CONMED CORP
Form 10-Q
May 01, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012	Commission File Number 0-16093

CONMED CORPORATION
(Exact name of the registrant as specified in its charter)

New York (State or other jurisdiction of incorporation or organization)	16-0977505 (I.R.S. Employer Identification No.)
525 French Road, Utica, New York (Address of principal executive offices)	13502 (Zip Code)

(315) 797-8375
(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 ý 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 shorter period that the registrant was required to submit and post such files). ý

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 definition of “accelerated filer”, “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act (Check one).

Large accelerated filer ý   Accelerated filer o   Non-accelerated filer o   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 o No ý

The number of shares outstanding of registrant's common stock, as of April 26, 2012 is 28,289,720 shares.

CONMED CORPORATION
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2012

PART I FINANCIAL INFORMATION

Item Number		Page
Item 1.	Financial Statements (unaudited)	
	– Consolidated Condensed Statements of Comprehensive Income for the three month periods ended March 31, 2011 and 2012	1
	– Consolidated Condensed Balance Sheets as of December 31, 2011 and March 31, 2012	2
	– Consolidated Condensed Statements of Cash Flows for the three months ended March 31, 2011 and 2012	3
	– Notes to Consolidated Condensed Financial Statements	4
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	24
Item 4.	Controls and Procedures	24
PART II OTHER INFORMATION		
Item 1.	Legal Proceedings	24
Item 6.	Exhibits	25
Signatures		26

Table of Contents

PART I FINANCIAL INFORMATION
Item 1.
CONMED CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited, in thousands except per share amounts)

	Three Months Ended March 31,	
	2011	2012
Net sales	$183,450	$194,316
Cost of sales	87,734	93,405
Gross profit	95,716	100,911
Selling and administrative expense	70,078	74,806
Research and development expense	7,681	7,095
Other expense	694	1,988
	78,453	83,889
Income from operations	17,263	17,022
Amortization of debt discount	1,094	—
Interest expense	1,805	1,437
Income before income taxes	14,364	15,585
Provision for income taxes	5,369	5,617
Net income	$8,995	$9,968
Comprehensive income	$12,024	$11,045
Per share data:		
Net Income		
Basic	$0.32	$0.36
Diluted	0.31	0.35
Dividends per share of common stock	$—	$0.15
Weighted average common shares		
Basic	28,261	28,029
Diluted	28,701	28,484

See notes to consolidated condensed financial statements.

1

Table of Contents

CONMED CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(Unaudited, in thousands except share and per share amounts)

	December 31, 2011	March 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$26,048	$19,454
Accounts receivable, net	135,641	142,351
Inventories	168,438	163,390
Deferred income taxes	10,283	10,951
Prepaid expenses and other current assets	16,314	15,132
Total current assets	356,724	351,278
Property, plant and equipment, net	139,187	141,032
Deferred income taxes	2,389	2,422
Goodwill	234,815	234,794
Other intangible assets, net	195,531	193,643
Other assets	6,948	153,391
Total assets	$935,594	$1,076,560
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$54,557	$54,219
Accounts payable	21,162	27,088
Accrued compensation and benefits	31,142	20,863
Income taxes payable	6,470	4,991
Other current liabilities	17,853	58,684
Total current liabilities	131,184	165,845
Long-term debt	88,952	138,952
Deferred income taxes	92,785	95,791
Other long-term liabilities	49,602	89,247
Total liabilities	362,523	489,835
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, par value $ .01 per share; authorized 500,000 shares; none outstanding	—	—
Common stock, par value $ .01 per share; 100,000,000 shares authorized; 31,299,203 shares issued in 2011 and 2012, respectively	313	313
Paid-in capital	321,994	323,486
Retained earnings	354,439	360,185
Accumulated other comprehensive loss	(26,348)	(25,271)

Less: 3,358,078 and 3,115,110 shares of common stock in treasury, at cost in 2011 and 2012, respectively	(77,327)	(71,988)
Total shareholders' equity	573,071	586,725
Total liabilities and shareholders' equity	$935,594	$1,076,560

See notes to consolidated condensed financial statements.

