DOUGLAS DYNAMICS, INC
Form 10-Q
November 07, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

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: 001-34728

DOUGLAS DYNAMICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**134275891**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7777 North 73rd Street

Milwaukee, Wisconsin 53223

(Address of principal executive offices) (Zip code)

(414) 354-2310

(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 x No o

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 o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

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

Number of shares of registrant s common shares outstanding as of November 7, 2011 was 22,017,540

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Douglas Dynamics, Inc.

Consolidated Balance Sheets

(In thousands except share data)

	September 30, 2011 (unaudited)	December 31, 2010 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 3,084	$ 20,149
Accounts receivable, net	83,006	37,040
Inventories	27,067	23,481
Deferred income taxes	3,721	7,142
Prepaid income taxes	1,015	29
Prepaid and other current assets	1,164	1,131
Total current assets	119,057	88,972
Property, plant, and equipment, net	21,282	21,962
Assets held for sale	1,732	1,779
Goodwill	107,222	107,222
Other intangible assets, net	123,047	126,948
Deferred financing costs, net	3,545	953
Other long-term assets	9	207
Total assets	$ 375,894	$ 348,043
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 3,832	$ 2,847
Accrued expenses and other current liabilities	14,074	11,923
Accrued interest	352	23
Short-term borrowings	24,000	
Current portion of long-term debt	1,071	1,183
Total current liabilities	43,329	15,976
Retiree health benefit obligation	7,515	7,235
Pension obligation	10,381	10,753
Deferred income taxes	26,889	22,650
Deferred compensation	947	1,067
Long-term debt, less current portion	122,134	119,971
Other long-term liabilities	1,004	898
Stockholders equity:		

Common Stock, par value $0.01, 200,000,000 shares authorized, 22,003,912 and 21,579,655 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively		220		216
Additional paid-in capital		130,178		127,695
Stockholders notes receivable				(482)
Retained earnings		38,110		46,495
Accumulated other comprehensive loss, net of tax		(4,813)		(4,431)
Total stockholders equity		163,695		169,493
Total liabilities and stockholders equity	$	375,894	$	348,043

See the accompanying notes to consolidated financial statements

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Douglas Dynamics, Inc.

Consolidated Statements of Operations

(In thousands, except share and per share data)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
	(unaudited)		(unaudited)	
Net sales	$ 53,495	$ 47,448	$ 148,541	$ 128,338
Cost of sales	37,001	32,221	96,639	86,070
Gross profit	16,494	15,227	51,902	42,268
Selling, general, and administrative expense	6,535	6,819	19,195	20,527
Intangibles amortization	1,300	1,541	3,901	4,621
Management fees-related party	11	57	37	6,370
Income from operations	8,648	6,810	28,769	10,750
Interest expense, net	(2,332)	(2,334)	(6,678)	(9,038)
Loss on extinguishment of debt			(673)	(7,967)
Other expense, net	(25)	(12)	(202)	(7)
Income (loss) before taxes	6,291	4,464	21,216	(6,262)
Income tax expense (benefit)	2,324	2,279	8,326	(2,803)
Net income (loss)	$ 3,967	$ 2,185	$ 12,890	$ (3,459)
Less net income attributable to participating securities	51		271	
Net income (loss) attributable to common shareholders	$ 3,916	$ 2,185	$ 12,619	$ (3,459)
Weighted average number of common shares outstanding:				
Basic	21,760,753	21,158,573	21,609,810	17,963,720
Diluted	21,838,062	21,546,767	21,755,552	17,963,720
Earnings (loss) per common share:				
Basic	$ 0.18	$ 0.10	$ 0.59	$ (0.19)
Diluted	$ 0.18	$ 0.10	$ 0.57	$ (0.19)
Cash dividends declared and paid per share	$ 0.20	$ 0.18	$ 0.97	$ 0.18

See the accompanying notes to consolidated financial statements.

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Douglas Dynamics, Inc.

Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
	(unaudited)	
Operating activities		
Net income (loss)	$ 12,890	$ (3,459)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	6,146	9,448
Amortization of deferred financing costs	527	741
Loss on extinguishment of debt	673	7,967
Amortization of debt discount	100	
Stock-based compensation	1,210	3,158
Provision for losses on accounts receivable	454	281
Deferred income taxes	7,660	3,374
Changes in operating assets and liabilities:		
Accounts receivable	(46,420)	(50,446)
Inventories	(3,586)	2,222
Prepaid and other assets and prepaid income taxes	(821)	(6,069)
Accounts payable	985	1,375
Accrued expenses and other current liabilities	2,480	(7,268)
Deferred compensation	(120)	187
Benefit obligations and other long-term liabilities	(368)	54
Net cash used in operating activities	(18,190)	(38,435)
Investing activities		
Capital expenditures	(1,585)	(2,414)
Proceeds from sale of equipment	67	212
Net cash used in investing activities	(1,518)	(2,202)
Financing activities		
Stock repurchases		(2)
Proceeds from exercise of stock options	1,277	
Payment of call premium and post payoff interest on senior notes redemption		(3,876)
Collection of stockholders notes receivable	482	535
Payments of financing costs	(3,454)	(2,605)
Dividends paid	(21,275)	(3,867)
Revolver borrowings	24,000	37,000
Proceeds from public offering, net		63,938
Borrowings on long-term debt	123,750	40,000
Repayment of long-term debt	(122,137)	(150,838)

Net cash provided by (used in) financing activities		2,643		(19,715)
Change in cash and cash equivalents		(17,065)		(60,352)
Cash and cash equivalents at beginning of period		20,149		69,073
Cash and cash equivalents at end of period	$	3,084	$	8,721

See the accompanying notes to consolidated financial statements.

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Douglas Dynamics, Inc.

Notes to Unaudited Consolidated Financial Statements

(in thousands except share and per share data)

1. Basis of presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for fiscal year end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the financial statements and related footnotes included in our Form 10-K (Commission File No. 1-34728) filed with the Securities and Exchange Commission.

We operate as a single business unit.

