

STERIS CORP
Form 10-Q
November 04, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q
(Mark One)

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

x

For the quarterly period ended September 30, 2014

or

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

o

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)
440-354-2600

44060-1834
(Zip code)

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

(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 common shares outstanding as of October 31, 2014: 59,421,562

1

Table of Contents

STERIS Corporation and Subsidiaries
Form 10-Q
Index

| | Page |
|--|-----------|
| <u>Part I—Financial Information</u> | |
| <u>Item 1. Financial Statements</u> | <u>3</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>36</u> |
| <u>Item 4. Controls and Procedures</u> | <u>36</u> |
| <u>Part II—Other Information</u> | |
| <u>Item 1. Legal Proceedings</u> | <u>37</u> |
| <u>Item 1A. Risk Factors</u> | <u>38</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>38</u> |
| <u>Item 6. Exhibits</u> | <u>39</u> |
| <u>Signature</u> | <u>40</u> |

Table of Contents

PART I— FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STERIS CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands)

| | September 30, 2014 (Unaudited) | March 31, 2014 |
|---|--------------------------------------|-------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$147,413 | \$152,802 |
| Accounts receivable (net of allowances of \$9,774 and \$10,922, respectively) | 288,587 | 313,686 |
| Inventories, net | 184,447 | 155,146 |
| Deferred income taxes, net | 16,039 | 16,084 |
| Prepaid expenses and other current assets | 37,049 | 37,027 |
| Total current assets | 673,535 | 674,745 |
| Property, plant, and equipment, net | 474,967 | 454,410 |
| Goodwill and intangibles, net | 869,022 | 747,715 |
| Other assets | 9,883 | 10,292 |
| Total assets | \$2,027,407 | \$1,887,162 |
| Liabilities and equity | | |
| Current liabilities: | | |
| Accounts payable | \$90,436 | \$102,430 |
| Accrued payroll and other related liabilities | 55,801 | 58,774 |
| Accrued expenses and other | 98,643 | 93,302 |
| Total current liabilities | 244,880 | 254,506 |
| Long-term indebtedness | 619,950 | 493,480 |
| Deferred income taxes, net | 58,649 | 59,053 |
| Other liabilities | 36,068 | 38,877 |
| Total liabilities | \$959,547 | \$845,916 |
| Commitments and contingencies (see note 9) | | |
| 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; 59,413 and 58,968 shares outstanding, respectively | 250,277 | 246,186 |
| Common shares held in treasury, 10,627 and 11,072 shares, respectively | (313,465 |) (324,202 |
| Retained earnings | 1,141,663 | 1,112,240 |
| Accumulated other comprehensive income | (12,594 |) 4,481 |
| Total shareholders' equity | 1,065,881 | 1,038,705 |
| Noncontrolling interest | 1,979 | 2,541 |
| Total equity | 1,067,860 | 1,041,246 |
| Total liabilities and equity | \$2,027,407 | \$1,887,162 |

See notes to consolidated financial statements.

Table of ContentsSTERIS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(Unaudited)

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|--|-------------------------------------|-----------|-----------------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenues: | | | | |
| Product | \$256,845 | \$235,309 | \$487,285 | \$458,237 |
| Service | 205,884 | 148,453 | 388,087 | 293,177 |
| Total revenues | 462,729 | 383,762 | 875,372 | 751,414 |
| Cost of revenues: | | | | |
| Product | 142,991 | 133,629 | 272,966 | 263,166 |
| Service | 125,746 | 95,627 | 238,321 | 186,896 |
| Total cost of revenues | 268,737 | 229,256 | 511,287 | 450,062 |
| Gross profit | 193,992 | 154,506 | 364,085 | 301,352 |
| Operating expenses: | | | | |
| Selling, general, and administrative | 126,292 | 90,661 | 239,980 | 184,590 |
| Research and development | 13,006 | 13,527 | 25,415 | 25,380 |
| Restructuring expenses | 1,271 | 18 | 1,099 | 70 |
| Total operating expenses | 140,569 | 104,206 | 266,494 | 210,040 |
| Income from operations | 53,423 | 50,300 | 97,591 | 91,312 |
| Non-operating expenses, net: | | | | |
| Interest expense | 4,948 | 4,869 | 9,630 | 9,856 |
| Interest income and miscellaneous expense | (36 |) (227 |) (256 |) (475 |
| Total non-operating expenses, net | 4,912 | 4,642 | 9,374 | 9,381 |
| Income before income tax expense | 48,511 | 45,658 | 88,217 | 81,931 |
| Income tax expense | 17,507 | 15,915 | 32,676 | 19,871 |
| Net income | \$31,004 | \$29,743 | \$55,541 | \$62,060 |
| Net income per common share | | | | |
| Basic | \$0.52 | \$0.50 | \$0.94 | \$1.05 |
| Diluted | \$0.52 | \$0.50 | \$0.93 | \$1.04 |
| Cash dividends declared per common share outstanding | \$0.23 | \$0.21 | \$0.44 | \$0.40 |