2

Table of Contents

CONMED CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Three months ended March 31, 2011	2012
Cash flows from operating activities:		
Net income	$8,995	$9,968
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,416	4,688
Amortization of debt discount	1,094	—
Amortization, all other	4,830	7,124
Stock-based compensation expense	1,026	1,183
Deferred income taxes	4,625	2,735
Increase (decrease) in cash flows from changes in assets and liabilities:		
Accounts receivable	90	(5,618)
Inventories	420	2,764
Accounts payable	1,782	2,601
Income taxes payable	333	(1,232)
Accrued compensation and benefits	(7,442)	(10,446)
Other assets	(1,917)	(1,106)
Other liabilities	2,448	(5,032)
	11,705	(2,339)
Net cash provided by operating activities	20,700	7,629
Cash flows from investing activities:		
Purchases of property, plant and equipment	(4,143)	(6,424)
Payments related to business acquisitions and distribution agreement	(72)	(64,116)
Net cash used in investing activities	(4,215)	(70,540)
Cash flows from financing activities:		
Net proceeds from common stock issued under employee plans	1,287	5,345
Payments on senior credit agreement	(13,337)	(338)
Proceeds from senior credit agreement	—	50,000
Other, net	337	809
Net cash provided by (used in) financing activities	(11,713)	55,816
Effect of exchange rate changes on cash and cash equivalents	750	501
Net increase (decrease) in cash and cash equivalents	5,522	(6,594)
Cash and cash equivalents at beginning of period	12,417	26,048
Cash and cash equivalents at end of period	$17,939	$19,454

Non-cash financing activities:		
Dividends payable	$—	$4,328

See notes to consolidated condensed financial statements.

3

Table of Contents

CONMED CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited, in thousands except per share amounts)

Note 1 – Operations

CONMED Corporation ("CONMED", the "Company", "we" or "us") is a medical technology company with an emphasis on surgical devices and equipment for minimally invasive procedures and monitoring. The Company's products serve the clinical areas of arthroscopy, powered surgical instruments, electrosurgery, cardiac monitoring single-uses, endosurgery and endoscopic technologies. They are used by surgeons and physicians in a variety of specialties including orthopedics, general surgery, gynecology, neurosurgery, and gastroenterology.

Note 2 - Interim financial information

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. Results for the period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

The consolidated condensed financial statements and notes thereto should be read in conjunction with the financial statements and notes for the year ended December 31, 2011 included in our Annual Report on Form 10-K.

Note 3 – Comprehensive income

Comprehensive income consists of the following:

	Three months ended March 31,	
	2011	2012
Net income	$8,995	$9,968
Other comprehensive income:		
Pension liability, net of income tax	231	462
Cash flow hedging loss, net of income tax	(1,046)	(1,561)
Foreign currency translation adjustment	3,844	2,176
Comprehensive income	$12,024	$11,045

Table of Contents

Accumulated other comprehensive income (loss) consists of the following:

	Cash Flow Hedging Gain (Loss)	Pension Liability	Cumulative Translation Adjustments	Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2011	$2,973	$(31,250)	$1,929	$(26,348)
Pension liability, net of income tax	—	462	—	462
Cash flow hedging loss, net of income tax	(1,561)	—	—	(1,561)
Foreign currency translation adjustments	—	—	2,176	2,176
Balance, March 31, 2012	$1,412	$(30,788)	$4,105	$(25,271)

Note 4 – Fair value of financial instruments

We enter into derivative instruments for risk management purposes only. We operate internationally and, in the normal course of business, are exposed to fluctuations in interest rates, foreign exchange rates and commodity prices. These fluctuations can increase the costs of financing, investing and operating the business. We use forward contracts, a type of derivative instrument, to manage certain foreign currency exposures.

By nature, all financial instruments involve market and credit risks. We enter into forward contracts with major investment grade financial institutions and have policies to monitor the credit risk of those counterparties. While there can be no assurance, we do not anticipate any material non-performance by any of these counterparties.