Secondary Public Offering

On May 20, 2011, certain of the stockholders of Douglas Dynamics, Inc. (the Company), including affiliates of Aurora Capital Group and Ares Management, closed a registered secondary offering of 5,750,000 shares (the Shares) of the Company s common stock. The Company did not receive any proceeds from the sale of its stock by the selling stockholders in the offering.

Capitalization summary upon closing of the secondary offering:

Common stock issued and outstanding prior to secondary offering:	21,848,947
Shares issued for options exercised in connection with offering:	154,965
Common stock issued and outstanding subsequent to secondary offering:	22,003,912

Interim Consolidated Financial Information

The accompanying consolidated balance sheet as of September 30, 2011 and the consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010 and cash flows for the nine months ended September 30, 2011 and 2010 have been prepared by the Company and have not been audited.

As required by the new debt agreement the Company entered into in the second quarter of 2011, the Company entered into an interest-rate swap agreement to hedge against the potential impact on earnings from increases in market interest rates. Under the interest rate swap agreement, effective as of July 18, 2011 the Company either receives or makes payments on a monthly basis starting July 18, 2011, which is one month from the date the interest rate swap agreement was entered into, based on the differential between 6.335% and LIBOR plus 4.25% (with a LIBOR floor of 1.5%). The tax effected negative fair market value of the interest rate swap of ($382) is included in Accumulated other comprehensive loss at September 30, 2011 on the balance sheet. This fair value was determined using level 2 inputs as defined in Accounting Standards Codification (ASC) 820. The interest rate swap contract on $50,000 notional amount of the term loan expires in December 2014. The Company does not expect to record any unrecognized loss into earnings in the next twelve months. Additionally, other comprehensive income (loss) includes the net income (loss) of the Company plus the Company s adjustments for its defined benefit retirement plans based on the measurement date as of the Company s year-end. Other comprehensive income (loss) was $3,649 and $12,508 for the three and nine months ended September 30, 2011, respectively. Other comprehensive income (loss) was $2,185 and ($3,322) for the three and nine months ended September 30, 2010, respectively.

The Company s business is seasonal and consequently its results of operations and financial condition vary from quarter-to-quarter. Because of this seasonality, the Company s results of operations for any quarter may not be indicative of results of operations that may be achieved for a subsequent quarter or the full year, and may not be similar to results of operations experienced in prior years. The Company attempts to manage the seasonal impact of snowfall on its revenues in part through its pre-season sales program. This pre-season sales program encourages the Company s distributors to re-stock their inventory during the second and third quarters in anticipation of the peak fourth quarter retail sales period by offering favorable pre-season pricing and payment deferral until the fourth quarter. Thus, the Company tends to generate its greatest volume of sales during the second and third quarters. By contrast, its revenue and operating results tend to be lowest during the first quarter, as management believes the Company s end-users prefer to wait until the beginning of a snow season to purchase new equipment and as the Company s distributors sell off inventory and wait for the pre-season sales incentive period to re-stock inventory. Fourth quarter sales vary from year-to-year as they are primarily driven by the level, timing and location of snowfall during the quarter. This is because most of the Company s fourth quarter sales and shipments consist of re-orders by distributors seeking to restock inventory to meet immediate customer needs caused by snowfall during the winter months.

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2. Fair Value

Fair value is the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. A liability s fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor. Fair value measurements are categorized into one of three levels based on the lowest level of significant input used: Level 1 (unadjusted quoted prices in active markets); Level 2 (observable market inputs available at the measurement date, other than quoted prices included in Level 1); and Level 3 (unobservable inputs that cannot be corroborated by observable market data).

The following table presents financial assets and liabilities measured at fair value on a recurring basis and discloses the fair value of long-term debt:

		Fair Value at 9/30/2011		**Fair Value at 12/31/2010**
Assets:				
Assets (a)	$		$	
Total Assets	$		$	
Liabilities:				
Long term debt (b)		119,375		120,397
Other non-current liabilities				
Interest rate swaps(c)		615		
Total Liabilities	$	119,990	$	120,397

(a) The Company does not have any financial assets that are required to be measured at fair value on a recurring basis.

(b) The fair value of the Company s long-term debt, including current maturities, is estimated using discounted cash flows based on the Company s current incremental borrowing rates for similar types of borrowing arrangements, which is a level 2 input for all periods presented. Meanwhile, long-term debt is recorded at carrying amount, net of discount, as disclosed on face of the balance sheet.

(c) Valuation models are calibrated to initial trade price. Subsequent valuations are based on observable inputs to the valuation model (e.g. interest rates and credit spreads). Model inputs are changed only when corroborated by market data. A credit risk adjustment is made on each swap using observable market credit spreads. Thus, inputs used to determine fair value of the interest rate swap are level 2 inputs.

3. Inventories

Inventories consist of the following:

	September 30, 2011	December 31, 2010
Finished goods and work-in-process	$ 25,568	$ 21,896
Raw material and supplies	1,499	1,585
	$ 27,067	$ 23,481

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4. Property, plant and equipment

Property, plant and equipment are summarized as follows:

		September 30, 2011		December 31, 2010
Land	$	960	$	960
Land improvements		1,768		1,768
Buildings		12,591		12,554
Machinery and equipment		22,420		22,343
Furniture and fixtures		6,714		6,482
Mobile equipment and other		1,216		1,019
Construction-in-process		1,400		422
Total property, plant and equipment		47,069		45,548
Less accumulated depreciation		(25,787)		(23,586)
Net property, plant and equipment	$	21,282	$	21,962

5. Long-Term Debt

Long-term debt is summarized below:

		September 30, 2011		December 31, 2010
Term Loan	$	123,205	$	121,154
Total long-term debt		123,205		121,154
Less current maturities		1,071		1,183
	$	122,134	$	119,971

