|---|---|---|
| | 2018 | 2017 |
| Cash flows from operating activities | | |
| Net income | $13,535,000 | $157,000 |
| Adjustments to reconcile net income to net cash used in operations | | |
| Depreciation and amortization | 3,022,000 | 4,204,000 |
| Deferred income taxes | (17,157,000) | (3,347,000) |
| Gains on sale of bonds and capital asset | (3,182,000) | --- |
| Discounts earned on bonds | --- | (2,000) |
| Changes in operating assets and liabilities | | |
| (Increase) decrease in current assets | | |
| Accounts receivable, net | (2,954,000) | (942,000) |
| Inventories | (13,000) | (8,000) |
| Prepaid expenses and other assets | 311,000 | (133,000) |
| Income tax receivable | (599,000) | (66,000) |
| Increase (decrease) in liabilities | | |
| Accounts payable | 567,000 | 270,000 |
| Accrued liabilities | 361,000 | (313,000) |
| Income taxes | --- | (2,723,000) |
| Deferred subscriptions | (47,000) | (501,000) |
| Deferred maintenance agreements and others | 1,268,000 | 817,000 |
| Deferred installation contracts | (1,362,000) | (843,000) |
| Net cash used in operating activities | (6,250,000) | (3,430,000) |
| Cash flows from investing activities | | |
| Sales (purchases) of marketable securities | 8,125,000 | (5,013,000) |
| Purchases of property, plant and equipment, net | (199,000) | (251,000) |
| Net cash provided by (used in) investing activities | 7,926,000 | (5,264,000) |
| Cash flows from financing activities | | |
| Payment of real estate loan principal | (86,000) | (82,000) |
| Net cash used in financing activities | (86,000) | (82,000) |
| Increase (decrease) in cash and cash equivalents | 1,590,000 | (8,776,000) |
| Cash and cash equivalents | | |
| Beginning of period | 3,384,000 | 11,411,000 |

| | | |
|---|---|---|
| End of period | $4,974,000 | $2,635,000 |
| | | |
| Interest paid during period | $524,000 | $359,000 |
| Net income taxes paid during period | $6,000 | $1,000 |

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 websites covering California and Arizona and produces several specialized information services. It also serves as a newspaper representative specializing in public notice advertising.

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 June 30, 2018, its results of operations for the three- and nine-month periods ended June 30, 2018 and 2017 and cash flows for the nine months ended June 30, 2018 and 2017. The results of operations for the nine months ended June 30, 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, 2017.

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

Note 3 - Accounting Standards Adopted in Fiscal 2018 and Recent Accounting Pronouncements

*Accounting Standards Adopted in Fiscal 2018*

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. This update requires deferred tax liabilities and assets to be classified as noncurrent in the consolidated balance sheet. The Company has adopted this guidance effective October 1, 2017 and concluded that it has no significant impact on the Company's financial condition, results of operations or disclosures because it is simply a reclassification of current deferred taxes to non-current deferred taxes with an itemization of federal and state deferred taxes.

In February 2018, the FASB issued an amendment to ASC Subtopic 220-10, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("AOCI")*. This amendment permits entities to reclassify stranded tax effects resulting from tax rate changes related to the Tax Cuts and Jobs Act (the "Tax Act"), from AOCI to retained earnings. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The election can be applied as of the first day of the interim period in which it is adopted or retroactively to the first interim period in which the tax effects of the Tax Act were recognized. The Company elected to adopt this amendment as of January 1, 2018. Pursuant to this amendment, the Company can only reclassify the stranded tax effects resulting from the Tax Act and not those relative to the previous California/State apportionment. As such, the Company recorded a reclassification of stranded tax effects of $19,960,000 between AOCI and retained earnings. This represented a decrease to retained earnings and an increase to AOCI, both of which are listed under the "Shareholders' equity" section of the Company's Consolidated Balance Sheets.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (ASC Topic 606)* which requires that revenues be recognized in an amount reflecting the consideration an entity expects to receive in exchange for those goods or services when a customer obtains control of promised goods or services. The Company elected to adopt ASC Topic 606 early effective October 1, 2017 using the modified retrospective method.

The Company has concluded that the adoption of the ASC Topic 606 in fiscal 2018 has no significant impact on the Company's financial condition or results of operations. For the Company's traditional publishing business (the "Traditional Business"), revenue recognition related to advertising, circulation, and advertising service fees remains unchanged. For the Journal Technologies' software business, the Company previously utilized the completed performance method of accounting, pursuant to which the Company did not recognize revenues for implementation services or licenses, maintenance, support and hosting services until after the services were performed and accepted by the customer (go-live), due to the fact that the customer's acceptance was typically unpredictable and reliable estimates of the progress towards completion could not be made. In addition, maintenance services were recognized over the term of the maintenance period. Thus, the Company's past revenue recognition policy was already in conformity with ASU Topic 606, which calls for revenue recognition at the point of delivery when a performance obligation is fulfilled. Consequently, the Company believes there are no required material retrospective or accumulated catch-up adjustments with respect to prior years' financial figures, as revenues have been recognized consistently in the same manner throughout the comparative reporting periods.