Foreign Currency Forward Contracts. We hedge certain forecasted intercompany transactions denominated in foreign currencies through the use of forward contracts. We account for these forward contracts as cash flow hedges. To the extent these forward contracts meet hedge accounting criteria, changes in their fair value are not included in current earnings but are included in accumulated other comprehensive loss. These changes in fair value will be recognized into earnings as a component of sales or cost of sales when the forecasted transaction occurs. The notional contract amounts for forward contracts outstanding at March 31, 2012 which have been accounted for as cash flow hedges totaled $119.2 million. Net realized gains (losses) recognized for forward contracts accounted for as cash flow hedges approximated $(1.2) million and $0.8 million for the three months ended March 31, 2011 and 2012, respectively. Net unrealized gains on forward contracts outstanding, which have been accounted for as cash flow hedges and which have been included in other comprehensive income, totaled $1.4 million at March 31, 2012. These unrealized gains and any subsequent changes in fair value will be recognized in the consolidated statements of operations in 2012 and 2013 as the related forward contracts mature and gains and losses are realized.

We also enter into forward contracts to exchange foreign currencies for United States dollars in order to hedge our currency transaction exposures on intercompany receivables denominated in foreign currencies. These forward contracts settle each month at month-end, at which time we enter into new forward contracts. We have not designated these forward contracts as hedges and have not applied hedge accounting to them. The notional contract amounts for forward contracts outstanding at March 31, 2012 which have not been designated as hedges totaled $36.6 million. Net realized losses recognized in connection with those forward contracts not accounted for as hedges approximated $0.9 million and $0.7 million for the three months ended March 31, 2011 and 2012, respectively, offsetting gains on our intercompany receivables of $1.2 million and $0.4 million for the three months ended March 31, 2011 and 2012, respectively. These gains and losses have been recorded in selling and administrative expense in the consolidated statements of operations.

We record these forward foreign exchange contracts at fair value; the following tables summarize the fair value for forward foreign exchange contracts outstanding at December 31, 2011 and March 31, 2012:

Table of Contents

December 31, 2011	Asset Balance Sheet Location	Fair Value	Liabilities Balance Sheet Location	Fair Value	Net Fair Value
Derivatives designated as hedged instruments:					
Foreign exchange contracts	Prepaid expenses and other current assets	$5,042	Prepaid expenses and other current assets	$(326)	$4,716
Derivatives not designated as hedging instruments:					
Foreign exchange contracts	Prepaid expenses and other current assets	41	Prepaid expenses and other current assets	(95)	(54)
Total derivatives		$5,083		$(421)	$4,662

March 31, 2012	Asset Balance Sheet Location	Fair Value	Liabilities Balance Sheet Location	Fair Value	Net Fair Value
Derivatives designated as hedged instruments:					
Foreign exchange contracts	Prepaid expenses and other current assets	$2,488	Prepaid expenses and other current assets	$(248)	$2,240
Derivatives not designated as hedging instruments:					
Foreign exchange contracts	Prepaid expenses and other current assets	—	Prepaid expenses and other current assets	(94)	(94)
Total derivatives		$2,488		$(342)	$2,146

Our forward foreign exchange contracts are subject to a master netting agreement and qualify for netting in the consolidated balance sheets. Accordingly, we have recorded the net fair value of $4.7 million and $2.1 million in prepaid expenses and other current assets at December 31, 2011 and March 31, 2012, respectively.

Fair Value Disclosure. Financial Accounting Standards Board ("FASB") guidance defines fair value and establishes a framework for measuring fair value and related disclosure requirements. This guidance applies when fair value measurements are required or permitted. The guidance indicates, among other things, that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. Fair value is defined based upon an exit price model.

As of March 31, 2012, we do not have any significant non-recurring measurements of nonfinancial assets and nonfinancial liabilities.

Valuation Hierarchy. A valuation hierarchy was established for disclosure of the inputs to the valuations used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, including interest rates, yield curves and credit risks, or inputs that are derived principally from or corroborated by observable market data through correlation. Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based

Table of Contents

on the lowest level input that is significant to the fair value measurement.

Valuation Techniques. Assets and liabilities carried at fair value and measured on a recurring basis as of March 31, 2012 consist of forward foreign exchange contracts. The value of the forward foreign exchange contract assets and liabilities were determined within Level 2 of the valuation hierarchy and are listed in the table above.

The carrying amounts reported in our balance sheets for cash and cash equivalents, accounts receivable, accounts payable and long-term debt excluding the Notes approximate fair value. The fair value of the Notes was determined within Level 2 of the valuation hierarchy and approximated $0.3 million at both December 31, 2011 and March 31, 2012 based on their quoted market price.