On April 18, 2011, the Company amended its senior credit facilities to, among other things, (i) increase the borrowing ability under the revolving credit agreement by $10,000, and (ii) amend certain of the provisions in its senior credit facilities which govern the Company s ability to pay dividends. Consequently, as of April 18, 2011, the Company s senior credit facilities consisted of a $125,000 term loan facility and a $70,000 revolving credit facility with a group of banks. Prior to the April 2011 changes to the Company s senior credit facilities, the interest on the original $85,000 term loan facility was (at the Company s option) either the base rate (which shall be no less than 3%) plus 3.5% or the eurodollar rate (which shall be no less than 2%) plus 4.5%. The interest for the additional $40,000 in the Company s term loan facility was an interest rate equal to (at the Company s option) either the base rate (which shall be no less than 3%) plus 4% or the eurodollar rate (which shall be no less than 2%) plus 5%. Under the previous revolving credit facility, the margin for base rate loans was either 0.25% or 0.50% and the margin for eurodollar rate loans was either 1.25% or 1.50%, in each case determined based on the Company s leverage ratio from time to time. The previous term loans consisted of an initial term loan of $85,000 and a tack on of $40,000. These were replaced by a term loan of $125,000. The $60,000 revolving credit facility was amended and restated to provide for borrowings of up to $70,000. The agreement for the new term loan (the Term Loan Credit Agreement) provides for a senior secured term loan facility in the aggregate principal amount of $125,000 and generally bears interest at (at the Company s election) either (i) 3.25% per annum plus the greatest of (a) the Prime Rate (as defined in the Term Loan Credit Agreement) in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the

Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) 1.00% plus the greater of (1) the London Interbank Offered Rate for a one month interest period multiplied by the Statutory Reserve Rate (as defined in the Term Loan Credit Agreement) and (2) 1.50% or (ii) 4.25% per annum plus the greater of (a) the London Interbank Offered Rate for the applicable interest period multiplied by the Statutory Reserve Rate and (b) 1.50%. The revolving credit facility as amended and restated (the Revolving Credit Agreement) provides that the Company has the option to select whether borrowings will bear interest at either (i) 2.25% per annum plus the London Interbank Offered Rate for the applicable interest period multiplied by the Statutory Reserve Rate or (ii) 1.25% per annum plus the greatest of (a) the Prime Rate in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) the London Interbank Offered Rate for a one month interest period multiplied by the Statutory Reserve Rate plus 1%. The maturity date for the Company s amended and restated revolving credit facility is April 18, 2016, and the Company s new term loan amortizes in nominal amounts quarterly with the balance payable on April 18, 2018.

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The new term loan entered into in the second quarter of 2011 was issued at a $1,250 discount which is being amortized over the term of the new term loan.

The Company s entry into the new term loan facility resulted in a significant modification of the Company s debt which resulted in the write off of unamortized capitalized deferred financing costs of $335 and write off of unamortized debt discount of $338 which in total resulted in a loss on extinguishment of debt of $673 in the Consolidated Statement of Operations during the nine months ended September 30,2011.

At September 30, 2011, the Company had borrowings of $24,000 on the revolving credit facility and remaining borrowing availability of $45,964.

The Company s senior credit facilities include certain negative and operating covenants, including restrictions on its ability to pay dividends, and other customary covenants, representations and warranties and events of default. The senior credit facilities entered into and recorded by the Company s subsidiaries significantly restrict its subsidiaries from paying dividends and otherwise transferring assets to Douglas Dynamics, Inc. The terms of the Company s revolving credit facility specifically restrict subsidiaries from paying dividends if a minimum availability under the revolving credit facility is not maintained, and both senior credit facilities restrict subsidiaries from paying dividends above certain levels or at all if an event of default has occurred. These restrictions would affect the Company indirectly since the Company relies principally on distributions from its subsidiaries to have funds available for the payment of dividends. In addition, the Company s revolving credit facility includes a requirement that, subject to certain exceptions, capital expenditures may not exceed $10,000 in any calendar year and, if certain minimum availability under the revolving credit facility is not maintained, that the Company comply with a monthly minimum fixed charge coverage ratio test of 1.0:1.0. Compliance with the fixed charge coverage ratio test is subject to certain cure rights under the Company s revolving credit facility. At September 30, 2011, the Company was in compliance with the respective covenants. The credit facilities are collateralized by substantially all assets of the Company.

In accordance with the senior credit facilities, the Company is required to make additional principal prepayments over the above scheduled payments under certain conditions. This includes, in the case of the term loan facility, 100% of the net cash proceeds of certain asset sales, certain insurance or condemnation events, certain debt issuances, and, within 150 days of the end of the fiscal year, 50% of excess cash flow, as defined, including a deduction for certain distributions (which percentage is reduced to 25% or 0% upon the achievement of certain leverage ratio thresholds), for any fiscal year. Excess cash flow is defined in the senior credit facilities as consolidated adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) plus a working capital adjustment less the sum of repayments of debt and capital expenditures subject to certain adjustments, interest and taxes paid in cash, management fees and certain restricted payments (including dividends or distributions). Working capital adjustment is defined in the senior credit facilities as the change in working capital, defined as current assets excluding cash and cash equivalents less current liabilities excluding current portion of long term debt. As of September 30, 2011, the Company was not required to make an excess cash flow payment.

Each of the senior secured facilities entered into in the second quarter of 2011 includes a hedge provision, which requires the Company to enter into an interest rate hedge commencing 90 days after the closing date. The hedging provision requires the Company to hedge the interest rate on at least 25% of the aggregate outstanding principal amount of the term loans. The purpose of the interest rate swap is to reduce the Company s exposure to interest rate volatility. Effective June 20, 2011, the Company entered into an interest rate swap agreement with a notional amount of $50,000. The interest rate swap negative fair value at September 30, 2011 of $615 is included in other long-term liabilities on the Consolidated Balance Sheet. The Company has counterparty credit risk resulting from the interest rate swap, which it monitors on an on-going basis. This risk lies with one global financial institution. Under the interest rate swap agreement, effective as of July 18, 2011, the Company either receives or makes payments on a monthly basis based on the differential between 6.335% and LIBOR plus 4.25% (with a LIBOR floor of 1.5%). The interest rate swap contract on the term loan expires in December 2014.

