CONMED CORP
Form 10-Q
August 05, 2008

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 June 30, 2008	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 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 oNo ý

The number of shares outstanding of registrant's common stock, as of July 30, 2008 is 28,751,229 shares.

CONMED CORPORATION
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2008

PART I FINANCIAL INFORMATION

Index

PART I FINANCIAL INFORMATION
Item 1.

CONMED CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited, in thousands except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2008	2007	2008
Net sales	$ 169,258	$ 192,755	$ 340,272	$ 383,528
Cost of sales	83,398	91,865	169,187	184,874
Gross profit	85,860	100,890	171,085	198,654
Selling and administrative expense	58,207	69,549	118,012	138,195
Research and development expense	7,453	8,689	15,047	16,767
Other expense (income)	1,312	-	(4,102)	-
	66,972	78,238	128,957	154,962
Income from operations	18,888	22,652	42,128	43,692
Interest expense	4,329	2,439	8,845	5,613
Income before income taxes	14,559	20,213	33,283	38,079
Provision for income taxes	5,214	7,758	12,016	14,614
Net income	$ 9,345	$ 12,455	$ 21,267	$ 23,465
Per share data:				
Net Income				
Basic	$ .33	$ .43	$ .76	$ .82
Diluted	.32	.43	.74	.81
Weighted average common shares				
Basic	28,180	28,662	27,988	28,643
Diluted	28,831	29,063	28,608	29,035

See notes to consolidated condensed financial statements.

1

Index

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

	December 31, 2007	June 30, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,695	$ 17,850
Accounts receivable, net	80,642	106,317
Inventories	164,969	161,057
Income taxes receivable	1,425	-
Deferred income taxes	11,697	11,664
Prepaid expenses and other current assets	8,594	9,971
Total current assets	279,022	306,859
Property, plant and equipment, net	123,679	134,805
Goodwill	289,508	289,767
Other intangible assets, net	191,807	198,021
Other assets	9,935	8,595
Total assets	$ 893,951	$ 938,047
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 3,349	$ 3,830
Accounts payable	38,987	36,111
Accrued compensation and benefits	19,724	19,144
Other current liabilities	15,224	17,000
Total current liabilities	77,284	76,085
Long-term debt	219,485	224,791
Deferred income taxes	71,188	84,512
Other long-term liabilities	20,992	18,623
Total liabilities	388,949	404,011
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 and 31,299,203 shares issued in 2007 and 2008, respectively	313	313
Paid-in capital	287,926	289,219

Retained earnings	284,850	307,997
Accumulated other comprehensive income (loss)	(505)	2,375
Less 2,684,163 and 2,616,107 shares of common stock in		
treasury, at cost in 2007 and 2008, respectively	(67,582)	(65,868)
Total shareholders’ equity	505,002	534,036
Total liabilities and shareholders’ equity	$ 893,951	$ 938,047

See notes to consolidated condensed financial statements.

Index

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

	Six months ended June 30, 2007	2008
Cash flows from operating activities:		
Net income	$ 21,267	$ 23,465
Adjustments to reconcile net income		
to net cash provided by operating activities:		
Depreciation	6,134	6,621
Amortization	9,266	8,908
Stock-based compensation expense	1,885	2,094
Deferred income taxes	10,470	12,360
Sale of accounts receivable	2,000	(3,000)
Increase (decrease) in cash flows		
from changes in assets and liabilities:		
Accounts receivable	(3,924)	(4,768)
Inventories	(15,150)	3,028
Accounts payable	(2,579)	(5,299)
Accrued compensation and benefits	(2,388)	(843)
Other assets	619	(1,081)
Other liabilities	(1,802)	(6,399)
	4,531	11,621
Net cash provided by operating activities	25,798	35,086
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(9,556)	(15,212)
Payments related to business acquisitions	(1,278)	(21,838)
Net cash used in investing activities	(10,834)	(37,050)
Cash flows from financing activities:		
Net proceeds from common stock issued		
under employee plans	10,604	595
Payments on senior credit agreement	(26,326)	(675)
Proceeds of senior credit agreement	-	7,000
Payments on mortgage notes	(471)	(538)
Net change in cash overdrafts	(236)	-
Net cash provided by		
(used in) financing activities	(16,429)	6,382
Effect of exchange rate changes		
on cash and cash equivalents	1,513	1,737
Net increase in cash and cash equivalents	48	6,155
Cash and cash equivalents at beginning of period	3,831	11,695

Cash and cash equivalents at end of period	$ 3,879	$ 17,850

See notes to consolidated condensed financial statements.

3

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

Note 1 – Operations and Significant Accounting Policies

Organization and 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 disposables, 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 June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

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, 2007 included in our Annual Report on Form 10-K.

