STERIS CORP
Form 10-Q
November 08, 2012

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, 2012
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 1-14643

STERIS Corporation
(Exact name of registrant as specified in its charter)

Ohio (State or other jurisdiction of incorporation or organization)	34-1482024 (IRS Employer Identification No.)
5960 Heisley Road, Mentor, Ohio (Address of principal executive offices)	44060-1834 (Zip code)

440-354-2600
(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.

Large Accelerated Filer x	Accelerated Filer o
Non-Accelerated Filer o (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 o   No x

The number of common shares outstanding as of October 26, 2012: 58,472,547

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PART 1—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STERIS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2012 (Unaudited)	March 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$156,609	$150,821
Accounts receivable (net of allowances of $8,570 and $11,428, respectively)	231,034	280,324
Inventories, net	160,537	157,712
Deferred income taxes, net	28,403	43,211
Prepaid expenses and other current assets	29,103	19,815
Total current assets	605,686	651,883
Property, plant, and equipment, net	413,763	386,409
Goodwill and intangibles, net	584,328	337,784
Other assets	28,955	29,620
Total assets	$1,632,732	$1,405,696
Liabilities and equity		
Current liabilities:		
Accounts payable	$70,575	$83,188
Accrued income taxes	—	—
Accrued payroll and other related liabilities	35,741	29,899
Accrued SYSTEM 1 Rebate Program and class action settlement	26,446	69,065
Accrued expenses and other	98,946	96,243
Total current liabilities	231,708	278,395
Long-term indebtedness	434,340	210,000
Deferred income taxes, net	36,799	42,703
Other liabilities	48,259	51,934
Total liabilities	$751,106	$583,032
Commitments and contingencies (see note 10)		
Serial preferred shares, without par value; 3,000 shares authorized; no shares issued or outstanding	—	—
Common shares, without par value; 300,000 shares authorized; 70,040 shares issued; 58,423 and 57,733 shares outstanding, respectively	241,601	244,091
Common shares held in treasury, 11,617 and 12,307 shares, respectively	(333,212)	(350,718)
Retained earnings	963,954	914,401
Accumulated other comprehensive income	8,018	13,627
Total shareholders' equity	880,361	821,401
Noncontrolling interest	1,265	1,263
Total equity	881,626	822,664
Total liabilities and equity	$1,632,732	$1,405,696

See notes to consolidated financial statements.

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STERIS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2012	2011	2012	2011
Revenues:				
Product	$231,650	$223,502	$445,403	$425,515
Service	124,671	119,205	247,878	235,831
Total revenues	356,321	342,707	693,281	661,346
Cost of revenues:				
Product	127,147	138,805	252,629	256,238
Service	76,053	70,593	150,279	138,874
Total cost of revenues	203,200	209,398	402,908	395,112
Gross profit	153,121	133,309	290,373	266,234
Operating expenses:				
Selling, general, and administrative	81,040	76,652	160,814	153,661
Research and development	9,852	8,915	19,164	17,672
Restructuring expenses	(48)	99	(184)	357
Total operating expenses	90,844	85,666	179,794	171,690
Income from operations	62,277	47,643	110,579	94,544
Non-operating expenses, net:				
Interest expense	3,406	3,081	6,379	6,078
Interest income and miscellaneous expense	(31)	(682)	(291)	(575)
Total non-operating expenses, net	3,375	2,399	6,088	5,503
Income before income tax expense	58,902	45,244	104,491	89,041
Income tax expense	18,757	15,680	33,992	30,746
Net income	$40,145	$29,564	$70,499	$58,295
Net income per common share				
Basic	$0.69	$0.50	$1.21	$0.99
Diluted	$0.68	$0.50	$1.20	$0.98
Cash dividends declared per common share outstanding	$0.19	$0.17	$0.36	$0.32

See notes to consolidated financial statements.