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6. Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities are summarized as follows:

	September 30, 2011	December 31, 2010
Payroll and related costs	$ 2,558	$ 2,993
Employee benefits	3,294	2,334
Accrued warranty	3,776	3,399
Other	4,446	3,197
	$ 14,074	$ 11,923

7. Warranty Liability

The Company accrues for estimated warranty costs as sales are recognized and periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. The Company s warranties generally provide, with respect to its snow and ice control equipment, that all material and workmanship will be free from defect for a period of two years after the date of purchase by the end-user, and with respect to its parts and accessories purchased separately, that such parts and accessories will be free from defect for a period of one year after the date of purchase by the end-user. Certain snowplows only provide for a one year warranty. The Company determines the amount of the estimated warranty costs (and its corresponding warranty reserve) based on the Company s prior five years of warranty history utilizing a formula driven by historical warranty expense and applying management s judgment. The Company adjusts its historical warranty costs to take into account unique factors such as the introduction of new products into the marketplace that do not provide a historical warranty record to assess. The warranty reserve is included in Accrued Expenses and Other Current Liabilities in the accompanying consolidated balance sheets.

The following is a rollforward of the Company s warranty liability:

	Three months ended		Nine months ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Balance at the beginning of the period	$ 3,070	$ 2,489	$ 3,399	$ 3,040
Warranty provision	890	721	2,521	1,775
Claims paid/settlements	(184)	(171)	(2,144)	(1,776)
Balance at the end of the period	$ 3,776	$ 3,039	$ 3,776	$ 3,039

8. Employee Retirement Plans

The components of net periodic pension cost consist of the following:

	Three months ended		Nine months ended	
	September 30, 2011	**September 30, 2010**	**September 30, 2011**	**September 30, 2010**
Component of net periodic pension cost:				
Service cost	$ 240	$ 200	$ 720	$ 600
Interest cost	385	358	1,155	1,074
Expected return on plan assets	(339)	(290)	(1,017)	(870)
Amortization of net loss	113	81	339	243
Net periodic pension cost	$ 399	$ 349	$ 1,197	$ 1,047

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The Company estimates its total required minimum contributions to its pension plans in 2011 will be $1,917. Through September 30, 2011, the Company has made $1,570 of cash contributions to the pension plans in 2011 versus $711 through the same period in 2010.

Components of net periodic other postretirement benefit cost consist of the following:

	Three months ended		Nine months ended	
	September 30, 2011	**September 30, 2010**	**September 30, 2011**	**September 30, 2010**
Components of net periodic other postretirement benefit cost				
Service cost	$ 66	$ 71	$ 197	$ 237
Interest cost	102	107	306	348
Amortization of net gain	(15)		(46)	(7)
Curtailment gain - Johnson City closing				(667)
Net periodic other postretirement benefit cost	$ 153	$ 178	$ 457	$ (89)

9. Dividends

Cash dividends declared and paid on a per share basis were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	**2010**	**2011**	**2010**
Dividends declared	$ 0.20	$ 0.18	$ 0.97	$ 0.18
Dividends paid	$ 0.20	$ 0.18	$ 0.97	$ 0.18

10. Earnings Per Share

Basic earnings per share of common stock is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings per share of common stock is computed by dividing net income (loss) by the weighted average number of common shares and common stock equivalents related to the assumed exercise of stock options, using the two-class method. Stock options for which the exercise price exceeds the average fair value have an anti-dilutive effect on earnings per share and are excluded from the calculation. There were 299,408 shares excluded from diluted earnings per share for the nine months ended September 30, 2010 as the shares would be anti-dilutive for that period as the Company incurred a net loss.

As restricted shares participate in dividends, in accordance with ASC 260, the Company has calculated earnings per share pursuant to the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends.

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	Three months ended		Nine months ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Basic earnings (loss) per common share				
Net income (loss)	$ 3,967	$ 2,185	$ 12,890	$ (3,459)
Less income allocated to participating securities	51		271	
Net income (loss) allocated to common shareholders	$ 3,916	$ 2,185	$ 12,619	$ (3,459)
Weighted average common shares outstanding	21,760,753	21,158,573	21,609,810	17,963,720
	$ 0.18	$ 0.10	$ 0.59	$ (0.19)
Earnings (loss) per common share assuming dilution				
Net income (loss)	$ 3,967	$ 2,185	$ 12,890	$ (3,459)
Less income allocated to participating securities	51		271	
Net income (loss) allocated to common shareholders	$ 3,916	$ 2,185	$ 12,619	$ (3,459)
Weighted average common shares outstanding	21,760,753	21,158,573	21,609,810	17,963,720
Incremental shares applicable to stock based compensation	77,309	388,194	145,742	
Weighted average common shares assuming dilution	21,838,062	21,546,767	21,755,552	17,963,720
	$ 0.18	$ 0.10	$ 0.57	$ (0.19)

11. Employee Stock Plans

Amended and Restated 2004 Stock Incentive Plan

In connection with the Company s initial public offering (IPO), in May 2010, the Company s Board of Directors and stockholders amended and restated the Company s 2004 Stock Incentive Plan (as amended and restated, the A&R 2004 Plan) and certain outstanding award agreements thereunder, to among other things, eliminate the ability of the holders thereunder to use a promissory note to pay any portion of the exercise price of the options, to provide that the use of net exercises to pay any portion of the exercise price of the options shall be at the sole discretion of the committee administering the A&R 2004 Plan, and to effect certain ministerial changes under the A&R 2004 Plan. In addition, in connection with the IPO, the Board of Directors also resolved not to issue any further awards under the A&R 2004 Plan. As of September 30, 2011, 53,022 shares of common stock are reserved for issuance upon the exercise of outstanding options under the A&R 2004 Plan. All outstanding options are fully vested. Previously unvested shares vested upon the completion of the secondary offering in May 2011. All options expire ten years from the date of grant.