See notes to consolidated financial statements.

Table of ContentsSTERIS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|-------------------------------------|----------|-----------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | 31,004 | 29,743 | 55,541 | 62,060 |
| Unrealized gain (loss) on available for sale securities | (44 |) 93 | 59 | 95 |
| Amortization of pension and postretirement benefit plans costs, net of taxes of \$137, \$89, \$275 and \$178, respectively) | (221 |) (139 |) (443 |) (279 |
| Change in cumulative foreign currency translation adjustment | (21,362 |) 12,018 | (16,691 |) 7,299 |
| Total other comprehensive income (loss) | (21,627 |) 11,972 | (17,075 |) 7,115 |
| Comprehensive income | \$9,377 | \$41,715 | \$38,466 | \$69,175 |

See notes to consolidated financial statements.

Table of ContentsSTERIS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

| | Six Months Ended September | |
|---|----------------------------|-----------|
| | 30, | |
| | 2014 | 2013 |
| Operating activities: | | |
| Net income | \$55,541 | \$62,060 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, depletion, and amortization | 47,835 | 36,115 |
| Deferred income taxes | (1,005 |) 685 |
| Share-based compensation expense | 7,606 | 6,078 |
| Loss (gain) on the disposal of property, plant, equipment, and intangibles, net | (373 |) 1,003 |
| Other items | (4,985 |) 1,282 |
| Changes in operating assets and liabilities, net of effects of acquisitions: | | |
| Accounts receivable, net | 39,447 | 16,750 |
| Inventories, net | (24,251 |) (10,739 |
| Other current assets | 552 | (140 |
| Accounts payable | (15,241 |) 2,956 |
| Tax benefit from share-based compensation | (4,505 |) (1,462 |
| Accruals and other, net | 4,287 | (34,543 |
| Net cash provided by operating activities | 104,908 | 80,045 |
| Investing activities: | | |
| Purchases of property, plant, equipment, and intangibles, net | (36,527 |) (47,110 |
| Proceeds from the sale of property, plant, equipment, and intangibles | 796 | 8 |
| Acquisition of business, net of cash acquired | (179,380 |) (115 |
| Net cash used in investing activities | (215,111 |) (47,217 |
| Financing activities: | | |
| Payments on long-term obligations | — | (30,000 |
| Deferred financing fees and debt issuance costs | — | (43 |
| Proceeds under credit facilities, net | 126,470 | 46,230 |
| Repurchases of common shares | (5,440 |) (18,653 |
| Cash dividends paid to common shareholders | (26,118 |) (23,644 |
| Stock option and other equity transactions, net | 8,686 | 9,159 |
| Tax benefit from share-based compensation | 4,505 | 1,462 |
| Net cash provided by (used in) financing activities | 108,103 | (15,489 |
| Effect of exchange rate changes on cash and cash equivalents | (3,289 |) 4,447 |
| Increase (decrease) in cash and cash equivalents | (5,389 |) 21,786 |
| Cash and cash equivalents at beginning of period | 152,802 | 142,008 |
| Cash and cash equivalents at end of period | \$147,413 | \$163,794 |

See notes to consolidated financial statements.