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STERIS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Six Months Ended September 30, 2012	Six Months Ended September 30, 2011
Net income	$40,145	$29,564	70,499	58,295
Unrealized gain (loss) on available for sale securities	80	(261)	(18)	(255)
Amortization of pension and postretirement benefit plans costs, net of taxes	(184)	(270)	(359)	(539)
Change in cumulative foreign currency translation adjustment	8,946	(23,266)	(5,232)	(13,953)
Total other comprehensive income (loss)	8,842	(23,797)	(5,609)	(14,747)
Comprehensive income	$48,987	$5,767	$64,890	$43,548

See notes to consolidated financial statements.

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STERIS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	Six Months Ended September 30,	
	2012	2011
Operating activities:		
Net income	$70,499	$58,295
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, and amortization	30,188	30,187
Deferred income taxes	8,545	17,283
Share-based compensation expense	4,125	3,811
Loss on the disposal of property, plant, equipment, and intangibles, net	240	313
Other items	1,297	(1,166)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	56,060	36,545
Inventories, net	3,135	(15,955)
Other current assets	(8,432)	(11,525)
Accounts payable	(14,183)	(20,363)
Accrued SYSTEM 1 Rebate Program and class action settlement	(42,619)	(15,921)
Accruals and other, net	3,168	(20,967)
Net cash provided by operating activities	112,023	60,537
Investing activities:		
Purchases of property, plant, equipment, and intangibles, net	(45,062)	(34,445)
Proceeds from the sale of property, plant, equipment, and intangibles	22	—
Acquisition of business, net of cash acquired	(276,595)	(22,269)
Net cash used in investing activities	(321,635)	(56,714)
Financing activities:		
Proceeds under credit facilities, net	224,340	—
Repurchases of common shares	(2,688)	(43,679)
Cash dividends paid to common shareholders	(20,946)	(18,928)
Stock option and other equity transactions, net	11,709	3,172
Tax benefit from stock options exercised	1,772	745
Net cash provided by (used in) financing activities	214,187	(58,690)
Effect of exchange rate changes on cash and cash equivalents	1,213	(4,038)
Increase (decrease) in cash and cash equivalents	5,788	(58,905)
Cash and cash equivalents at beginning of period	150,821	193,016
Cash and cash equivalents at end of period	$156,609	$134,111

See notes to consolidated financial statements.

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STERIS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
For the Three and Six Months Ended September 30, 2012 and 2011
(dollars in thousands, except per share amounts)

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

STERIS Corporation, an Ohio corporation, develops, manufactures and markets infection prevention, contamination control, microbial reduction, and surgical and critical care support products and services for healthcare, pharmaceutical, scientific, research, industrial, and governmental Customers throughout the world. As used in this Quarterly Report, STERIS Corporation and its subsidiaries together are called "STERIS," the "Company," "we," "us," or "our, unless otherwise noted.

We operate in three reportable business segments: Healthcare, Life Sciences, and STERIS Isomedix Services ("Isomedix"). We describe our business segments in note 11 to our consolidated financial statements titled, "Business Segment Information." Our fiscal year ends on March 31. References in this Quarterly Report to a particular "year" or "year-end" mean our fiscal year. The significant accounting policies applied in preparing the accompanying consolidated financial statements of the Company are summarized below:

Interim Financial Statements

We prepared the accompanying unaudited consolidated financial statements of the Company according to accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and the instructions to the Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. This means that they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. Our unaudited interim consolidated financial statements contain all material adjustments (including normal recurring accruals and adjustments) management believes are necessary to fairly state our financial condition, results of operations, and cash flows for the periods presented.

These interim consolidated financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2012 dated May 29, 2012. The Consolidated Balance Sheet at March 31, 2012 was derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Principles of Consolidation

We use the consolidation method to report our investment in our subsidiaries. Therefore, the accompanying consolidated financial statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. We eliminate inter-company accounts and transactions when we consolidate these accounts.

Use of Estimates

We make certain estimates and assumptions when preparing financial statements according to U.S. GAAP that affect the reported amounts of assets and liabilities at the financial statement dates and the reported amounts of revenues and expenses during the periods presented. These estimates and assumptions involve judgments with respect to many factors that are difficult to predict and are beyond our control. Actual results could be materially different from these estimates. We revise the estimates and assumptions as new information becomes available. This means that operating results for the three and six month periods ended September 30, 2012 are not necessarily indicative of results that may be expected for future quarters or for the full fiscal year ending March 31, 2013.