2010 Stock Incentive Plan

In connection with the IPO, in May 2010, the Company s Board of Directors and stockholders adopted the 2010 Stock Incentive Plan (the 2010 Plan). The 2010 Plan provides for the issuance of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock awards and restricted stock units, any of which may be performance-based, and for incentive bonuses, which may be paid in cash or stock or a combination of both, to eligible employees, officers, non-employee directors and other service providers to the Company and its subsidiaries. A maximum of 2,130,000 shares of common stock may be issued pursuant to all awards under the 2010 Plan.

The following summarizes restricted stock grants under the 2010 Plan:

- May 2010 - An aggregate of 208,130 shares of restricted stock were granted to certain officers and employees under the 2010 Plan. The restricted stock awards were time-based and vest over a five-year period in equal annual installments of 20% per year, commencing on the first anniversary of the grant date. The first tranche of 41,621 shares vested and thus converted from participating securities to common shares in May 2011.

- October 2010- An aggregate of 33,954 shares of restricted stock were granted to certain officers and employees under the 2010 Plan. The restricted stock awards were time based and vest over a three-year period in equal annual installments. The first tranche vested upon issuance in January 2011 and the remaining two tranches will vest in January 2012 and 2013, contingent on the continuous employment through the applicable vesting date.

- January 2011- An aggregate of 4,500 shares of restricted stock were granted to certain employees under the 2010 Plan. The restricted stock awards are time based and vest over a three-year period in equal annual installments commencing on January 1, 2012.

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- March 2011- An aggregate of 38,190 shares of restricted stock were granted to certain officers and employees under the 2010 Plan. The restricted stock awards are time based and vest over a three-year period in equal annual installments commencing on January 1, 2012.

The restricted stock does not carry voting rights until the stock vests. However, restricted stock holders do participate in dividends.

In March 2011, long-term incentive awards relating to an aggregate of 57,305 shares of unrestricted stock were granted to certain officers and employees under the 2010 Plan. These awards are performance based and the shares underlying the units will be issued as unrestricted stock in March 2012 if performance targets for the 2009-2011 performance period are achieved. The Company recognized $249 and $580 of compensation expense related to unrestricted stock awards granted for the three and nine months ended September 30, 2011. The awards do not carry voting rights or participate in dividends until the underlying stock is issued.

As of September 30, 2011, the Company had 1,801,214 shares of common stock available for future issuance of awards under the 2010 Plan. The shares of common stock to be issued under the 2010 Plan will be made available from authorized and unissued Company common stock.

Stock Options

The following table summarizes information with respect to the Company s stock option activity under the A&R 2004 Plan for the nine months ended September 30, 2011. Certain of the Company s stockholders exercised 303,616 stock options during the nine months ended September 30, 2011, of which 182,082 options were exercised utilizing a broker assisted cashless exercise for the nine month period. The options exercised were granted under APB 25 with an exercise price equal to fair value at date of grant, and accordingly so, no compensation expense was recorded at the time of grant. The Company did not bear the risk and rewards of the options and thus, did not record stock based compensation expense. The option holders paid the Company the required exercise price for the remaining options at the time of exercise and therefore did not record any stock based compensation expense. The following is a rollforward of stock option activity for the periods presented.

	Three months ended September 30, 2011	Nine months ended September 30, 2011
Stock options - beginning of period	53,022	356,638
Options exercised		303,616
Stock options end of period	53,022	53,022

Restricted Stock Awards

A summary of restricted stock activity for the nine months ended September 30, 2011 is as follows:

	Weighted	Weighted Average

	Shares (In thousands)		Average Grant Date Fair value	Remaining Contractual Term
Unvested at December 31, 2010	242,084	$	11.68	4.01 years
Granted	42,690	$	15.00	2.25 years
Vested	(50,111)	$	11.77	
Cancelled and forfeited				
Unvested at September 30, 2011	234,663	$	12.27	3.09 years
Expected to vest in the future at September 30, 2011	226,215	$	12.27	3.09 years

The fair value of the Company s restricted stock awards is the closing stock price on the date of grant. The Company recognized $215 and $630 of compensation expense related to restricted stock awards granted for the three and nine months ended September 30, 2011, respectively. The unrecognized compensation expense calculated under the fair value method for shares expected to vest as of September 30, 2011 was approximately $2,360 and is expected to be recognized over a weighted average period of 3.09 years.

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12. Commitments and Contingencies

In the ordinary course of business, the Company is engaged in various litigation including product liability and intellectual property disputes. However, the Company does not believe that any pending litigation will have a material adverse effect on its consolidated financial position. In addition, the Company is not currently a party to any environmental-related claims or legal matters.

13. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The largest item affecting deferred taxes is the difference between book and tax amortization of goodwill and other intangibles amortization. The Company estimates that the combined federal and state tax rate for 2011 will be approximately 39%. The Company s effective tax rate was 36.9% and 51.1% for the three months ended September 30, 2011 and 2010, respectively. The Company s effective tax rate for the nine months ended September 30, 2011 and 2010 was 39.2% and (44.8%), respectively. The effective tax rate (benefit) for the nine months ended September 30, 2011 was lower than the corresponding period in 2010 due to adjusting the Company s net deferred tax liabilities to the higher estimated federal rate for 2011 compared to the actual rate incurred in 2010.

14. Related Party Transactions

The Company is party to a Joint Management Services Agreement with Aurora Management Partners, LLC (AMP) and ACOF Management, LP (ACOF), affiliates of its principal stockholders. Prior to the IPO, this agreement obligated the Company to pay an annual management fee of $1,250 per annum, to AMP and ACOF, pro rata in accordance with their respective holdings, plus reimbursement of reasonable out-of-pocket expenses, in exchange for consultation and advice in fields such as financial services, accounting, general business management, acquisitions, dispositions and banking.