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.

*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, 2017.

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)*.

For the 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. (Also see Note 12 for additional disclosures related to ASC Topic 606 adoption.) 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.

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 fees (i.e. 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

Investments in marketable securities categorized as “available-for-sale” 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 June 30, 2018 and September 30, 2017, unrealized gains of $149,050,000 and $165,872,000, respectively, were recorded before taxes of $39,683,000 and $64,550,000, respectively, in “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 and securities with fixed maturity as of June 30, 2018 and September 30, 2017 are summarized below.

| | June 30, 2018 (Unaudited) | | | September 30, 2017 | | |
|---|---|---|---|---|---|---|
| | | Amortized/ | Pretax | | Amortized/ | Pretax |
| | Aggregate | Adjusted | unrealized | Aggregate | Adjusted | unrealized |
| | fair value | cost basis | gains | fair value | cost basis | gains |
| Marketable securities | | | | | | |
| Common stocks | $207,499,000 | $58,449,000 | $149,050,000 | $220,973,000 | $58,449,000 | $162,524,000 |
| Bonds | --- | --- | --- | 8,292,000 | 4,944,000 | 3,348,000 |
| | $207,499,000 | $58,449,000 | $149,050,000 | $229,265,000 | $63,393,000 | $165,872,000 |

All investments are classified as "Current assets" because they are available for sale at any time. In February 2018, the Company sold its bond investments for $8,125,000, realizing a gain of approximately $3,180,000, and simultaneously reclassified a previously lodged tax effect of $30,000 from accumulated other comprehensive income to retained earnings. This represented a decrease to retained earnings and an increase to accumulated other comprehensive income. (The Company uses an "individual security approach" to release stranded tax effects for its available-for-sale securities when sold or extinguished.)

As of June 30, 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 June 30, 2018, the unrealized loss related to an equity security it owns was temporary.

Note 7 - Intangible Assets

| | Intangible Assets June 30, 2018 | September 30, 2017 |
|---|---|---|

| | Customer Relationships | Developed Technology | Total | Customer Relationships | Developed Technology | Total |
|---|---|---|---|---|---|---|
| Gross intangibles | $21,950,000 | $2,525,000 | $24,475,000 | $21,950,000 | $2,525,000 | $24,475,000 |
| Accumulated amortization | (21,495,000) | (2,481,000) | (23,976,000) | (19,174,000) | (2,243,000) | (21,417,000) |
| | $455,000 | $44,000 | $499,000 | $2,776,000 | $282,000 | $3,058,000 |

These intangible assets are being amortized over five years for financial statement purposes due to the short life cycle of technology on which customer relationships depend and over 15 years on a straight-line basis for tax purposes. The intangible amortization expenses were $2,559,000 for the nine-month period ended June 30, 2018, as compared with $3,671,000 in the prior year period, primarily because the intangible assets of one of the two acquisitions in fiscal 2013 were fully amortized during the first quarter of fiscal 2018.

Note 8 – 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 2017 did not result in an impairment charge based on the qualitative assessment. There was no indicator of impairment during the nine-month periods ended June 30, 2018 and 2017.

Note 9 - Income Taxes

The December 2017 Tax Cuts and Jobs Act ("Tax Act") reduced the maximum corporate income tax rate from 35% to 21%, effective January 1, 2018. The Company has completed its review of the Tax Act. The impact to its financial statements is as follows: (i) current income tax expense or benefit is calculated using a blended rate of 24.28% pursuant to IRC Section 15, (ii) deferred tax expense includes 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 are expected to reverse during fiscal 2018 are valued at the blended rate of 24.28% while temporary differences that will reverse after fiscal 2018 are valued at the 21% rate, and (iv) approximately $20 million of the revaluation of deferred taxes relates to items that were initially recorded as accumulated other comprehensive income ("AOCI"). This revaluation of approximately $20 million was recorded as a component of income tax expense or benefit in continuing operations.

For the nine months ended June 30, 2018, the Company recorded an income tax benefit of $17,660,000 on pretax loss of $4,125,000. The income tax benefit was the result of applying the effective tax rate anticipated for fiscal 2018 to pretax loss for the nine-month period ended June 30, 2018. The effective tax rate (before the discrete Tax Act item discussed above) was greater than the statutory rate primarily due to the dividends received deduction which increases the loss for tax purposes.

During the prior fiscal year, on pretax loss of $5,858,000 for the nine months ended June 30, 2017, the Company recorded an income tax benefit of $6,015,000 which was the net result of applying the effective tax rate anticipated for fiscal 2017 to pretax loss for the nine months ended June 30, 2017 and included a reversal of an accrued liability of approximately $2,665,000 for uncertain and unrecognized tax benefits relating to an acquisition in fiscal 2013. The Internal Revenue Service concluded its examination of the Company's fiscal 2014 income tax return with no proposed changes to the tax position that gave rise to this liability. As a result, this liability was reversed along with the related accrued interest and penalty expense of $743,000. In addition, a deferred tax liability, in the amount of $352,000, relating to temporary differences that would only exist if the uncertain tax position was never recognized, was reversed. The effective tax rate (before the discrete IRS item) was greater than the statutory rate mainly resulting from the dividends received deduction.

The Company's effective tax rate was 428% and 103% for the nine months ended June 30, 2018 and 2017, respectively.

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 10 - 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 June 30, 2018 was 2.5%. These investment margin account borrowings do not mature.

In fiscal 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 $1.99 million as of June 30, 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 (expiring in October 2019) with a current monthly rent of approximately $25,000 for about 6,200 square feet. In fiscal 2017, Journal Technologies leased approximately 9,800 square feet of office space (expiring in August 2020) in Englewood, Colorado.

The Company is responsible for a portion of maintenance, insurance and property tax expenses relating to the leased properties. Rental expenses were $741,000 for the nine-month period ended June 30, 2018, as compared with $537,000 in the prior year period.

Note 11 - 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.

Note 12 - 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 |
| Nine months ended June 30, 2018 | | | | |
| Revenues | | | | |
| Advertising | $6,700,000 | $--- | $--- | $6,700,000 |
| Circulation | 4,065,000 | --- | --- | 4,065,000 |
| Advertising service fees and other | 1,985,000 | --- | --- | 1,985,000 |
| Licensing and maintenance fees | --- | 13,087,000 | --- | 13,087,000 |
| Consulting fees | --- | 2,147,000 | --- | 2,147,000 |
| Other public service fees | --- | 2,613,000 | --- | 2,613,000 |
| Operating expenses | 12,721,000 | 28,403,000 | --- | 41,124,000 |
| Income (loss) from operations | 29,000 | (10,556,000) | --- | (10,527,000) |
| Dividends and interest income | --- | --- | 3,722,000 | 3,722,000 |
| Gains on sales of bonds and capital asset | --- | --- | 3,182,000 | 3,182,000 |
| Other income | --- | --- | 28,000 | 28,000 |
| Interest expenses on note payable collateralized by real estate | (72,000) | --- | --- | (72,000) |
| Interest expenses on margin loans | --- | --- | (458,000) | (458,000) |
| Pretax (loss) income | (43,000) | (10,556,000) | 6,474,000 | (4,125,000) |
| Income tax benefit (expense) | --- | (455,000) | 18,115,000 | 17,660,000 |
| Net income (loss) | (43,000) | (11,011,000) | 24,589,000 | 13,535,000 |
| Total assets | 20,851,000 | 29,818,000 | 207,499,000 | 258,168,000 |
| Capital expenditures, net | 199,000 | --- | --- | 199,000 |
| Amortization of intangible assets | --- | 2,559,000 | --- | 2,559,000 |

| | Reportable Segments | | | |
|---|---|---|---|---|
| | Traditional Business | Journal Technologies | Corporate income and expenses | Total |
| Nine months ended June 30, 2017 | | | | |
| Revenues | | | | |
| Advertising | $6,833,000 | $--- | $--- | $6,833,000 |

| | | | | |
|---|---|---|---|---|
| Circulation | 4,258,000 | --- | --- | 4,258,000 |
| Advertising service fees and other | 2,111,000 | --- | --- | 2,111,000 |
| Licensing and maintenance fees | --- | 11,764,000 | --- | 11,764,000 |
| Consulting fees | --- | 3,027,000 | --- | 3,027,000 |
| Other public service fees | --- | 2,477,000 | --- | 2,477,000 |
| Operating expenses | 13,295,000 | 26,927,000 | --- | 40,222,000 |
| Loss from operations | (93,000) | (9,659,000) | --- | (9,752,000) |
| Dividends and interest income | --- | --- | 3,491,000 | 3,491,000 |
| Other income | 22,000 | --- | 3,000 | 25,000 |
| Interest expenses on note payable collateralized by real estate | (75,000) | --- | --- | (75,000) |
| Interest expenses on margin loans | --- | --- | (290,000) | (290,000) |
| Interest and penalty expense reversal for uncertain and unrecognized tax benefits | --- | 743,000 | --- | 743,000 |
| Pretax (loss) income | (146,000) | (8,916,000) | 3,204,000 | (5,858,000) |
| Income tax (expense) benefit | (125,000) | 6,690,000 | (550,000) | 6,015,000 |
| Net income (loss) | (271,000) | (2,226,000) | 2,654,000 | 157,000 |
| Total assets | 16,333,000 | 34,517,000 | 210,553,000 | 261,403,000 |
| Capital expenditures | 160,000 | 91,000 | --- | 251,000 |
| Amortization of intangible assets | --- | 3,671,000 | --- | 3,671,000 |