Recently Adopted Accounting Pronouncements

In June 2011, the FASB issued an accounting standard update titled "Presentation of Comprehensive Income," amending Accounting Standards Codification ASC Topic 220, "Comprehensive Income." This guidance requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance became effective retrospectively for the interim periods and annual periods beginning after December 15, 2011; however, the FASB agreed to an indefinite deferral of the reclassification requirement as defined in accounting standard update titled "Deferral of the Effective Date for Amendments to the Presentation of

Reclassifications of Items Out of Accumulated Other Comprehensive Income," issued in December 2011. As required by the standard, Consolidated Statements of Comprehensive Income have been presented. The adoption of this standard did not have an impact on our consolidated financial position, results of operations or cash flows.

In July 2012, the FASB issued an accounting standards update titled "Testing Indefinite-Lived Intangible Assets for Impairment," amending certain sections of Subtopic 350-30 Intangibles-Goodwill and Other-General Intangibles Other than Goodwill. This amended guidance allows an entity to first assess qualitative factors to determine if it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount. If based on its qualitative assessment an entity concludes it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, quantitative impairment testing is required. However, if an entity concludes otherwise, quantitative impairment testing is not required. The standards update is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The anticipated adoption of this standard is not expected to impact our consolidated financial position, results of operations or cash flows.

Significant Accounting Policies

A detailed description of our significant and critical accounting policies, estimates, and assumptions is included in our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2012 dated May 29, 2012. Our significant and critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2012 with the exception of the estimation of the SYSTEM 1 Rebate Program.

SYSTEM 1 Rebate Program. The SYSTEM 1 Rebate Program (the "Rebate Program") was initially recognized during the first quarter of fiscal 2011. The rebate portion of the Rebate Program is recognized as contra-revenue consistent with other returns and allowances offered to Customers. The estimated costs to facilitate the disposal of the returned SYSTEM 1 processors portion of the Rebate Program is recognized as cost of revenues. Both components are recorded as current liabilities. The key assumptions involved in the estimates associated with the Rebate Program included: the number and age of SYSTEM 1 processors eligible for rebates under the Rebate Program, the number of Customers that would elect to participate in the Rebate Program, the proportion of Customers that would choose each rebate option, and the estimated per unit costs of disposal.

The Rebate Program ended August 2, 2012. Through September 30, 2012, Customers have utilized or committed to utilize rebates totaling approximately $66,600 on orders placed since the initiation of the Rebate Program. Additional Customer orders utilizing rebates are not anticipated although exceptions can be made at the discretion of the Company and existing orders may be modified or canceled by Customers. Remaining disposal costs are based on the actual costs experienced to date. During the second quarter of fiscal 2013, we adjusted the liability related to the SYSTEM 1 Rebate Program. The total pre-tax adjustment was $21,500, of which $20,400 was recorded as an increase to revenue for the Customer Rebate portion, and $1,100 was recorded as a reduction to cost of revenues related to the disposal portion of the liability. This adjustment resulted primarily from a lower number of eligible Customers electing to participate in the Rebate Program than previously estimated. While the remaining recorded accrual of $9,044 as of September 30, 2012 is still an estimate, it is based on actual experience to date. No further material adjustments are expected.

2. Restructuring

The following summarizes our restructuring plans announced in prior fiscal years. We recognize restructuring expenses as incurred. In addition, we assess the property, plant and equipment associated with the related facilities for impairment. Additional information regarding our restructuring plans is included in our Annual Report on Form 10-K for the year ended March 31, 2012 dated May 29, 2012.

Fiscal 2010 Restructuring Plan.

During the fourth quarter of fiscal 2010 we adopted a restructuring plan primarily related to the transfer of the remaining operations in our Erie, Pennsylvania facility to the U.S. headquarters in Mentor, Ohio and the consolidation of our European Healthcare manufacturing operations into two central locations within Europe (the “Fiscal 2010 Restructuring Plan”). In addition, we rationalized certain products and eliminated certain positions.