In connection with the Company s IPO, the Company amended and restated the terms of its Joint Management Services Agreement to, among other things, (i) extend the term of service until the earlier of (A) the fifth anniversary of the consummation of the Company s IPO, (B) such time as AMP and ACOF, together with their affiliates, collectively hold less than 5% of the Company s outstanding common stock and (C) such time as all parties mutually agree in writing, while eliminating all other termination events (other than termination for cause); (ii) eliminate the annual management fee, as well as the provision obligating the Company to pay AMP and ACOF a transaction fee in the event of an acquisition or any sale or disposition of the Company or any of its divisions or any sale of substantially all Company assets or similar transactions in exchange for a one-time fee of $5,800 upon the consummation of the IPO, pro rata in accordance with their respective holdings; and (iii) modify the expense reimbursement provisions to include reimbursement for out-of-pocket expenses incurred in connection with SEC and other legally required filings made by each of AMP and ACOF with respect to the Company s securities and certain other expenses.

In connection with the registered secondary offering of 5,750,000 shares of the Company s common stock by certain of the Company s stockholders, including Aurora Equity Partners II L.P., Aurora Overseas Equity Partners II, L.P. and Ares Corporate Opportunities Fund, L.P., on May 20, 2011, the Company paid $1,046 in expenses pursuant to the requirements of that certain Second Amended and Restated Securityholders Agreement, dated June 30, 2004, among the Company and certain stockholders, related entities and executives and directors of the Company.

During the three month periods ended September 30, 2011 and 2010, the Company recognized management fees and related expenses of $11 and $57, respectively, and during the nine month periods ended September 30, 2011 and 2010, the Company recognized management fees and related expenses of $37 and $6,370, respectively, relating to the Joint Management Service Agreement.

Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes which are included in Item 1 of this Quarterly Report on Form 10-Q, as well as the information contained in our Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission.

In this Quarterly Report on Form 10-Q, unless the context indicates otherwise: Douglas Dynamics, the Company, we, our, or us refer to Douglas Dynamics, Inc.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements include information relating to future events, product demand, the payment of dividends, future financial performance, strategies, expectations, competitive environment, regulation and availability of financial resources. These statements are often identified by use of words such as anticipate, believe, intend, estimate, expect, continue, should, could, may, plan, project, predict, will and similar expressions and include references to assumptions and relate to our future prospects, developments and business strategies. Such statements involve known and unknown risks, uncertainties and other factors that could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to: (i) weather conditions, particularly lack of or reduced levels of snowfall or the timing of such snowfall; (ii) a significant decline in economic conditions; (iii) our inability to maintain good relationships with our distributors; (iv) lack of available or favorable financing options for our end-users or distributors; (v) increases in the price of steel or other materials necessary for the production of our products that cannot be passed on to our distributors; (vi) increases in the price of fuel; (vii) the inability of our suppliers to meet our volume or quality requirements; (viii) our inability to protect or continue to build our intellectual property portfolio; (ix) our inability to develop new products or improve upon existing products in response to end-user needs; (x) losses due to lawsuits arising out of personal injuries associated with our products; (xi) factors that could impact the future declaration and payment of dividends; and (xii) our inability to compete effectively against competition, as well as those discussed in the section entitled Risk Factors, set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. In addition, the forward-looking statements in this Quarterly Report on Form 10-Q speak only as of the date hereof and we undertake no obligation, except as required by law, to update or release any revisions to any forward-looking statement, even if new information becomes available in the future.

Results of Operations

Overview

During the three months ended September 30, 2011 and 2010, we sold 13,824 and 13,085 units of snow and ice control equipment, respectively, and during the nine months ended September 30, 2011 and 2010 we sold 35,835 and 32,491 units of snow and ice control equipment, respectively. The following table shows our sales of snow and ice control equipment and related parts and accessories as a percentage of net sales for the three and nine months ended September 30, 2011 and 2010.

	Three months ended		Nine months ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Equipment	89%	91%	84%	87%
Parts and accessories	11%	9%	16%	13%

The following table sets forth, for the three and nine months ended September 30, 2011 and 2010, the consolidated statements of operations of Douglas Dynamics, Inc. and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the table below and throughout this Management s Discussion and Analysis of Financial Condition and Results of Operations, consolidated statements of operations data for the three and nine months ended September 30, 2011 and 2010 have been derived from our unaudited consolidated financial statements. The information contained in the table below should be read in conjunction with our consolidated financial statements and the

related notes included elsewhere in this Quarterly Report on Form 10-Q.

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	Three Months Ended		Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(unaudited) (in thousands)		(unaudited) (in thousands)	
Net sales	$ 53,495	$ 47,448	$ 148,541	$ 128,338
Cost of sales	37,001	32,221	96,639	86,070
Gross profit	16,494	15,227	51,902	42,268
Selling, general, and administrative expense	6,535	6,819	19,195	20,527
Intangibles amortization	1,300	1,541	3,901	4,621
Management fees-related party	11	57	37	6,370
Income from operations	8,648	6,810	28,769	10,750
Interest expense, net	(2,332)	(2,334)	(6,678)	(9,038)
Loss on extinguishment of debt			(673)	(7,967)
Other expense, net	(25)	(12)	(202)	(7)
Income (loss) before taxes	6,291	4,464	21,216	(6,262)
Income tax expense (benefit)	2,324	2,279	8,326	(2,803)
Net income (loss)	$ 3,967	$ 2,185	$ 12,890	$ (3,459)

The following table sets forth for the three and nine months ended September 30, 2011 and 2010, the percentage of certain items in our consolidated statement of operations, relative to net sales:

	Three Months Ended		Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(unaudited)		(unaudited)	
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	69.2%	67.9%	65.1%	67.1%
Gross profit	30.8%	32.1%	34.9%	32.9%
Selling, general, and administrative expense	12.2%	14.4%	12.9%	16.0%
Intangibles amortization	2.4%	3.2%	2.6%	3.6%
Management fees-related party	0.0%	0.1%	0.0%	4.9%
Income from operations	16.2%	14.4%	19.4%	8.4%
Interest expense, net	(4.4)%	(5.0)%	(4.5)%	(7.1)%
Loss on extinguishment of debt	0.0%	0.0%	(0.5)%	(6.2)%
Other expense, net	(0.0)%	0.0%	(0.1)%	0.0%
Income (loss) before taxes	11.8%	9.4%	14.3%	(4.9)%
Income tax expense (benefit)	4.3%	4.8%	5.6%	(2.2)%
Net income (loss)	7.5%	4.6%	8.7%	(2.7)%