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

For the Three and Six Months Ended September 30, 2014 and 2013

(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 gastrointestinal 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 10 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, 2014 dated May 29, 2014. The Consolidated Balance Sheet at March 31, 2014 was derived from the audited consolidated financial statements at March 31, 2014, 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. Income attributable to non-controlling interests is reported in the "Interest income and miscellaneous expense" line of our Consolidated Statements of Income and is not material.

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, 2014 are not necessarily indicative of results that may be expected for future quarters or for the full fiscal year ending March 31, 2015.

Recent Accounting Pronouncements

In May 2014, the FASB issued the Accounting Standards Update (ASU) 2014-09 titled "Revenue from Contracts with Customers", superseding Accounting Standards Codification ASC Topic 605, "Revenue Recognition" and most industry-specific guidance throughout the Industry Topics of the Codification. This amended guidance states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

to which the entity expects to be entitled in exchange for those goods or services. The guidance further states in order to achieve that core principle an entity should apply a series of five steps which include: identify the contract(s) with the Customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligation in the contract, and recognize revenue when (or as) the entity satisfies a performance obligation. Entities are given the option to apply either a full retrospective with practical expedients or a modified retrospective transition method. ASU 2014-09 will also require additional disclosures in the notes to the consolidated financial statements. The standard update is effective for annual periods beginning after December 15, 2016 and interim periods within that period, early adoption is not permitted. We are currently in the process of evaluating the impact that the standard will have on our consolidated financial position, results of operations and cash flows.

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, 2014 dated May 29, 2014. Our significant and critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2014.

2. Restructuring

Fiscal 2014 Restructuring Plan. During the fourth quarter of fiscal 2014, we adopted and announced a targeted restructuring plan primarily focused on the closure of our Hopkins manufacturing facility located in Mentor, Ohio (the “Fiscal 2014 Restructuring Plan”). As a result of this plan, we will transfer operations located at Hopkins to other North American locations. We believe that by closing the operations at Hopkins we will more effectively utilize our existing North American manufacturing network while reducing operating costs.

Since the inception of the Restructuring Plan we have incurred pre-tax expenses totaling \$20,880 related to these actions, of which \$13,186 was recorded as restructuring expenses and \$7,694 was recorded in cost of revenues, with restructuring expenses of \$18,808, \$745, and \$1,327 related to the Healthcare, Life Sciences and Isomedix segments, respectively. We do not expect to incur any significant additional 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 and first half of fiscal 2015:

| | Fiscal 2014 Restructuring Plan | |
|--|---|---|
| | Three months ended September 30, (1) | Six months ended September 30, (2) |
| Severance and other compensation related costs | \$1,176 | \$980 |
| Asset impairment and accelerated depreciation | — | (38) |
| Lease termination obligation and other | 95 | 157 |
| Product rationalization | (336) | (450) |
| Total restructuring expenses | \$935 | \$649 |

(1) Includes \$(336) in expense recorded to cost to revenues on Consolidated Statements of Income.

(2) Includes \$(450) in expense recorded to cost to revenues on Consolidated Statements of Income.

Pre-tax restructuring expenses of \$18 and \$70 incurred during the second quarter and first half of fiscal 2014, respectively, related to previously announced restructuring plans.

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 restructuring liability balances and activity:

8

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

| | Fiscal 2014 Restructuring Plan | | | September 30, 2014 |
|---|--------------------------------|------------------------------|--------------|-----------------------|
| | March 31, 2014 | Fiscal 2015 Provision (1) | Payments (1) | |
| Severance and termination benefits | \$6,389 | \$980 | \$(2,509) |) \$4,860 |
| Lease termination obligations and other | 1,589 | 18 | (1,101) |) 506 |
| Total | \$7,978 | \$998 | \$(3,610) |) \$5,366 |

(1) 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:

| | September 30, 2014 | March 31, 2014 |
|--|-----------------------|-------------------|
| Land and land improvements (1) | \$35,765 | \$33,601 |
| Buildings and leasehold improvements | 269,904 | 256,879 |
| Machinery and equipment | 371,595 | 360,977 |
| Information systems | 102,623 | 100,349 |
| Radioisotope | 274,215 | 258,547 |
| Construction in progress (1) | 30,867 | 35,016 |
| Total property, plant, and equipment | 1,084,969 | 1,045,369 |
| Less: accumulated depreciation and depletion | (610,002) |) (590,959) |
| Property, plant, and equipment, net | \$474,967 | \$454,410 |