Note 5 - Inventories

Inventories consist of the following:

	December 31, 2011	March 31, 2012
Raw materials	$52,351	$48,756
Work-in-process	15,499	16,043
Finished goods	100,588	98,591
Total	$168,438	$163,390

Note 6 – Earnings and dividends per share

Basic earnings per share (“basic EPS”) is computed by dividing net income by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share (“diluted EPS”) gives effect to all dilutive potential shares outstanding resulting from employee stock options, restricted stock units, performance share units and stock appreciation rights (“SARs”) during the period. The following table sets forth the computation of basic and diluted earnings per share for three months ended March 31, 2011 and 2012.

	Three months ended March 31, 2011	2012
Net income	$8,995	$9,968
Basic – weighted average shares outstanding	28,261	28,029
Effect of dilutive potential securities	440	455
Diluted – weighted average shares outstanding	28,701	28,484
Net income		
Basic	$0.32	$0.36
Diluted	$0.31	$0.35

The shares used in the calculation of diluted EPS exclude options and SARs to purchase shares where the exercise price was greater than the average market price of common shares for the period. Shares excluded from the calculation of diluted EPS

7

Table of Contents

aggregated 0.7 million and 0.4 million for the three months ended March 31, 2011 and 2012, respectively.

On February 29, 2012, the Board of Directors adopted a cash dividend policy and declared an initial quarterly dividend of $0.15 per share. The initial quarterly dividend was paid on April 5, 2012 to shareholders of record as of March 15, 2012. The total dividend payable at March 31, 2012 was $4.3 million and is included in other current liabilities in the consolidated condensed balance sheet.

Note 7 – Goodwill, other intangible assets, and other assets

The changes in the net carrying amount of goodwill for the three months ended March 31, 2012 are as follows:

Balance as of January 1, 2012	$234,815
Foreign currency translation	(21)
Balance as of March 31, 2012	$234,794

Goodwill associated with each of our principal operating units is as follows:

	December 31, 2011	March 31, 2012
CONMED Electrosurgery	$16,645	$16,645
CONMED Endosurgery	42,439	42,439
CONMED Linvatec	175,731	175,710
Balance	$234,815	$234,794

Total accumulated impairment losses (associated with our CONMED Patient Care and CONMED Endoscopic Technologies operating units) aggregated $106,991 at both December 31, 2011 and March 31, 2012.

Other intangible assets consist of the following:

	December 31, 2011		March 31, 2012	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer relationships	$133,965	$(45,112)	$133,965	$(46,345)
Patents and other intangible assets	52,702	(34,368)	52,746	(35,067)
Unamortized intangible assets:				
Trademarks and tradenames	88,344	—	88,344	—

Balance	$275,011	$(79,480)	$275,055	$(81,412)

8

Table of Contents

Other intangible assets primarily represent allocations of purchase price to identifiable intangible assets of acquired businesses. The weighted average amortization period for intangible assets which are amortized is 29 years. Customer relationships are being amortized over a weighted average life of 33 years. Patents and other intangible assets are being amortized over a weighted average life of 14 years.

Amortization expense related to intangible assets which are subject to amortization totaled $1,623 and $1,932 in the three months ended March 31, 2011 and March 31, 2012, respectively, and is included in selling and administrative expense on the consolidated condensed statements of income.

The estimated amortization expense for the year ending December 31, 2012, including the three month period ended March 31, 2012 and for each of the five succeeding years is as follows:

2012	$7,726
2013	7,503
2014	6,880
2015	6,491
2016	6,390
2017	6,390

On January 3, 2012, the Company entered into a Sports Medicine Joint Development and Distribution Agreement (the "JDDA") with Musculoskeletal Tissue Foundation (“MTF”) to obtain (i) MTF's worldwide promotion rights with respect to allograft tissues within the field of sports medicine, and (ii) an exclusive license to an autograft (patient's own) blood Platelet-Rich Plasma (“PRP”) therapy technology and products (collectively, the “Transaction”).