Note 3 – Other comprehensive income

Comprehensive income consists of the following:

	Three months ended June 30,		Six months ended June 30,	
	2007	2008	2007	2008
Net income	$ 9,345	$ 12,455	$ 21,267	$ 23,465
Other comprehensive income:				
Pension liability	144	90	289	180
Foreign currency translation adjustment	1,452	715	1,941	2,700
Comprehensive income	$ 10,941	$ 13,260	$ 23,497	$ 26,345

Index

Accumulated other comprehensive income consists of the following:

	Minimum Pension Liability	Cumulative Translation Adjustments	Accumulated Other Comprehensive Income (loss)
Balance, December 31, 2007	$ (9,563)	$ 9,058	$ (505)
Pension liability	180	-	180
Foreign currency translation adjustments	-	2,700	2,700
Balance, June 30, 2008	$ (9,383)	$ 11,758	$ 2,375

Note 4 – Fair value measurement

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. This statement defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. This statement applies under other accounting pronouncements that require or permit fair value measurements. The statement 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. SFAS 157 defines fair value based upon an exit price model.

Relative to SFAS 157, the FASB issued FASB Staff Positions ("FSP") 157-1 and 157-2. FSP 157-1 amends SFAS 157 to exclude SFAS No. 13, "Accounting for Leases" ("SFAS 13") and its related interpretive accounting pronouncements that address leasing transactions, while FSP 157-2 delays the effective date of the application of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis.

We adopted SFAS 157 as of January 1, 2008 with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities. Nonrecurring nonfinancial assets and nonfinancial liabilities for which we have not applied the provisions of SFAS 157 include those measured at fair value in goodwill impairment testing, indefinite lived intangible assets measured at fair value for impairment testing, and those initially measured at fair value in a business combination.

Liabilities carried at fair value and measured on a recurring basis as of June 30, 2008 consist of a forward foreign exchange contract and two embedded derivatives associated with our 2.50% convertible senior subordinated notes (the "Notes"). The value of these liabilities was determined within Level 2 of the valuation hierarchy and was not material either individually or in the aggregate to our financial position, results of operations or cash flows.

Index

Note 5 - Inventories

Inventories consist of the following:

	December 31, 2007	June 30, 2008
Raw materials	$ 60,081	$ 53,717
Work-in-process	18,669	21,055
Finished goods	86,219	86,285
Total	$ 164,969	$ 161,057

Note 6 – Earnings 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 and stock appreciation rights during the period. The following table sets forth the computation of basic and diluted earnings per share for the three and six month periods ended June 30, 2007 and 2008.

	Three months ended June 30,		Six months ended June 30,	
	2007	2008	2007	2008
Net income	$ 9,345	$ 12,455	$ 21,267	$ 23,465
Basic – weighted average shares outstanding	28,180	28,662	27,988	28,643
Effect of dilutive potential securities	651	401	620	392
Diluted – weighted average shares outstanding	28,831	29,063	28,608	29,035
Basic EPS	$ .33	$ .43	$ .76	$ .82
Diluted EPS	.32	.43	.74	.81

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 aggregated 0.3 and 0.6 million for the three and six months ended June 30, 2007, respectively. Shares excluded from the calculation of diluted EPS aggregated 1.0 million for both the three and six months ended June 30, 2008. Upon conversion of our 2.50% convertible senior subordinated notes (the "Notes"), the holder of each Note will receive the conversion value of the Note payable in cash up to the principal amount of the Note and CONMED common stock for the Note's conversion value in excess of such principal amount. As of June 30, 2008, our share price has not exceeded the conversion price of the Notes, therefore the conversion value was less than the principal amount of the Notes. Under the net share settlement method and in accordance with Emerging Issues Task Force (“EITF”) Issue 04-8, “The Effect of Contingently Convertible Debt on Diluted Earnings per Share”, there were no potential shares issuable under the Notes to be used in the calculation of diluted EPS. The maximum number of shares we may issue with respect to the Notes is 5,750,000.

Index

Note 7 – Goodwill and other intangible assets

The changes in the net carrying amount of goodwill for the six months ended June 30, 2008 are as follows:

Balance as of January 1, 2008	$ 289,508
Adjustments to goodwill resulting from	
business acquisitions finalized	441
Foreign currency translation	(182)
Balance as of June 30, 2008	$ 289,767

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

	December 31, 2007	June 30, 2008
CONMED Electrosurgery	$ 16,645	$ 16,645
CONMED Endosurgery	42,439	42,439
CONMED Linvatec	171,332	171,150
CONMED Patient Care	59,092	59,533
Balance	$ 289,508	$ 289,767

Other intangible assets consist of the following:

	December 31, 2007		June 30, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer relationships	$ 118,124	$ (28,000)	$ 127,026	$ (30,096)
Patents and other intangible assets	39,812	(26,473)	40,231	(27,484)
Unamortized intangible assets:				
Trademarks and tradenames	88,344	-	88,344	-
	$ 246,280	$ (54,473)	$ 255,601	$ (57,580)

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 24 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 11 years.

Index

Amortization expense related to intangible assets which are subject to amortization totaled $1,402 and $2,557 in the three and six months ended June 30, 2007, respectively, and $1,559 and $3,107 in the three and six months ended June 30, 2008, respectively, and is included in selling and administrative expense on the consolidated condensed statement of income.