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

4. 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, 2014 | March 31, 2014 |
|---|-----------------------|-------------------|
| Raw materials | \$70,108 | \$60,328 |
| Work in process | 29,901 | 24,449 |
| Finished goods | 116,598 | 102,928 |
| LIFO reserve | (17,171) |) (19,450) |
| Reserve for excess and obsolete inventory | (14,989) |) (13,109) |
| Inventories, net | \$184,447 | \$155,146 |

5. Debt

Indebtedness was as follows:

9

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

| | September 30, 2014 | March 31, 2014 |
|--|-----------------------|-------------------|
| Private Placement | \$340,000 | \$340,000 |
| Credit Agreement and Swing Line Facility | 279,950 | 153,480 |
| Total long term debt | \$619,950 | \$493,480 |

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, 2014 dated May 29, 2014.

6. Additional Consolidated Balance Sheet Information

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

| | September 30, 2014 | March 31, 2014 |
|---|-----------------------|-------------------|
| Accrued payroll and other related liabilities: | | |
| Compensation and related items | \$22,177 | \$19,418 |
| Accrued vacation/paid time off | 6,561 | 6,172 |
| Accrued bonuses | 13,803 | 18,451 |
| Accrued employee commissions | 9,930 | 11,322 |
| Other postretirement benefit obligations-current portion | 2,950 | 2,950 |
| Other employee benefit plans' obligations-current portion | 380 | 461 |
| Total accrued payroll and other related liabilities | \$55,801 | \$58,774 |
| Accrued expenses and other: | | |
| Deferred revenues | \$41,877 | \$39,441 |
| Self-insured risk reserves-current portion | 5,460 | 4,656 |
| Accrued dealer commissions | 11,689 | 10,017 |
| Accrued warranty | 6,271 | 7,765 |
| Other | 33,346 | 31,423 |
| Total accrued expenses and other | \$98,643 | \$93,302 |
| Other liabilities: | | |
| Self-insured risk reserves-long-term portion | \$10,688 | \$10,689 |
| Other postretirement benefit obligations-long-term portion | 16,974 | 18,393 |
| Defined benefit pension plans obligations-long-term portion | 99 | 691 |
| Other employee benefit plans obligations-long-term portion | 5,379 | 6,013 |
| Other | 2,928 | 3,091 |
| Total other liabilities | \$36,068 | \$38,877 |

7. 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, 2014 and 2013 were 36.1% and 34.9%, respectively. During the second quarter of fiscal 2014, we benefited from higher projected income in lower tax rate jurisdictions and discrete item adjustments. The effective income tax rates for the six-month periods

ended September 30, 2014 and 2013 were 37.0% and 24.3%, respectively. During the first half of fiscal 2015, we were unfavorably impacted by pretax losses in jurisdictions for which no tax benefit is recognized. Conversely, during the first half of fiscal 2014, we benefited from the recognition of previously unrecognized tax benefits due to the settlement of a federal tax examination.

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.

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

As of March 31, 2014 and September 30, 2014, we had no unrecognized tax benefits and have not recorded any liability for interest and penalties.

We operate in numerous taxing jurisdictions and are subject to regular examinations by various United States federal, state and local authorities, as well as foreign jurisdictions. We are no longer subject to United States federal examinations for years before fiscal 2014 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 2010. 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 effect on our consolidated financial statements.

8. Benefit Plans

We provide defined benefit pension plans for certain former manufacturing and plant administrative personnel 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 some of the same employees who receive pension benefits. Benefits under this plan include retiree life insurance and retiree medical coverage, including prescription drug coverage. We are in the process of terminating our defined benefit pension plan covering certain former U.S. union employees.

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, 2014, dated May 29, 2014.