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STERIS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Six Months Ended September 30, 2012 and 2011
(dollars in thousands)

Since the inception of the Fiscal 2010 Restructuring Plan, we have incurred pre-tax expenses totaling $8,557 related to these actions, of which $7,451 was recorded as restructuring expenses and $1,106 was recorded in cost of revenues. We do not expect to incur any significant restructuring expenses related to this plan. These actions are intended to enhance profitability and improve efficiencies.

The following table summarizes our total pre-tax restructuring expenses for the second quarter of fiscal 2013 and fiscal 2012:

	Fiscal 2010 Restructuring Plan	
Three Months Ended September 30,	2012	2011 (1)
Severance and other compensation related costs	$(48)	$(26)
Asset impairment and accelerated depreciation	—	92
Total restructuring charges	$(48)	$66

(1) Includes $(33) in charges recorded in cost of revenues on Consolidated Statements of Income for 2011.

The following table summarizes our total pre-tax restructuring expenses for the first half of fiscal 2013 and fiscal 2012:

	Fiscal 2010 Restructuring Plan		Fiscal 2008 Restructuring Plan		Total	
Six Months Ended September 30,	2012	2011 (1)	2012	2011	2012	2011 (1)
Severance and other compensation related costs	$(167)	$(80)	$—	$—	$(167)	$(80)
Product rationalization	—	335	—	—	—	335
Asset impairment and accelerated depreciation	(17)	183	—	—	(17)	183
Lease termination obligation and other	—	—	—	(152)	—	(152)
Total restructuring charges	$(184)	$438	$—	$(152)	$(184)	$286

(1) Includes $(71) in charges recorded in cost of revenues on Consolidated Statements of Income for 2011.

Liabilities related to restructuring activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within “Accrued payroll and other related liabilities” and “Accrued expenses and other.” The following table summarizes our liabilities related to these restructuring activities:

	Fiscal 2010 Restructuring Plan			
		Fiscal 2013		
	March 31, 2012	Provision (1)	Payments/ Impairments (2)	September 30, 2012
Severance and termination benefits	$659	$(167)	$(58)	$434
Asset impairments and accelerated depreciation	—	(17)	17	—
Lease termination obligations	947	—	(670)	277
Other	76	—	—	76
Total	$1,682	$(184)	$(711)	$787

(1) Includes curtailment benefit of $125 related to International defined benefit plan. Additional information is included in note 9, "Benefit Plans."
(2) Certain amounts reported include the impact of foreign currency movements relative to the U.S. dollar.

3. Property, Plant and Equipment

Information related to the major categories of our depreciable assets is as follows:

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STERIS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Six Months Ended September 30, 2012 and 2011
(dollars in thousands)

	September 30, 2012	March 31, 2012
Land and land improvements (1)	$35,032	$33,099
Buildings and leasehold improvements	236,734	230,823
Machinery and equipment	306,858	301,665
Information systems	107,625	110,130
Radioisotope	226,616	210,899
Construction in progress (1)	41,904	22,811
Total property, plant, and equipment	954,769	909,427
Less: accumulated depreciation and depletion	(541,006)	(523,018)
Property, plant, and equipment, net	$413,763	$386,409

(1) Land is not depreciated. Construction in progress is not depreciated until placed in service.

4. Business Acquisitions

On August 15, 2012, the Company completed the previously announced acquisition of all the outstanding shares of capital stock of United States Endoscopy Group, Inc. ("US Endoscopy") pursuant to a Stock Purchase Agreement dated July 16, 2012 with US Endoscopy and its shareholders. US Endoscopy is a leader in the design, manufacture and sale of therapeutic and diagnostic medical devices and support accessories used in the gastrointestinal (GI) endoscopy markets worldwide and will be integrated into the Healthcare business segment.

The purchase price was approximately $270,000, subject to a customary working capital adjustment. In addition, STERIS purchased all real estate used in the US Endoscopy business for approximately $7,000, including properties owned by two US Endoscopy affiliates. STERIS did not assume any existing debt in connection with the purchases. The purchases were financed by a combination of cash on hand and borrowings under STERIS's existing credit facility.