Under the JDDA, we acquired the worldwide marketing, educational and promotion rights for sports medicine allograft tissue. We also acquired certain assets relating to instrument sets used for allograft procedures and approximately 35 MTF sales and marketing employees joined the Company. The JDDA has a term of 25 years with renewals thereafter. This transaction was not accounted for as a business combination as it does not meet the definition of a business as defined by ASC 805. The initial consideration from the Company includes a $63.0 million up-front payment for the rights and certain assets, with an additional $84.0 million contingently payable over a four year period depending on MTF meeting supply targets, as further set forth in the JDDA ($34 million is due within the next fiscal year with the remainder due in equal installments in each year thereafter). As compensation for our marketing efforts, the Company will receive 50% of the revenue streams relating to MTF's sports medicine allograft product line and 100% of the revenue from the PRP products. At March 31, 2012, the gross carrying amount of this arrangement amounted to $148.1 million and the related accumulated amortization was $1.5 million. This has been recorded in other assets. $84.0 million related to the contingent payment is accrued in other current and other long term liabilities as we believe it is probable MTF will meet the supply targets. The Company is amortizing the upfront payment as well as the accrued $84.0 million over the 25 year term of the JDDA. Amortization expense is recorded as a reduction to sales.

Note 8 – Guarantees

We provide warranties on certain of our products at the time of sale. The standard warranty period for our capital and reusable equipment is generally one year. Liability under service and warranty policies is based upon a review of historical warranty and service claim experience. Adjustments are made to accruals as claim data and historical experience warrant.

Changes in the carrying amount of service and product warranties for the three months ended March 31, are as follows:

9

Table of Contents

	2011	2012
Balance as of January 1,	$3,363	$3,618
Provision for warranties	1,145	1,125
Claims made	(1,075)	(1,047)
Balance as of March 31,	$3,433	$3,696

Note 9 – Pension plan

Net periodic pension costs consist of the following:

	Three months ended March 31,	
	2011	2012
Service cost	$70	$65
Interest cost on projected benefit obligation	1,096	859
Expected return on plan assets	(1,057)	(1,131)
Net amortization and deferral	366	732
Net periodic pension cost	$475	$525

We contributed $6.5 million during the first quarter of 2012 related to the 2011 plan year. We are required and expect to make $2.7 million in contributions to our pension plan for the 2012 plan year during the remainder of 2012 and the first quarter of 2013.

Note 10 – Other expense

Other expense consists of the following:

	Three months ended March 31,	
	2011	2012
Administrative consolidation costs	$694	$273
Costs associated with legal arbitration	—	1,011
Costs associated with purchase of a distributor	—	704
Other expense	$694	$1,988

During 2011, we consolidated certain administrative functions in our Utica, New York facility. For the three months ended March 31, 2011, we incurred $0.7 million in related costs consisting principally of severance charges. During 2012, we restructured certain administrative functions related to our CONMED Linvatec division. For the three months ended March 31, 2012, we incurred $0.3 million in related costs consisting principally of severance charges.

10

During 2012, we incurred legal costs totaling $1.0 million related to an arbitration matter relative to a contract dispute with a former distributor as further described in Note 12.

During 2012, we incurred $0.7 million in costs associated with the purchase of the Company's former distributor in the Nordic region of Europe.

Note 11 — Business segments and geographic areas

CONMED conducts its business through five principal operating segments, CONMED Endoscopic Technologies, CONMED Endosurgery, CONMED Electrosurgery, CONMED Linvatec and CONMED Patient Care. We believe each of our segments are similar in the nature of their products, production processes, customer base, distribution methods and regulatory environment. Our CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec operating segments also have similar economic characteristics and therefore qualify for aggregation. Our CONMED Patient Care and CONMED Endoscopic Technologies operating units do not qualify for aggregation since their economic characteristics do not meet the criteria for aggregation as a result of the lower overall operating margin in these segments.

CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec consist of a single aggregated segment comprising a complete line of endo-mechanical instrumentation for minimally invasive laparoscopic procedures, electrosurgical generators and related surgical instruments, arthroscopic instrumentation for use in orthopedic surgery and small bone, large bone and specialty powered surgical instruments. CONMED Patient Care product offerings include a line of vital signs and cardiac monitoring products as well as suction instruments & tubing for use in the operating room. CONMED Endoscopic Technologies product offerings include a comprehensive line of minimally invasive endoscopic diagnostic and therapeutic instruments used in procedures which require examination of the digestive tract.

The following is net sales information by product line and reportable segment: