

OWENS & MINOR INC/VA/
Form 10-Q
November 02, 2016
Table of Contents

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 September 30, 2016

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 1-9810

Owens & Minor, Inc.
(Exact name of Registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	54-1701843 (I.R.S. Employer Identification No.)
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9120 Lockwood Boulevard, Mechanicsville, Virginia (Address of principal executive offices)	23116 (Zip Code)
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Post Office Box 27626, Richmond, Virginia (Mailing address of principal executive offices)	23261-7626 (Zip Code)
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Registrant's telephone number, including area code (804) 723-7000

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 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 No

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 "larger accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

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

The number of shares of Owens & Minor, Inc.'s common stock outstanding as of October 28, 2016, was 61,509,219 shares.

Table of Contents

Owens & Minor, Inc. and Subsidiaries
Index

<u>Part I. Financial Information</u>	Page
<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Consolidated Statements of Income—Three and Nine Months Ended September 30, 2016 and 2015</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income—Three and Nine Months Ended September 30, 2016 and 2015</u>	<u>4</u>
<u>Consolidated Balance Sheets—September 30, 2016 and December 31, 2015</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows—Nine Months Ended September 30, 2016 and 2015</u>	<u>6</u>
<u>Consolidated Statements of Changes in Equity—Nine Months Ended September 30, 2016 and 2015</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>22</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>30</u>
<u>Item 4. Controls and Procedures</u>	<u>30</u>
<u>Part II. Other Information</u>	
<u>Item 1. Legal Proceedings</u>	<u>30</u>
<u>Item 1A. Risk Factors</u>	<u>30</u>
<u>Item 2. Unregistered Sales of Equity Securities, Use of Proceeds and Issuer Purchases of Equity Securities</u>	<u>31</u>
<u>Item 6. Exhibits</u>	<u>32</u>

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

Owens & Minor, Inc. and Subsidiaries

Consolidated Statements of Income

(unaudited)

(in thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net revenue	\$2,415,601	\$2,471,669	\$7,355,069	\$7,285,032
Cost of goods sold	2,119,326	2,165,315	6,462,739	6,382,740
Gross margin	296,275	306,354	892,330	902,292
Distribution, selling, and administrative expenses	241,305	246,959	726,944	743,611
Acquisition-related and exit and realignment charges	2,739	6,134	19,974	21,757
Other operating income, net	(1,337)	(311)	(5,179)	(5,484)
Operating earnings	53,568	53,572	150,591	142,408
Interest expense, net	6,770	6,744	20,324	20,305
Income before income taxes	46,798	46,828	130,267	122,103
Income tax provision	16,967	18,652	48,585	50,761
Net income	\$29,831	\$28,176	\$81,682	\$71,342
Net income per common share:				
Basic	\$0.48	\$0.45	\$1.32	\$1.14
Diluted	\$0.48	\$0.45	\$1.32	\$1.14
Cash dividends per common share	\$0.255	\$0.2525	\$0.765	\$0.7575

See accompanying notes to consolidated financial statements.

3

Owens & Minor, Inc. and Subsidiaries
 Consolidated Statements of Comprehensive Income
 (unaudited)

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	\$29,831	\$28,176	\$81,682	\$71,342
Other comprehensive income (loss), net of tax:				
Currency translation adjustments (net of income tax of \$0 in 2016 and 2015)	1,401	2,054	2,443	(19,281)
Change in unrecognized net periodic pension costs (net of income tax of \$194 and \$532 in 2016 and \$117 and \$402 in 2015)	218	284	701	802
Other (net of income tax of \$0 in 2016 and 2015)	82	(105)	119	(75)
Total other comprehensive income (loss), net of tax	1,701	2,233	3,263	(18,554)
Comprehensive income	\$31,532	\$30,409	\$84,945	\$52,788

See accompanying notes to consolidated financial statements.

4

Owens & Minor, Inc. and Subsidiaries
 Consolidated Balance Sheets
 (unaudited)

(in thousands, except per share data)	September 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	\$213,096	\$ 161,020
Accounts and notes receivable, net of allowances of \$12,927 and \$13,177	579,031	587,935
Merchandise inventories	944,897	940,775
Other current assets	283,753	284,970
Total current assets	2,020,777	1,974,700
Property and equipment, net of accumulated depreciation of \$202,535 and \$189,105	198,780	208,930
Goodwill, net	418,095	419,619
Intangible assets, net	86,982	95,250
Other assets, net	69,998	75,277
Total assets	\$2,794,632	\$2,773,776
Liabilities and equity		
Current liabilities		
Accounts payable	\$768,570	\$ 710,609
Accrued payroll and related liabilities	41,424	45,907
Other current liabilities	283,831	307,073
Total current liabilities	1,093,825	1,063,589
Long-term debt, excluding current portion	566,474	568,495
Deferred income taxes	83,553	86,326
Other liabilities	64,097	62,776
Total liabilities	1,807,949	1,781,186
Commitments and contingencies		
Equity		
Common stock, par value \$2 per share; authorized - 200,000 shares; issued and outstanding - 61,699 shares and 62,803 shares	123,398	125,606
Paid-in capital	216,866	211,943
Retained earnings	694,981	706,866
Accumulated other comprehensive loss	(48,562)	(51,825)
Total equity	986,683	992,590
Total liabilities and equity	\$2,794,632	\$2,773,776

See accompanying notes to consolidated financial statements.

Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Nine Months Ended September 30,	
	2016	2015
Operating activities:		
Net income	\$ 81,682	\$ 71,342
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	42,182	51,871
Share-based compensation expense	8,934	7,611
Provision for losses on accounts and notes receivable	(216)	(182)
Deferred income tax (benefit) expense	(3,233)	3,643
Changes in operating assets and liabilities:		
Accounts and notes receivable	5,023	(13,758)
Merchandise inventories	(5,066)	(25,339)
Accounts payable	58,742	83,434
Net change in other assets and liabilities	(44,903)	25,890
Other, net	686	1,526
Cash provided by operating activities	143,831	206,038
Investing activities:		
Additions to property and equipment	(13,682)	(15,321)
Additions to computer software and intangible assets	(7,081)	(16,876)
Proceeds from sale of property and equipment	4,497	119
Cash used for investing activities	(16,266)	(32,078)
Financing activities:		
Change in bank overdraft	21,753	—
Repayment of revolving credit facility	—	(33,700)

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Cash dividends paid	(47,802)	(47,780)
Repurchases of common stock	(48,654)	(15,821)
Excess tax benefits related to share-based compensation	680		521	
Other, net	(8,118)	(6,296)
Cash used for financing activities	(82,141)	(103,076)
Effect of exchange rate changes on cash and cash equivalents	6,652		(2,411)
Net increase (decrease) in cash and cash equivalents	52,076		68,473	
Cash and cash equivalents at beginning of period	161,020		56,772	
Cash and cash equivalents at end of period	\$ 213,096		\$ 125,245	
Supplemental disclosure of cash flow information:				
Income taxes paid, net	\$ 57,996		\$ 38,709	
Interest paid	\$ 20,023		\$ 20,195	

See accompanying notes to consolidated financial statements.

6

Owens & Minor, Inc. and Subsidiaries
 Consolidated Statements of Changes in Equity
 (unaudited)

(in thousands, except per share data)	Common Shares Outstanding	Common Stock (\$ 2 par value)	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance December 31, 2014	63,070	\$ 126,140	\$ 202,934	\$ 685,765	\$ (24,001)	\$ 990,838
Net income				71,342		71,342
Other comprehensive loss					(18,554)	(18,554)
Dividends declared (\$0.7575 per share)				(47,648)		(47,648)
Shares repurchased and retired	(469)	(938)		(14,882)		(15,820)
Share-based compensation expense, exercises and other	331	661	5,282			5,943
Balance September 30, 2015	62,932	\$ 125,863	\$ 208,216	\$ 694,577	\$ (42,555)	\$ 986,101
Balance December 31, 2015	62,803	\$ 125,606	\$ 211,943	\$ 706,866	\$ (51,825)	\$ 992,590
Net income				81,682		81,682
Other comprehensive income					3,263	3,263
Dividends declared (\$0.765 per share)				(47,671)		(47,671)
Shares repurchased and retired	(1,378)	(2,757)		(45,896)		(48,653)
Share-based compensation expense, exercises and other	274	549	4,923			5,472
Balance September 30, 2016	61,699	\$ 123,398	\$ 216,866	\$ 694,981	\$ (48,562)	\$ 986,683

See accompanying notes to consolidated financial statements.

Owens & Minor, Inc. and Subsidiaries
 Notes to Consolidated Financial Statements
 (unaudited)

(in thousands, unless otherwise indicated)

Note 1—Basis of Presentation and Use of Estimates

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Owens & Minor, Inc. and the subsidiaries it controls (we, us, or our) and contain all adjustments (which are comprised only of normal recurring accruals and use of estimates) necessary to conform with U.S. generally accepted accounting principles (GAAP). All significant intercompany accounts and transactions have been eliminated. The results of operations for interim periods are not necessarily indicative of the results expected for the full year.

Recently, we have made certain changes to the leadership team, organizational structure, budgeting and financial reporting processes which drive changes to segment reporting. These changes align our operations into three distinct business units: Domestic, International and Clinical & Procedural Solutions (CPS). Domestic is our U.S. distribution, logistics and value-added services business, while International is our European distribution, logistics and value-added services business. CPS provides product-related solutions, including surgical and procedural kitting and sourcing. Beginning with the quarter ended March 31, 2016, we now report our financial results using this three segment structure and have recast prior year segment results on the same basis.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation. Depreciation and amortization, previously reported as a separate financial statement line item in the consolidated statements of income is now

included in distribution, selling and administrative expenses for all periods presented.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make assumptions and estimates that affect reported amounts and related disclosures. Actual results may differ from these estimates.

Note 2—Fair Value

The carrying amounts of cash and cash equivalents, accounts receivable, financing receivables, accounts payable and financing payables included in the consolidated balance sheets approximate fair value due to the short-term nature of these instruments. The fair value of long-term debt is estimated based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market (Level 1) or, if quoted market prices or dealer quotes are not available, on the borrowing rates currently available for loans with similar terms, credit ratings and average remaining maturities (Level 2). We determine the fair value of our derivatives based on estimated amounts that would be received or paid to terminate the contracts at the reporting date based on current market prices for applicable currencies. See Note 7 for the fair value of long-term debt and Note 8 for the fair value of derivatives.

Note 3—Financing Receivables and Payables

At September 30, 2016 and December 31, 2015, we had financing receivables of \$190.7 million and \$198.5 million and related payables of \$98.4 million and \$148.5 million outstanding under our order-to-cash program and product financing arrangements, which were included in other current assets and other current liabilities, respectively, in the consolidated balance sheets.

Note 4—Goodwill and Intangible Assets

In connection with our new three segment structure, goodwill has been reallocated based on the relative fair value of the underlying reporting units. We performed an interim impairment analysis in the first quarter of 2016 as a result of this change and noted no impairment. The following table summarizes the changes in the carrying amount of goodwill through September 30, 2016:

	Domestic	International	CPS	Consolidated
Carrying amount of goodwill, December 31, 2015	\$ 180,006	\$ 23,426	\$ 216,187	\$ 419,619
Currency translation adjustments	—	(2,022)	498	(1,524)
Carrying amount of goodwill, September 30, 2016	\$ 180,006	\$ 21,404	\$ 216,685	\$ 418,095

Intangible assets at September 30, 2016, and December 31, 2015, were as follows:

	September 30, 2016		December 31, 2015	
	Customer Relationships	Other Intangibles	Customer Relationships	Other Intangibles
Gross intangible assets	\$ 120,999	\$ 3,910	\$ 121,888	\$ 4,621
Accumulated amortization (36,125)	(1,802)	(29,872)	(1,387)	()
Net intangible assets	\$ 84,874	\$ 2,108	\$ 92,016	\$ 3,234

At September 30, 2016, \$12.2 million in net intangible assets were held in the Domestic segment, \$12.0 million were held in the International segment and \$62.8 million were held in the CPS segment. Amortization expense for intangible assets was \$2.2 million and \$2.4 million for the three months ended September 30, 2016 and 2015 and \$6.6 million and \$7.2 million for the nine months ended September 30, 2016 and 2015.

Based on the current carrying value of intangible assets subject to amortization, estimated amortization expense is \$2.7 million for the remainder of 2016, \$9.7 million for 2017, \$9.1 million for 2018, \$9.0 million for 2019, \$8.9 million for 2020 and \$8.5 million for 2021.

Note 5—Exit and Realignment Charges

We periodically incur exit and realignment and other charges associated with optimizing our operations, which includes the consolidation of certain distribution and logistics centers, administrative offices and warehouses in the United States and Europe. These charges also include costs associated with our strategic organizational realignment which include management changes, certain professional fees and costs to streamline administrative functions and processes.

Exit and realignment charges by segment for the three and nine months ended September 30, 2016 and 2015 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Domestic segment	\$ 1,224	\$ 1,582	\$ 14,194	\$ 4,096
International segment	457	3,217	3,284	12,135
CPS segment	465	—	1,574	—
Total exit and realignment charges	\$ 2,146	\$ 4,799	\$ 19,052	\$ 16,231

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For the three and nine months ended September 30, 2016, \$0.4 million and \$11.6 million in charges were associated with our voluntary employee separation program and other severance activities. The following table summarizes the activity related to exit and realignment cost accruals through September 30, 2016 and 2015:

	Lease Obligations	Severance and Other	Total
Accrued exit and realignment costs, December 31, 2015	\$ 486	\$ 1,840	\$2,326
Provision for exit and realignment activities	—	9,895	9,895
Cash payments, net of sublease income	(486)	(1,287)	(1,773)
Accrued exit and realignment costs, March 31, 2016	—	10,448	10,448
Provision for exit and realignment activities	—	1,254	1,254
Cash payments, net of sublease income	—	(7,087)	(7,087)
Accrued exit and realignment costs, June 30, 2016	—	4,615	4,615
Provision for exit and realignment activities	—	725	725
Change in Estimate	—	(268)	(268)
Cash payments, net of sublease income	—	(2,066)	(2,066)
Accrued exit and realignment costs, September 30, 2016	\$ —	\$ 3,006	\$3,006
Accrued exit and realignment costs, December 31, 2014	\$ 3,575	\$ 2,887	\$6,462
Provision for exit and realignment activities	256	142	398
Cash payments, net of sublease income	(385)	(873)	(1,258)
Accrued exit and realignment costs, March 31, 2015	3,446	2,156	5,602
Provision for exit and realignment activities	572	392	964
Cash payments, net of sublease income	(349)	(1,171)	(1,520)
Accrued exit and realignment costs, June 30, 2015	\$ 3,669	\$ 1,377	\$5,046
Provision for exit and realignment activities	—	1,033	1,033
Cash payments, net of sublease income	(446)	(285)	(731)
Accrued exit and realignment costs, September 30, 2015	\$ 3,223	\$ 2,125	\$5,348

In addition to the exit and realignment accruals in the preceding table, we also incurred \$1.7 million of costs that were expensed as incurred for the three months ended September 30, 2016, including \$0.7 million in other facility costs, \$0.5 million in labor costs, \$0.4 million in information systems costs, and \$0.1 million in other costs. For the nine months ended September 30, 2016, we recognized \$7.4 million of costs that were expensed as incurred, including \$3.6 million in consulting costs, \$1.8 million in information system costs, \$0.7 million in other facility costs, \$0.5 million in labor costs, and \$0.8 million in other costs.

In the three months ended September 30, 2015, we also incurred \$3.8 million of costs that were expensed as incurred, including \$1.2 million in information system costs, \$1.0 million in labor costs,