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Net Sales

Net sales were $53.5 million for the three months ended September 30, 2011 compared to $47.4 million in the three months ended September 30, 2010, an increase of $6.1 million, or 12.7%. Net sales were $148.5 million for the nine months ended September 30, 2011 compared to $128.3 million in the nine months ended September 30, 2010, an increase of $20.2 million, or 15.7%. The increase in net sales for the three and nine months ended September 30, 2011 was driven by a 5.6% and 10.3% increase in unit sales of snow and ice control equipment, respectively. In addition to the increase in unit sales of snow and ice control equipment was an increase in parts and accessories sales for the three and nine months ended September 30, 2011 compared to the corresponding period in 2010 of 33.9%, and 40.1%, respectively. The Company attributes the increases in both equipment and parts and accessories to the above average snowfall during the October 1, 2010 to March 31, 2011 snow season.

Cost of Sales

Cost of sales was $37.0 million for the three months ended September 30, 2011 compared to $32.2 million for the three months ended September 30, 2010, an increase of $4.8 million, or 14.9%. Cost of sales was $96.6 million for the nine months ended September 30, 2011 compared to $86.1 million in the nine months ended September 30, 2010, an increase of $10.5 million, or 12.2%. The increases in cost of sales for the three and nine months ended September 30, 2011 compared to the corresponding periods in 2010 were primarily driven by increases in volume as discussed above under Net Sales . In addition, the Company experienced slightly higher cost of sales as a percentage of sales of 69.2% for the three months ended September 30, 2011 compared to 67.9% for the three-month period ended September 30, 2010. Increase in cost of sales as a percentage of sales is due primarily to increases in target market programming and increases in raw material costs. Meanwhile the Company experienced lower cost of sales as a percentage of sales of 65.1% compared to 67.1% for the nine-month periods ending September 30, 2011 and September 30, 2010, respectively. The decrease in cost of sales as a percentage of net sales for the nine month period was in part due to the decreases in non-recurring accelerated depreciation, as the Company incurred costs for the nine month period ended September 30, 2010 totaling $1.9 million, associated with reassessing the useful lives of the Company s manufacturing facilities and certain equipment at our Johnson City plant. As a percentage of cost of sales, fixed and variable costs were approximately 16% and 84%, respectively, for both the three months ended September 30, 2011 and the three months ended September 30, 2010, and approximately 15% and 85%, respectively, for the nine months ended September 30, 2011 versus approximately 20% and 80%, respectively, for the nine months ended September 30, 2010.

Gross Profit

Gross profit was $16.5 million for the three months ended September 30, 2011 compared to $15.2 million in the three months ended September 30, 2010, an increase of $1.3 million, or 8.6%. Gross profit was $51.9 million for the nine months ended September 30, 2011 compared to $42.3 million in the nine months ended September 30, 2010, an increase of $9.6 million, or 22.7%. The increase in gross profit for the three and nine months ended September 30, 2011 was due primarily to the increased unit sales of snow and ice control equipment described above under Net Sales. As a percentage of net sales, gross profit decreased from 32.1% for the three months ended September 30, 2010 to 30.8% for the corresponding period in 2011 and increased from 32.9% for the nine months ended September 30, 2010 to 34.9% for the corresponding period in 2011, primarily as a result of the factors discussed above under Net Sales and Cost of Sales.

Selling, General and Administrative Expense

Selling, general and administrative expenses, including intangibles amortization and management fees, were $7.8 million for the three months ended September 30, 2011, compared to $8.4 million for the three months ended September 30, 2010, a decrease of $0.6 million, or 7.1%. This decrease was partially due to lower amortization expense of $0.2 million, which was the result of certain intangible assets becoming fully amortized. Selling, general and administrative expenses, including intangibles amortization and management fees, were $23.1 million for the nine months ended September 30, 2011, compared to $31.5 million for the nine months ended September 30, 2010, a decrease of $8.4 million, or 26.7%. The decrease for the nine months ended September 30, 2011 over the corresponding period in 2010 was primarily attributable to non-recurring expenses incurred at the time of the Company s IPO in 2010 totaling $8.5 million, which consisted of the buyout of the management services agreement at $5.8 million, compensation expense associated with net exercises of stock options totaling $1.7 million and the expense and payment of cash bonuses under the Company s liquidity bonus plan of $1.0 million.. Additionally, in 2010 the company incurred non-recurring legal expenses of $1.2 million for the nine-month period ending September 30, 2010. There was also a decrease for the nine months ended September 30, 2011 over the corresponding period in 2010 due to lower amortization expense of $0.7 million which was the result of certain intangible assets becoming fully amortized. Partially offsetting these decreases was stock based compensation expense of $1.2 million and offering costs of $1.1 million for the nine-month period ended September 30, 2011.

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Interest Expense

Interest expense was $2.3 million for the three months ended September 30, 2011 unchanged from the same period in the prior year. Interest expense was $6.7 million for the nine months ended September 30, 2011 compared to $9.0 million in the corresponding period in 2010, a decrease of $2.3 million, or 25.6%. This decrease in interest expense for the nine months ended September 30, 2011 was due to the redemption of the Company s 7.75% senior notes due January 15, 2012 (the Senior Notes) in 2010 with proceeds from the IPO, additional borrowings under the Company s senior credit facilities and cash on hand.

Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The largest item affecting deferred taxes is the difference between book and tax amortization of goodwill and other intangibles amortization. The Company estimates that the combined federal and state tax rate for 2011 will be approximately 39%. The Company s effective tax rate was 36.9% and 51.1% for the three months ended September 30, 2011 and 2010, respectively. The Company s effective tax rate for the nine months ended September 30, 2011 and 2010 was 39.2% and (44.8%), respectively. The effective tax rate (benefit) for the nine months ended September 30, 2011 was lower than the corresponding period in 2010 due to adjusting the Company s net deferred tax liabilities to the higher estimated federal rate for 2011 compared to the actual rate incurred in 2010.

Net Income (Loss)

Net income for the three months ended September 30, 2011 was $4.0 million compared to net income of $2.2 million for the corresponding period in 2010, an increase in net income of $1.8 million. Net income for the nine months ended September 30, 2011 was $12.9 million compared to net loss of ($3.5) million for the corresponding period in 2010, an increase in net income of $16.4 million. This increase in net income was driven by the factors described above. As a percentage of net sales, net income was 7.5% for the three months ended September 30, 2011 compared to 4.6% for the three months ended September 30, 2010. As a percentage of net sales, net income (loss) was 8.7% for the nine months ended September 30, 2011 compared to (2.7%) for the nine months ended September 30, 2010.

Adjusted EBITDA

Adjusted EBITDA (as defined below) for the three months ended September 30, 2011 was $12.1 million compared to $11.6 million in the corresponding period in 2010, an increase of $0.5 million, or 4.6%. Adjusted EBITDA for the nine months ended September 30, 2011 was $38.1 million compared to $32.1 million in the corresponding period in 2010, an increase of $6.0 million, or 18.7%. As a percentage of net sales, Adjusted EBITDA decreased from 24.4% for the three months ended September 30, 2010 to 22.6% for the three months ended September 30, 2011, and increased from 25.0% for the nine months ended September 30, 2010 to 25.6% for the nine months ended September 30, 2011. For the three-month period ended September 30, 2011 Adjusted EBITDA remained relatively constant compared to the three-month period ending September 30, 2010. For the nine-month period ending September 30, 2011, the increase in Adjusted EBITDA is primarily attributable to increased unit sales of snow and ice control equipment in addition to increases in parts and accessories compared to the corresponding period of 2010. Both above average snowfall in the October 1, 2010 to March 31, 2011 snow season and a slight improvement in overall macro-economic environment drove the increase in pre-season orders in the second quarter of 2011.

Free Cash Flow

Free cash flow (as defined below) for the three months ended September 30, 2011 was ($16.1) million compared to ($14.3) million in the corresponding period in 2010, an increase in cash used of $1.8 million, or 12.6%. Free cash flow for the nine months ended September 30, 2011 was ($19.8) million compared to ($40.8) million in the corresponding period in 2010, a decrease in cash used of $21.0 million, or 51.5%. For the three month period, the increase in cash used is primarily a result of $1.6 million more cash used by operating activities, while for the nine month period, the decrease in cash used is primarily a result of $20.2 million less cash used by operating activities, each as discussed below under Liquidity and Capital Resources. In addition to the changes in cash used by operating activities, capital expenditures increased for the three month period ending September 30, 2011 compared to the same period in 2010 by $0.2 million and decreased by $0.8 million for the nine-month period ending September 30, 2011 compared to the corresponding period in 2010. In 2010, there were higher capital expenditures to accommodate the increased production demands in Milwaukee and Rockland because of the closure of our Johnson City, TN manufacturing plant in the first half of the year.

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Non-GAAP Financial Measures

This Quarterly Report on Form 10-Q contains financial information calculated other than in accordance with U.S. generally accepted accounting principles (GAAP).

These non-GAAP measures include:

- Free cash flows;
- Adjusted net income; and
- Adjusted EBITDA.

These non-GAAP disclosures should not be construed as an alternative to the reported results determined in accordance with GAAP.

Free cash flow is a non-GAAP financial measure, which we define as net cash provided by operating activities less capital expenditures. Free cash flow should be evaluated in addition to, and not considered a substitute for, other financial measures such as net income and cash flow provided by operations. We believe that free cash flow represents our ability to generate additional cash flow from our business operations.

The following table reconciles net cash provided by operating activities, a GAAP measure, to free cash flow, a non-GAAP measure.

	Three months ended (In Thousands)		Nine months ended (In Thousands)	
	September 30, 2011	**September 30, 2010**	**September 30, 2011**	**September 30, 2010**
Net cash used in operating activities	$ (15,323)	$ (13,727)	$ (18,190)	$ (38,435)
Acquisition of property and equipment	(745)	(560)	(1,585)	(2,414)
Free cash flow	$ (16,068)	$ (14,287)	$ (19,775)	$ (40,849)

Adjusted net income represents net income as determined under GAAP, excluding certain expenses incurred at the time of our IPO in 2010 (namely the buyout of our management services agreement, loss on extinguishment of debt, stock based compensation expense associated with the net exercise of stock options and the payment of cash bonuses under our liquidity bonus plan); certain expenses incurred at the time of our secondary offering in 2011; costs incurred to pursue acquisitions and a loss on extinguishment of debt incurred in 2011. We believe that the presentation of adjusted net income for the three and nine months ended September 30, 2011 and September 30, 2010 allows investors to make

meaningful comparisons of our operating performance between periods and to view our business from the same perspective as our management. Because the excluded items are not predictable or consistent, management does not consider them when evaluating our performance or when making decisions regarding allocation of resources.

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The following table presents a reconciliation of net income (loss), the most comparable GAAP financial measure, to adjusted net income for the three and nine months ended September 30, 2011 and September 30, 2010.

	Three months ended		Nine months ended	
(in millions)	**September 30, 2011**	**September 30, 2010**	**September 30, 2011**	**September 30, 2010**
Net income (loss) - (GAAP)	$ 4.0	$ 2.2	$ 12.9	$ (3.5)
Addback non-recurring expenses, net of tax at 39.0% and 38.0% for 2011 and 2010, respectively:				
-Buyout of management service agreement				3.6
-Loss on extinguishment of debt			0.4	4.9
-Liquidity bonus payment				0.6
- Non-recurring stock based compensation expense		0.8		1.9
- Acquisition costs	0.5		0.5	
- Offering costs			0.7	
Adjusted Net Income - (Non-GAAP)	$ 4.5	$ 3.0	$ 14.5	$ 7.5