13

| | Reportable Segments | | | |
|---|---|---|---|---|
| | Traditional Business | Journal Technologies | Corporate income and expenses | Total |
| Three months ended June 30, 2018 | | | | |
| Revenues | | | | |
| Advertising | $2,375,000 | $--- | $--- | $2,375,000 |
| Circulation | 1,346,000 | --- | --- | 1,346,000 |
| Advertising service fees and other | 724,000 | --- | --- | 724,000 |
| Licensing and maintenance fees | --- | 4,756,000 | --- | 4,756,000 |
| Consulting fees | --- | 940,000 | --- | 940,000 |
| Other public service fees | --- | 866,000 | --- | 866,000 |
| Operating expenses | 4,214,000 | 9,502,000 | --- | 13,716,000 |
| Income (loss) from operations | 231,000 | (2,940,000) | --- | (2,709,000) |
| Dividends and interest income | --- | --- | 1,215,000 | 1,215,000 |
| Other income | --- | --- | 9,000 | 9,000 |
| Interest expenses on note payable collateralized by real estate | (24,000) | --- | --- | (24,000) |
| Interest expenses on margin loans | --- | --- | (173,000) | (173,000) |
| Pretax (loss) income | 207,000 | (2,940,000) | 1,051,000 | (1,682,000) |
| Income tax benefit (expense) | 785,000 | 480,000 | (555,000) | 710,000 |
| Net income (loss) | 992,000 | (2,460,000) | 496,000 | (972,000) |
| Total assets | 20,851,000 | 29,818,000 | 207,499,000 | 258,168,000 |
| Capital expenditures, net | 124,000 | --- | --- | 124,000 |
| Amortization of intangible assets | --- | 749,000 | --- | 749,000 |

| | Reportable Segments | | | |
|---|---|---|---|---|
| | Traditional Business | Journal Technologies | Corporate income and expenses | Total |
| Three months ended June 30, 2017 | | | | |
| Revenues | | | | |
| Advertising | $2,400,000 | $--- | $--- | $2,400,000 |
| Circulation | 1,385,000 | --- | --- | 1,385,000 |
| Advertising service fees and other | 778,000 | --- | --- | 778,000 |
| Licensing and maintenance fees | --- | 3,916,000 | --- | 3,916,000 |
| Consulting fees | --- | 869,000 | --- | 869,000 |
| Other public service fees | --- | 853,000 | --- | 853,000 |
| Operating expenses | 4,432,000 | 9,402,000 | --- | 13,834,000 |
| Loss from operations | 131,000 | (3,764,000) | --- | (3,633,000) |
| Dividends and interest income | --- | --- | 952,000 | 952,000 |
| Other income | 1,000 | --- | 3,000 | 4,000 |
| Interest expenses on note payable collateralized by real estate | (24,000) | --- | --- | (24,000) |
| Interest expenses on margin loans | --- | --- | (115,000) | (115,000) |

| | | | | |
|---|---|---|---|---|
| Pretax (loss) income | 108,000 | (3,764,000 ) | 840,000 | (2,816,000 ) |
| Income tax (expense) benefit | (50,000 ) | 1,570,000 | (55,000 ) | 1,465,000 |
| Net income (loss) | 58,000 | (2,194,000 ) | 785,000 | (1,351,000 ) |
| Total assets | 16,333,000 | 34,517,000 | 210,553,000 | 261,403,000 |
| Capital expenditures | --- | 57,000 | --- | 57,000 |
| Amortization of intangible assets | --- | 1,224,000 | --- | 1,224,000 |

During the nine months ended June 30, 2018, the Traditional Business had total revenues of $12,750,000 of which $8,685,000 were recognized after services were provided while $4,065,000 were recognized ratably over the subscription terms. Total revenues for the Company's software business were $17,847,000 of which $5,873,000 were recognized upon completion of services while $11,974,000 were recognized ratably over the subscription periods.

During the three months ended June 30, 2018, the Traditional Business had total revenues of $4,445,000 of which $3,099,000 were recognized after services were provided while $1,346,000 were recognized ratably over the subscription terms. Total revenues for the Company's software business were $6,562,000 of which $2,520,000 were recognized upon completion of services while $4,042,000 were recognized ratably over the subscription periods.

Approximately 60% and 58% of the Company's revenues during the three- and nine-month periods ended June 30, 2018, respectively, were derived from Journal Technologies, as compared with 55% and 57% in the prior year periods. In addition, the Company's revenues have been primarily from the United States, with approximately 1% from foreign countries. Journal Technologies' revenues are all from governmental agencies.

The following table sets forth certain deferred obligations from October 1, 2017 through June 30, 2018:

| | Beginning Balance | Addition | Recognized | Ending Balance |
|---|---|---|---|---|
| Deferred subscriptions | $3,284,000 | $4,018,000 | $(4,065,000 ) | $3,237,000 |
| Deferred installation contracts | 5,072,000 | 1,898,000 | (3,260,000 ) | 3,710,000 |
| Deferred maintenance agreements and others | 10,201,000 | 13,242,000 | (11,974,000) | 11,469,000 |

Note 13 - Subsequent Events

The Company has completed an evaluation of all subsequent events through the issuance date of these financial statements and concluded that no subsequent events occurred that required recognition to the financial statements or disclosures in the Notes to Consolidated Financial Statements or cash flows.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Results of Operations**

The Company continues to operate as two different businesses: (1) The Traditional Business, being the business of newspaper publishing and related services that the Company had before 1999 when it purchased a software development company, and (2) Journal Technologies, Inc. ("Journal Technologies"), a wholly-owned subsidiary which 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.

*Comprehensive Income*

Comprehensive income includes net income and unrealized net (losses) gains on investments, net of taxes, as summarized below:

Comprehensive Income

| | Nine months ended June 30 | |
|---|---|---|
| | 2018 | 2017 |
| Net income | $13,535,000 | $157,000 |
| Net (decrease) increase in unrealized appreciation of marketable securities (net of taxes) | (9,356,000 ) | 23,915,000 |
| | $4,179,000 | $24,072,000 |

*Comparable nine-month periods ended June 30, 2018 and 2017*

Consolidated revenues were $30,597,000 and $30,470,000 for the nine months ended June 30, 2018 and 2017, respectively. This increase of $127,000 was primarily from increased Journal Technologies' license and maintenance fees of $1,323,000 and public service fees of $136,000, partially offset by decreased Journal Technologies' consulting fees of $880,000, which are recognized upon project go-lives, and the reduction in The Traditional Business's trustee sale notice revenues of $72,000, commercial advertising revenues of $167,000 and circulation revenues of $193,000. The Company's revenues derived from Journal Technologies' operations constituted about 58% and 57% of the Company's total revenues for the nine months ended June 30, 2018 and 2017, respectively.

Consolidated operating expenses increased by $902,000 (2%) to $41,124,000 from $40,222,000, primarily resulting from additional personnel costs and services for Journal Technologies. Total personnel costs increased by $1,363,000 (6%) to $25,227,000 from $23,864,000. Postage and delivery expenses decreased by $196,000 (23%) to $650,000 from $846,000, primarily due to reduced subscriptions and delivery service fees. Depreciation and amortization costs, which included primarily the amortization of Journal Technologies' intangible assets, decreased by $1,182,000 to $3,022,000 from $4,204,000 primarily because the intangible assets of one of the two acquisitions in fiscal 2013 were fully amortized during the first quarter of fiscal 2018. Other general and administrative expenses increased by $1,079,000 (14%) to $8,541,000 from $7,462,000 mainly because of additional computer services for Journal Technologies.

The Company's non-operating income, net of expenses, increased by $2,508,000 (64%) to $6,402,000 from $3,894,000 primarily because of the capital gains of $3,180,000 from the sale of bonds, partially offset by the prior year's reversal of accrued interest and penalty expenses of $743,000 for uncertain and unrecognized tax benefits.

During the nine months ended June 30, 2018, consolidated pretax loss was $4,125,000 as compared with $5,858,000 in the prior year period. There was consolidated net income of $13,535,000 ($9.80 per share) after tax benefits, primarily from tax cuts, for the nine months ended June 30, 2018, as compared with $157,000 ($0.11 per share) in the prior year period. (See *Taxes*.)

At June 30, 2018, the aggregate fair market value of the Company's marketable securities was $207,499,000. These securities had approximately $149,050,000 of unrealized gains before estimated taxes of $39,683,000 and generated approximately $3,722,000 in dividends and interest income during the nine months ended June 30, 2018, which lowers the Company's effective income tax rate because of the dividends received deduction. Most of the unrealized gains were in the common stocks of three U.S. financial institutions and one foreign manufacturer.

Additional detail about each of the Company's reportable segments, and its corporate income and expenses, is set forth below:

**Overall Financial Results (000)**
For the nine months ended June 30

| | Reportable Segments | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Traditional Business | | Journal Technologies | | Corporate income and expenses | | Total | |
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| Revenues | | | | | | | | |
| Advertising | $6,700 | $6,833 | $--- | $--- | $--- | $--- | $6,700 | $6,833 |
| Circulation | 4,065 | 4,258 | --- | --- | --- | --- | 4,065 | 4,258 |
| Advertising service fees and other | 1,985 | 2,111 | --- | --- | --- | --- | 1,985 | 2,111 |
| Licensing and maintenance fees | --- | --- | 13,087 | 11,764 | --- | --- | 13,087 | 11,764 |
| Consulting fees | --- | --- | 2,147 | 3,027 | --- | --- | 2,147 | 3,027 |
| Other public service fees | --- | --- | 2,613 | 2,477 | --- | --- | 2,613 | 2,477 |
| Total revenues | 12,750 | 13,202 | 17,847 | 17,268 | --- | --- | 30,597 | 30,470 |
| Operating expenses | | | | | | | | |
| Salaries and employee benefits | 7,718 | 7,818 | 17,509 | 16,046 | --- | --- | 25,227 | 23,864 |
| Amortization of intangible assets | --- | --- | 2,559 | 3,671 | --- | --- | 2,559 | 3,671 |
| Others | 5,003 | 5,477 | 8,335 | 7,210 | --- | --- | 13,338 | 12,687 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total operating expenses | 12,721 | 13,295 | 28,403 | 26,927 | --- | --- | 41,124 | 40,222 |
| Loss from operations | 29 | (93) | (10,556) | (9,659) | --- | --- | (10,527) | (9,752) |
| Dividends and interest income | --- | --- | --- | --- | 3,722 | 3,491 | 3,722 | 3,491 |
| Gains on sales of bonds and capital asset | --- | --- | --- | --- | 3,182 | --- | 3,182 | --- |
| Other income (net) | --- | 22 | --- | --- | 28 | 3 | 28 | 25 |
| Interest expenses on note payable collateralized by real estate | (72) | (75) | --- | --- | --- | --- | (72) | (75) |
| Interest expenses on margin loans | --- | --- | --- | --- | (458) | (290) | (458) | (290) |
| Reversal of accrued interest and penalty expenses for uncertain and unrecognized tax benefits | --- | --- | --- | 743 | --- | --- | --- | 743 |
| Pretax (loss) income | $(43) | $(146) | $(10,556) | $(8,916) | $6,474 | $3,204 | $(4,125) | $(5,858) |

17

*The Traditional Business*

The Traditional Business segment's pretax loss decreased by $103,000 to $43,000 from $146,000.

Advertising revenues decreased by $133,000 to $6,700,000 from $6,833,000, primarily resulting from the declines in net commercial advertising revenues of $167,000 and trustee sales notice revenues of $72,000, partially offset by increased Conference revenues of $63,000.

Trustee sale notices are very much dependent on the number of California and Arizona foreclosures for which public notice advertising is required by law. The number of foreclosure notices published by the Company decreased by 10% during the nine months ended June 30, 2018 as compared to the prior year period. Because this slowing is expected to continue, the Company expects there will be fewer foreclosure notice and other public notice advertisements and declining revenues in fiscal 2018, and the Company's print-based earnings will also likely decline significantly because it will be impractical for the Company to offset all revenue losses by expense reduction. The Company's smaller newspapers, those other than the Los Angeles and San Francisco Daily Journals ("The Daily Journals"), accounted for about 88% of the total public notice advertising revenues in the nine months ended June 30, 2018. Public notice advertising revenues and related advertising and other service fees constituted about 21% and 22% of the Company's total revenues for the nine months ended June 30 2018 and 2017, respectively. Because of this concentration, the Company's revenues would be significantly adversely affected if California and Arizona eliminated the legal requirement to publish public notices in adjudicated newspapers of general circulation, as had been recently implemented in Arizona for one notice type. Also, if the adjudication of one or more of the Company's newspapers was challenged and revoked, those newspapers would no longer be eligible to publish public notice advertising, and it could have a material adverse effect on the Company's revenues.

The Daily Journals accounted for about 89% of The Traditional Business' total circulation revenues, which declined by $193,000 to $4,065,000 from $4,258,000. The court rule and judicial profile services generated about 8% of the total circulation revenues, with the other newspapers and services accounting for the balance. Advertising service fees and other are Traditional Business segment revenues, which include primarily (i) agency commissions received from outside newspapers in which the advertising is placed, and (ii) fees generated when filing notices with government agencies.

The Traditional Business segment operating expenses decreased by $574,000 (4%) to $12,721,000 from $13,295,000, primarily due to decreased personnel costs.

*Journal Technologies*

Journal Technologies' business segment pretax loss increased by $1,640,000 (18%) to $10,556,000 from $8,916,000, after the amortization costs of intangible assets of $2,559,000 and $3,671,000 for the nine months ended June 30, 2018 and 2017, respectively.

Revenues increased by $579,000 (3%) to $17,847,000 from $17,268,000 in the prior year period. Licensing and maintenance fees increased by $1,323,000 (11%) to $13,087,000 from $11,764,000. Consulting fees decreased by $880,000 (29%) to $2,147,000 from $3,027,000 because consulting fees are recognized upon project go-lives. Other public service fees increased by $136,000 (5%) to $2,613,000 from $2,477,000 primarily due to an increase in the number of traffic tickets processed online for the public to pay traffic citations.

Operating expenses increased by $1,476,000 (5%) to $28,403,000 from $26,927,000, primarily due to increased personnel costs and computer services.

Intangible assets, including customer relationships and developed technology, are being amortized on a straight-line basis over five years for financial statement purposes, due to the short life cycle of technology on which customer relationships depend, and over 15 years for tax purposes. Goodwill, which is not amortized for financial statement purposes, is amortized over 15 years for tax purposes. Goodwill represents the expected synergies in expanding the Company's software business. Goodwill is 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 include the current year's operating financial results before intangible asset amortization, fluctuations of revenues, changes in the market place, the status of installation contracts and new business, among other things. There was no indicator of impairment during the nine-month periods ended June 30, 2018 and 2017. Journal Technologies is continuing to update and upgrade its software products. These costs are expensed as incurred and will impact earnings at least through the foreseeable future.

*Taxes*

The December 2017 Tax Cuts and Jobs Act ("Tax Act") reduced the maximum corporate income tax rate from 35% to 21%, effective January 1, 2018. The Company has completed its review of the Tax Act. The impact to its financial statements is as follows: (i) current income tax expense or benefit is calculated using a blended rate of 24.28% pursuant to IRC Section 15, (ii) deferred tax expense includes 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 are expected to reverse during fiscal 2018 are valued at the blended rate of 24.28% while temporary differences that will reverse after fiscal 2018 are valued at the 21% rate, and (iv) approximately $20 million of the revaluation of deferred taxes relates to items that were initially recorded as accumulated other comprehensive income ("AOCI"). This revaluation of approximately $20 million was recorded as a component of income tax expense or benefit in continuing operations.

For the nine months ended June 30, 2018, the Company recorded an income tax benefit of $17,660,000 on pretax loss of $4,125,000. The income tax benefit was the result of applying the effective tax rate anticipated for fiscal 2018 to pretax loss for the nine-month period ended June 30, 2018. The effective tax rate (before the discrete Tax Act item discussed above) was greater than the statutory rate primarily due to the dividends received deduction which increases the loss for tax purposes.

During the prior fiscal year, on pretax loss of $5,858,000 for the nine months ended June 30, 2017, the Company recorded an income tax benefit of $6,015,000 which was the net result of applying the effective tax rate anticipated for fiscal 2017 to pretax loss for the nine months ended June 30, 2017 and included a reversal of an accrued liability of approximately $2,665,000 for uncertain and unrecognized tax benefits relating to an acquisition in fiscal 2013. The

Internal Revenue Service concluded its examination of the Company's fiscal 2014 income tax return with no proposed changes to the tax position that gave rise to this liability. As a result, this liability was reversed along with the related accrued interest and penalty expense of $743,000. In addition, a deferred tax liability, in the amount of $352,000, relating to temporary differences that would only exist if the uncertain tax position was never recognized, was reversed. The effective tax rate (before the discrete IRS item) was greater than the statutory rate mainly resulting from the dividends received deduction.

The Company's effective tax rate was 428% and 103% for the nine months ended June 30, 2018 and 2017, respectively.

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.

*Comparable three-month periods ended June 30, 2018 and 2017*

Consolidated revenues were $11,007,000 and $10,201,000 for the three months ended June 30, 2018 and 2017, respectively. This increase of $806,000 was primarily from increased Journal Technologies' license and maintenance fees of $840,000, public service fees of $13,000 and consulting fees of $71,000, which are recognized upon project go-lives, partially offset by the reduction in The Traditional Business's commercial advertising revenues of $117,000. The Company's revenues derived from Journal Technologies' operations constituted about 60% and 55% of the Company's total revenues for the three months ended June 30, 2018 and 2017, respectively.

Consolidated operating expenses decreased by $118,000 to $13,716,000 from $13,834,000, primarily resulting from reduced depreciation and amortization costs, partially offset by additional personnel costs for Journal Technologies. Total personnel costs increased by $349,000 (4%) to $8,475,000 from $8,126,000. Postage and delivery expenses decreased by $66,000 (23%) to $217,000 from $283,000 primarily due to reduced subscriptions and delivery service fees. Depreciation and amortization costs, which included primarily the amortization of Journal Technologies' intangible assets, decreased by $518,000 (36%) to $905,000 from $1,423,000 because the intangible assets of one of the two acquisitions in fiscal 2013 were fully amortized. Other general and administrative expenses increased by $259,000 (10%) to $2,921,000 from $2,662,000 mainly because of increased office equipment and software maintenance fees for Journal Technologies.

The Company's non-operating income, net of expenses, increased by $210,000 to $1,027,000 from $817,000 primarily because of increased dividends income.

During the three months ended June 30, 2018, consolidated pretax loss was $1,682,000 as compared with $2,816,000 in the prior year period. There was a consolidated net loss of $972,000 (-$.70 per share) after tax benefits, for the three months ended June 30, 2018, as compared with $1,351,000 (-$0.98 per share) in the prior year period. (See *Taxes*.)

**Liquidity and Capital Resources**

During the nine months ended June 30, 2018, the Company's cash and cash equivalents and marketable security positions decreased by $20,176,000 to $212,473,000 after the sale of the bonds for $8,125,000 with a capital gain of $3,180,000. Cash and cash equivalents were used for the purchase of capital assets of $199,000 and operating activities of $6,250,000, which included net increases of $2,954,000 in accounts receivable and net decreases of $141,000 in deferred subscriptions, deferred installation contracts and deferred maintenance agreements and others.

The investments in marketable securities, which had a market value of about $207,499,000 at June 30, 2018, had approximately $149,050,000 of unrealized gains before estimated taxes of $39,683,000 and generated approximately $3,722,000 in dividends and interest income.

Cash flows from operating activities decreased by $2,820,000 during the nine months ended June 30, 2018 as compared to the prior year period, primarily resulting from (i) gains on sale of bonds and capital asset of $3,182,000, (ii) increases in deferred income taxes of $13,810,000 mainly because of the discrete tax items mentioned above and (iii) net increases in accounts receivable of $2,012,000 resulting from more billings, partially offset by increases in net income of $13,378,000 and income tax payable of $2,723,000. Cash flows from investing activities increased by $13,190,000 primarily because of the sale of bond investments of $8,125,000 in February 2018 versus the purchases of marketable securities of $5,013,000 during the prior year period.

As of June 30, 2018, the Company had working capital of $197,521,000, including the liabilities for deferred subscriptions, deferred installation and maintenance agreements and others of $18,104,000.

The Company believes that it will be able to fund its operations for the foreseeable future through its cash flows from operations and its current working capital and expects that any such cash flows will be invested in its businesses. The Company may or may not have the ability to borrow against its marketable securities. The Company also may entertain additional business acquisition opportunities. Any excess cash flows could be used to reduce the investment margin account liability or note payable collateralized by real estate or invested as management and the Board of Directors deem appropriate at the time.

Such investments may include additional securities of the companies in which the Company has already invested, securities of other companies, government securities (including U.S. Treasury Notes and Bills) or other instruments. The decision as to particular investments will be driven by the Company’s belief about the risk/reward profile of the various investment choices at the time, and it may utilize government securities as a default if attractive opportunities for a better return are not available. The Company’s Chairman of the Board, Charles Munger, is also the vice chairman of Berkshire Hathaway Inc., which maintains a substantial investment portfolio. The Company’s Board of Directors has utilized his judgment and suggestions, as well as those of J.P. Guerin, the Company’s vice chairman, when selecting investments, and both of them will continue to play an important role in monitoring existing investments and selecting any future investments.

As of June 30, 2018, the investments were concentrated in six companies. Accordingly, a significant decline in the market value of one or more of the Company’s investments may not be offset by the hypothetically better performance of other investments, and that could result in a large decrease in the Company’s shareholders’ equity and, under certain circumstances, in the recognition of impairment losses in the Company’s comprehensive income statement.

**Critical Accounting Policies and Estimates**

The Company's financial statements and accompanying notes are prepared in accordance with U.S. generally accepted accounting principles. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are affected by management's application of accounting policies. Management believes that revenue recognition, accounting for software costs, fair value measurement and disclosures (including for the long-term Incentive Plan liabilities), accounting for business combinations, testing for goodwill impairment and income taxes are critical accounting policies and estimates.

The Company's critical accounting policies are detailed in its Annual Report on Form 10-K for the year ended September 30, 2017. The above discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and notes thereto included in this report.

**Disclosure Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Certain statements contained in this document, including but not limited to those in "Management's Discussion and Analysis of Financial Condition and Results of Operations," are "forward-looking" statements that involve risks and uncertainties that may cause actual future events or results to differ materially from those described in the forward-looking statements. Words such as "expects," "intends," "anticipates," "should," "believes," "will," "plans," "estimates," "may," variations of such similar expressions are intended to identify such forward-looking statements. We disclaim any intention or obligation to revise any forward-looking statements whether as a result of new information, future developments, or otherwise. There are many factors that could cause actual results to differ materially from those contained in the forward-looking statements. These factors include, among others: risks associated with software development and implementation efforts; Journal Technologies' reliance on professional services engagements with justice agencies, including California courts, for a substantial portion of its revenues; material changes in the costs of postage and paper; possible changes in the law, particularly changes limiting or eliminating the requirements for public notice advertising; possible loss of the adjudicated status of the Company's newspapers and their legal authority to publish public notice advertising; a further decline in public notice advertising revenues because of fewer foreclosures; a further decline in subscriber and commercial advertising revenues; possible security breaches of the Company's software or websites; the Company's reliance on its president and chief executive officer; changes in accounting guidance; material weaknesses in the Company's internal control over financial reporting; and declines in the market prices of the securities owned by the Company. In addition, such statements could be affected by general industry and market conditions, general economic conditions (particularly in California) and other factors. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from those in the forward-looking statements are discussed in this Form 10-Q, including in conjunction with the forward-looking statements themselves. Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained from time to time in documents filed by the Company with the Securities and Exchange Commission, including in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding the Company’s market risk, refer to Item 7A – Quantitative and Qualitative Disclosures about Market Risk in the Company’s Form 10-K for the fiscal year ended September 30, 2017. There have been no material changes to the Company’s market risk exposures since September 30, 2017.

## Item 4. CONTROLS AND PROCEDURES

*Changes in Internal Control over Financial Reporting*

Since the material weaknesses previously identified at last fiscal year-end were rectified during the past two quarters of this fiscal year, there were no material changes in the Company’s internal control over financial reporting or in other factors reasonably likely to affect its internal control over financial reporting during this quarter. Management will continue to assess the effectiveness of its remediation efforts in connection with management's future evaluations of internal control over financial reporting.

*Evaluation of Disclosure Controls and Procedures*

Based on the evaluation performed under the supervision and with the participation of the Company’s management, including Gerald L. Salzman, its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of June 30, 2018, Mr. Salzman concluded that the Company’s disclosure controls and procedures were effective.

**PART II**

Item 6. Exhibits

| | |
|---|---|
| 31 | Certification by Chief Executive Officer and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification by Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS** | XBRL Instance |
| 101.SCH** | XBRL Taxonomy Extension Schema |
| 101.CAL** | XBRL Taxonomy Extension Calculation |
| 101.DEF** | XBRL Taxonomy Extension Definition |
| 101.LAB** | XBRL Taxonomy Extension Labels |
| 101.PRE** | XBRL Taxonomy Extension Presentation |

** XBRL information is furnished and not filed as a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DAILY JOURNAL CORPORATION

(Registrant)

/s/ Gerald L. Salzman

Chief Executive Officer

President

Chief Financial Officer

Treasurer

(Principal Executive Officer,

Principal Financial Officer and

Principal Accounting Officer)

DATE: August 8, 2018