The following table summarizes the preliminary allocation of the purchase price to the net assets acquired based on fair values at the acquisition date.

Cash	$767
Accounts receivable	8,291
Inventory	7,228
Property, plant and equipment	12,457
Other assets	913
Intangible assets	144,000
Goodwill	109,116
Total assets acquired	282,772
Accounts payable	(2,167)
Other liabilities	(3,243)
Total liabilities assumed	(5,410)
Net assets acquired	$277,362

The Company recorded acquisition related costs of $3,205, before tax, which are reported in selling, general and administrative expense. The Company anticipates that the acquisition will qualify for a joint election tax benefit under Section 338(h)(10) of the Internal Revenue Code, which allows goodwill and intangibles to be fully deductible for tax purposes. The intangible assets acquired consist of trademarks, trade names and developed technologies, which will be amortized on an straight line basis over thirteen to fifteen years, with the exception of the US Endoscopy trade name which will be treated as indefinite lived.

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STERIS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Six Months Ended September 30, 2012 and 2011
(dollars in thousands)

The Consolidated Financial Statements include the operating results US Endoscopy from the date of acquisition. Pro forma results of operations for fiscal 2013 and 2012 periods have not been presented because the effects of the acquisition were not material to the Company's financial results.

5. Inventories, Net

Inventories, net are stated at the lower of cost or market. We use the last-in, first-out (“LIFO”) and first-in, first-out cost methods. An actual valuation of inventory under the LIFO method is made only at the end of the fiscal year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management’s estimates of expected year-end inventory levels and are subject to the final fiscal year-end LIFO inventory valuation. Inventory costs include material, labor, and overhead. Inventories, net consisted of the following:

	September 30, 2012	March 31, 2012
Raw materials	$55,957	$56,525
Work in process	28,499	25,236
Finished goods	105,701	109,422
LIFO reserve	(15,783)	(18,158)
Reserve for excess and obsolete inventory	(13,837)	(15,313)
Inventories, net	$160,537	$157,712

6. Debt

Indebtedness was as follows:

	September 30, 2012	March 31, 2012
Private Placement	$210,000	$210,000
Credit facility	224,340	—
Total long term debt	$434,340	$210,000

During the first half of fiscal 2013, the Company borrowed $224.3 million under our credit facility. These borrowings were used to partially fund the acquisition of privately-owned US Endoscopy.

Additional information regarding our indebtedness is included in the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2012 dated May 29, 2012.

7. Additional Consolidated Balance Sheet Information

Additional information related to our Consolidated Balance Sheets is as follows:

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STERIS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Six Months Ended September 30, 2012 and 2011
(dollars in thousands)

	September 30, 2012	March 31, 2012
Accrued payroll and other related liabilities:		
Compensation and related items	$11,657	$9,273
Accrued vacation/paid time off	6,047	6,583
Accrued bonuses	7,821	750
Accrued employee commissions	6,687	9,845
Other postretirement benefit obligations-current portion	3,256	3,255
Other employee benefit plans' obligations-current portion	273	193
Total accrued payroll and other related liabilities	$35,741	$29,899
Accrued expenses and other:		
Deferred revenues	$52,309	$51,412
Self-insured risk reserves-current portion	3,342	3,006
Accrued dealer commissions	8,048	9,171
Accrued warranty	12,714	11,189
Other	22,533	21,465
Total accrued expenses and other	$98,946	$96,243
Other liabilities:		
Self-insured risk reserves-long-term portion	$8,786	$8,786
Other postretirement benefit obligations-long-term portion	20,124	21,639
Defined benefit pension plans obligations-long-term portion	7,817	9,881
Other employee benefit plans obligations-long-term portion	4,529	4,486
Accrued long-term income taxes	1,981	1,925
Other	5,022	5,217
Total other liabilities	$48,259	$51,934

8. Income Tax Expense

Income tax expense includes United States federal, state and local, and foreign income taxes, and is based on reported pre-tax income. The effective income tax rates for the three-month periods ended September 30, 2012 and 2011 were 31.8% and 34.7%, respectively. The effective income tax rates for the six-month periods ended September 30, 2012 and 2011 were 32.5% and 34.5%, respectively. During the first half of fiscal 2013, we benefited from higher projected income in lower tax rate jurisdictions and discrete item adjustments.

Income tax expense is provided on an interim basis based upon our estimate of the annual effective income tax rate, adjusted each quarter for discrete items. In determining the estimated annual effective income tax rate, we analyze various factors, including projections of our annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, our ability to use tax credits and net operating loss carry forwards, and available tax planning alternatives.

As of March 31, 2012, we had $1,527 in unrecognized tax benefits, of which $1,242 would favorably impact the effective tax rate if recognized. As of September 30, 2012, we had $1,648 in unrecognized tax benefits, of which $1,363 would favorably impact the effective tax rate if recognized. We believe that it is reasonably possible that unrecognized tax benefits could decrease by up to $1,245 within 12 months of September 30, 2012, primarily as a result of settlements with tax authorities. As of September 30, 2012, we have recognized a liability for interest of $1,062 and penalties of $64.

We operate in numerous taxing jurisdictions and are subject to regular examinations by various United States federal, state and local, as well as foreign jurisdictions. We are no longer subject to United States federal examinations for years before fiscal 2009 and, with limited exceptions, we are no longer subject to United States state and local, or non-United States, income tax examinations by tax authorities for years before fiscal 2008. We remain subject to tax authority audits in various jurisdictions wherever we do business. We do not expect the results of these examinations to have a material adverse affect on our consolidated financial statements.

STERIS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Six Months Ended September 30, 2012 and 2011
(dollars in thousands)

9. Benefit Plans

We provide defined benefit pension plans for certain current and former manufacturing and plant administrative personnel throughout the world as determined by collective bargaining agreements or employee benefit standards set at the time of acquisition of certain businesses. In addition to providing pension benefits to certain employees, we sponsor an unfunded postretirement welfare benefits plan for two groups of United States employees, including the same employees who receive pension benefits under the United States defined benefit pension plan. Benefits under this plan include retiree life insurance and retiree medical coverage, including prescription drug coverage. Additional information regarding our defined benefit pension plans and other postretirement benefits plan is included in our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2012, dated May 29, 2012.

Components of the net periodic benefit cost for our defined benefit pension plans and other postretirement medical benefits plan were as follows:

	Defined Benefit Pension Plans				Other Postretirement Benefits Plan	
	U.S. Qualified		International			
Three Months Ended September 30,	2012	2011	2012	2011	2012	2011
Service cost	$37	$51	$20	$119	$—	$—
Interest cost	523	609	18	69	217	248
Expected return on plan assets	(834)	(821)	(24)	(70)	—	—
Amortization of loss	333	267	—	—	181	106
Amortization of prior service cost	—	—	—	—	(816)	(816)
Net periodic benefit cost (income)	$59	$106	$14	$118	$(418)	$(462)

	Defined Benefit Pension Plans				Other Postretirement Benefits Plan	
	U.S. Qualified		International			
Six Months Ended September 30,	2012	2011	2012	2011	2012	2011
Service cost	$75	$103	$41	$238	$—	$—
Interest cost	1,046	1,219	36	138	434	496
Expected return on plan assets	(1,669)	(1,642)	(48)	(140)	—	—
Amortization of loss	667	533	—	—	362	212
Curtailment	—	—	(125)	—	—	—
Amortization of prior service cost	—	—	—	—	(1,631)	(1,631)
Net periodic benefit cost (income)	$119	$213	$(96)	$236	$(835)	$(923)

We contribute amounts to the defined benefit pension plans at least sufficient to meet the minimum requirements as stated in applicable employee benefit laws and local tax laws. We record liabilities for the difference between the fair value of the plan assets and the benefit obligation (the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for other postretirement benefits plans) on our accompanying Consolidated Balance Sheets.

10. Commitments and contingencies

We are, and will likely continue to be, involved in a number of legal procee