The estimated amortization expense for the year ending December 31, 2008, including the six month period ended June 30, 2008 and for each of the five succeeding years is as follows:

2008	6,286
2009	6,286
2010	6,227
2011	5,596
2012	5,502
2013	5,269

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 six months ended June 30, 2008 are as follows:

Balance as of January 1, 2008	$ 3,306
Provision for warranties	1,200
Claims made	(1,446)
Balance as of June 30, 2008	$ 3,060

Note 9 – Pension plan

Net periodic pension costs consist of the following:

	Three months ended June 30,		Six months ended June 30,	
	2007	2008	2007	2008
Service cost	$ 1,381	$ 1,536	$ 2,763	$ 3,072
Interest cost on projected benefit obligation	737	843	1,474	1,685

Expected return on plan assets	(683)	(845)	(1,367)	(1,690)
Net amortization and deferral	229	142	458	285
Net periodic pension cost	$ 1,664	$ 1,676	$ 3,328	$ 3,352

8

Index

We previously disclosed in our Annual Report on Form 10-K for the year-ended December 31, 2007 that we expect to make $12.0 million in contributions to our pension plan in 2008. We made $6.0 million in contributions for the six months ended June 30, 2008.

Note 10 – Other expense (income)

Other expense (income) consists of the following:

	Three months ended June 30, 2007	Three months ended June 30, 2008	Six months ended June 30, 2007	Six months ended June 30, 2008
Termination of product offering	$ 58	$ -	$ 148	$ -
Facility closure costs	1,254	-	1,822	-
Litigation settlement	-	-	(6,072)	-
Other expense (income)	$ 1,312	$ -	$ (4,102)	$ -

During 2006, we elected to close our facility in Montreal, Canada which manufactured products for our CONMED Linvatec line of integrated operating room systems and equipment. The products which had been manufactured in the Montreal facility will now be purchased from a third party vendor. The closing of this facility was completed in the first quarter of 2007. We incurred a total of $2.2 million in costs associated with this closure, of which $1.3 million related to the write-off of inventory and was included in cost of goods sold during 2006. The remaining $0.9 million (including $0.3 million in the first quarter of 2007) primarily relates to severance expense and the disposal of fixed assets which we have recorded in other expense (income).

During 2007, we elected to close our Endoscopic Technologies sales office in France. During the three and six months ended June 30, 2007, we incurred $1.3 million and $1.5 million in costs associated with this closure primarily related to severance expense. We have recorded such costs in other expense (income); no further expenses are expected to be incurred.

In November 2003, we commenced litigation against Johnson & Johnson and several of its subsidiaries, including Ethicon, Inc. for violations of federal and state antitrust laws. In the lawsuit we claimed that Johnson & Johnson engaged in illegal and anticompetitive conduct with respect to sales of product used in endoscopic surgery, resulting in higher prices to consumers and the exclusion of competition. We sought relief including an injunction restraining Johnson & Johnson from continuing its anticompetitive practices as well as receiving the maximum amount of damages allowed by law. During the litigation, Johnson & Johnson represented that the marketing practices which gave rise to the litigation had been altered with respect to CONMED. On March 31, 2007, CONMED and Johnson & Johnson settled the litigation. Under the terms of the final settlement agreement, CONMED received a payment of $11.0 million from Johnson & Johnson in return for which we terminated the lawsuit. After deducting legal and other related costs, we recorded a pre-tax gain of $6.1 million related to the settlement which we have recorded in other expense (income).

Note 11 — Business Segments and Geographic Areas

CONMED conducts its business through five principal operating units, 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 products, production processes, customer base, distribution methods and regulatory environment.

Index

In accordance with Statement of Financial Accounting Standards No. 131 “Disclosures About Segments of an Enterprise and Related Information” (“SFAS 131”), our CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec operating units also have similar economic characteristics and therefore qualify for aggregation under SFAS 131. Our CONMED Patient Care and CONMED Endoscopic Technologies operating units do not qualify for aggregation under SFAS 131 since their economic characteristics do not meet the criteria for aggregation as a result of the lower overall operating income (loss) 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 in the digestive tract.

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

	Three months ended June 30,		Six months ended June 30,	
	2007	2008	2007	2008
Arthroscopy	64,949	76,775	127,192	152,298
Powered Surgical Instruments	35,993	39,718	73,543	80,175
CONMED Linvatec	100,942	116,493	200,735	232,473
CONMED Electrosurgery	22,123	25,856	46,149	52,640
CONMED Endosurgery	15,465	17,284	29,040	32,485
CONMED Linvatec, Endosurgery, and Electrosurgery	138,530	159,633	275,924	317,598
CONMED Patient Care	17,315	19,807	37,676	40,118
CONMED Endoscopic Technologies	13,413	13,315	26,672	25,812
Total	$ 169,258	$ 192,755	$ 340,272	$ 383,528

Total assets, capital expenditures, depreciation and amortization information are not available by segment.

The following is a reconciliation between segment operating income and income before income taxes:

Index

	Three months ended June 30,		Six months ended June 30,	
	2007	2008	2007	2008
CONMED Endosurgery, Electrosurgery and Linvatec	$ 24,916	$ 27,678	$ 43,709	$ 55,175
CONMED Patient Care	(1,265)	589	(238)	1,143
CONMED Endoscopic Technologies	(2,432)	(2,366)		