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 | |
|------------------------------------|----------------------------------|----------|--|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Three Months Ended September 30, | | | | |
| Service cost | \$35 | \$40 | \$— | \$— |
| Interest cost | 471 | 450 | 173 | 171 |
| Expected return on plan assets | (785) | (861) | — | — |
| Amortization of loss | 277 | 365 | 180 | 223 |
| Amortization of prior service cost | — | — | (816) | (816) |
| Net periodic benefit cost | \$(2) | \$(6) | \$(463) | \$(422) |
| | | | | |
| | Defined Benefit Pension Plans | | Other Postretirement Benefits Plan | |
| | 2014 | 2013 | 2014 | 2013 |
| Six Months Ended September 30, | | | | |
| Service cost | \$70 | \$80 | \$— | \$— |
| Interest cost | 944 | 899 | 346 | 342 |
| Expected return on plan assets | (1,570) | (1,721) | — | — |
| Amortization of loss | 553 | 729 | 360 | 445 |
| Amortization of prior service cost | — | — | (1,631) | (1,631) |

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

We are, and will likely continue to be, involved in a number of legal proceedings, government investigations, and claims, which we believe generally arise in the course of our business, given our size, history, complexity, and the nature of our business, products, Customers, regulatory environment, and industries in which we participate. These legal proceedings, investigations and claims generally involve a variety of legal theories and allegations, including, without limitation, personal injury (e.g., slip and falls, burns, vehicle accidents), product liability or regulation (e.g., based on product operation or claimed malfunction, failure to warn, failure to meet specification, or failure to comply with regulatory requirements), product exposure (e.g., claimed exposure to chemicals, asbestos, contaminants, radiation), property damage (e.g., claimed damage due to leaking equipment, fire, vehicles, chemicals), commercial claims (e.g., breach of contract, economic loss, warranty, misrepresentation), financial (e.g., taxes, reporting), employment (e.g., wrongful termination, discrimination, benefits matters), and other claims for damage and relief. We believe we have adequately reserved for our current litigation and claims that are probable and estimable, and further believe that the ultimate outcome of these pending lawsuits and claims will not have a material adverse effect on our consolidated financial position or results of operations taken as a whole. Due to their inherent uncertainty, however, there can be no assurance of the ultimate outcome or effect of current or future litigation, investigations, claims or other proceedings (including without limitation the matters discussed below). For certain types of claims, we presently maintain insurance coverage for personal injury and property damage and other liability coverages in amounts and with deductibles that we believe are prudent, but there can be no assurance that these coverages will be applicable or adequate to cover adverse outcomes of claims or legal proceedings against us.

In April 2010, after ongoing discussions with the FDA regarding a 2008 warning letter relating to our SYSTEM 1® sterile processor and related sterilant, we reached agreement with the FDA on the terms of a consent decree (“Consent Decree”). The Consent Decree was approved the same month by the U.S. District Court for the Northern District of Ohio. In general, among other matters, the Consent Decree restricts further sales of SYSTEM 1 processors in the U.S., prohibits the sale of liquid chemical sterilization or disinfection products in the U.S. that do not have FDA clearance, describes various process and compliance matters, and defines penalties in the event of violation of the Consent Decree.

On May 31, 2012, our Albert Browne Limited subsidiary received a warning letter from the FDA regarding chemical indicators manufactured in the United Kingdom. These devices are intended for the monitoring of certain sterilization and other processes. The FDA warning letter states that the agency has concerns regarding operational business processes. We do not believe that the FDA’s concerns are related to product performance, or that they result from Customer complaints. We have reviewed our processes with the agency and finalized our remediation measures, and are awaiting FDA reinspection. We do not currently believe that the impact of this event will have a material adverse effect on our financial results.

On May 23, 2014, the Company received a warning letter from the FDA regarding an inspection that the FDA concluded on January 8, 2014 at our STERIS Isomedix Services facility located in Libertyville, Illinois. The facility primarily provides microbial reduction services for certain medical device Customers. Among other matters, the FDA warning letter asserts that certain processes and procedures observed during the inspection did not conform to current Good Manufacturing Practices for medical devices as required by Title 21 CFR Part 820 and, as a result, that certain devices processed at the subject facility are adulterated within the meaning of the Federal Food, Drug and Cosmetic Act. Since the inspection, the Company has provided detailed responses to the FDA regarding its corrective actions, and has continued to work diligently to remediate the FDA’s concerns. We do not believe that this inspection was a result of Customer complaints and there have been no reports of patient injury. We do not expect this situation to have a material adverse effect on our operations or financial condition.

Other civil, criminal, regulatory or other proceedings involving our products or services could possibly result in judgments, settlements or administrative or judicial decrees requiring us, among other actions, to pay damages or fines or effect recalls, or be subject to other governmental, Customer or other third party claims or remedies, which could materially effect our business, performance, prospects, value, financial condition, and results of operations.

For additional information regarding these matters, see the following portions of our Annual Report on Form 10-K for the fiscal year ended March 31, 2014: “Business - Information with respect to our Business in General - Government Regulation”, and the “Risk Factor” titled “We may be adversely affected by product liability claims or other legal actions or regulatory or compliance matters, including the Warning Letter and Consent Decree” and the “Risk Factor” titled “Compliance with the Consent Decree may be more costly and burdensome than anticipated.”

From time to time, STERIS is also involved in legal proceedings as a plaintiff involving contract, patent protection, and other claims asserted by us. Gains, if any, from these proceedings are recognized when they are realized.

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

We are subject to taxation from United States federal, state and local, and foreign jurisdictions. Tax positions are settled primarily through the completion of audits within each individual jurisdiction or the closing of statute of limitation. Changes in applicable tax law or other events may also require us to revise past estimates. Additional information regarding our contingencies is included in Item 7 of Part II titled, “Management's Discussion and Analysis of Financial Conditions and Results of Operations,” of our Annual Report on Form 10-K for the year ended March 31, 2014 dated May 29, 2014, and in Item 1 of Part II of this Form 10-Q titled, “Legal Proceedings.”

10. Business Segment Information

We operate and report in three business segments: Healthcare, Life Sciences, and Isomedix. Corporate and other, which is presented separately, contains the Defense and Industrial business unit plus costs that are associated with being a publicly traded company and certain other corporate costs.

Our Healthcare segment manufactures and sells capital equipment, accessory, consumable, and service solutions to healthcare providers, including acute care hospitals, surgery and gastrointestinal centers. These solutions aid our Customers in improving the safety, quality, and productivity of their surgical, sterile processing, gastrointestinal, and emergency environments.

Our Life Sciences segment manufactures and sells capital equipment, formulated cleaning chemistries, and service solutions to pharmaceutical companies, and private and public research facilities around the globe.

Our Isomedix segment operates through a network of facilities located in North America. We sell a comprehensive array of contract sterilization services using gamma irradiation and ethylene oxide (“EO”) technologies as well as an array of laboratory testing services. We provide microbial reduction services based on Customer specifications to companies that supply products to the healthcare, industrial, and consumer products industries.

Financial information for each of our segments is presented in the following table. Operating income (loss) for each segment is calculated as the segment’s gross profit less direct expenses and indirect cost allocations, which results in the full allocation of all distribution and research and development expenses, and the partial allocation of corporate costs. These allocations are based upon variables such as segment headcount and revenues. In addition, the Healthcare segment is responsible for the management of all but one manufacturing facility and uses standard cost to sell products to the Life Sciences segment. Corporate and other includes the gross profit and direct expenses of the Defense and Industrial business unit, as well as certain unallocated corporate costs related to being a publicly traded company and legacy pension and post-retirement benefits.

The accounting policies for reportable segments are the same as those for the consolidated Company. For the three and six month periods ended September 30, 2014, revenues from a single Customer did not represent ten percent or more of any reportable segment’s revenues. Additional information regarding our segments is included in our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2014 dated May 29, 2014.

Financial information for each of our segments is presented in the following tables:

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

| | Three Months Ended | | Six Months Ended | |
|---------------------------|--------------------|-----------|------------------|-----------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Revenues: | | | | |
| Healthcare | \$351,169 | \$277,332 | \$653,979 | \$536,220 |
| Life Sciences | 59,148 | 58,382 | 117,762 | 118,297 |
| Isomedix | 51,850 | 47,411 | 103,043 | 95,635 |
| Total reportable segments | 462,167 | 383,125 | 874,784 | 750,152 |
| Corporate and other | 562 | 637 | 588 | 1,262 |
| Total revenues | \$462,729 | \$383,762 | \$875,372 | \$751,414 |
| Operating income: | | | | |
| Healthcare | \$29,943 | \$25,926 | \$47,909 | \$40,873 |
| Life Sciences | 13,048 | 14,041 | 24,993 | 26,580 |
| Isomedix | 14,399 | 13,712 | 30,590 | 28,430 |
| Total reportable segments | 57,390 | 53,679 | 103,492 | 95,883 |
| Corporate and other | (3,967) | (3,379) | (5,901) | (4,571) |
| Total operating income | \$53,423 | \$50,300 | \$97,591 | \$91,312 |

11. Common Shares

We calculate basic earnings per common share based upon the weighted average number of common shares outstanding. We calculate diluted earnings per share based upon the weighted average number of common shares outstanding plus the dilutive effect of common share equivalents calculated using the treasury stock method. The following is a summary of common shares and common share equivalents outstanding used in the calculations of basic and diluted earnings per share:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|--------|------------------|--------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Denominator (shares in thousands): | | | | |
| Weighted average common shares outstanding—basic | 59,375 | 59,027 | 59,272 | 59,016 |
| Dilutive effect of common share equivalents | 645 | 735 | 645 | 760 |
| Weighted average common shares outstanding and common share equivalents—diluted | 60,020 | 59,762 | 59,917 | 59,776 |

Options to purchase the following number of common shares were outstanding but excluded from the computation of diluted earnings per share because the combined exercise prices, unamortized fair values, and assumed tax benefits upon exercise were greater than the average market price for the common shares during the periods, so including these options would be anti-dilutive:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------|------------------|------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| | | | | |

(shares in thousands)

| | | | | |
|--------------------------------|-----|-----|-----|-----|
| Number of common share options | 486 | 455 | 416 | 353 |
|--------------------------------|-----|-----|-----|-----|

12. Repurchases of Common Shares

During the first half of fiscal 2015, we obtained 137,183 of our common shares in connection with stock based compensation award programs. At September 30, 2014, \$86,939 of STERIS common shares remained authorized for repurchase pursuant to the most recent Board approved repurchase authorization (the March 2008 Board Authorization). Also, 10,626,853 common shares were held in treasury at September 30, 2014.

14

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

13. Share-Based Compensation

We maintain a long-term incentive plan that makes available common shares for grants, at the discretion of the Compensation Committee of the Board of Directors, to officers, directors, and key employees in the form of stock options, restricted shares, restricted share units, stock appreciation rights and common share grants. Stock options provide the right to purchase our common shares at the market price on the date of grant, subject to the terms of the option plans and agreements. Generally, one-fourth of the stock options granted become exercisable for each full year of employment following the grant date. Stock options granted generally expire 10 years after the grant date, or earlier if the option holder is no longer employed by us. Restricted shares and restricted share units generally may cliff vest after a four year period or vest in tranches of one-fourth of the number granted for each full year of employment after the grant date. As of September 30, 2014, 2,781,030 shares remained available for grant under the long-term incentive plan.

The fair value of share-based compensation awards was estimated at their grant date using the Black-Scholes-Merton option pricing model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics that are not present in our option grants. If the model permitted consideration of the unique characteristics of employee stock options, the resulting estimate of the fair value of the stock options could be different. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statements of Income. The expense is classified as cost of goods sold or selling, general and administrative expenses in a manner consistent with the employee's compensation and benefits.

The following weighted-average assumptions were used for options granted during the first half of fiscal 2015 and fiscal 2014:

| | Fiscal 2015 | Fiscal 2014 |
|----------------------------------|-------------|-------------|
| Risk-free interest rate | 1.89 | % 0.95% |
| Expected life of options | 5.75 years | 5.70 years |
| Expected dividend yield of stock | 1.87 | % 2.22% |
| Expected volatility of stock | 29.86 | % 31.22% |

The risk-free interest rate is based upon the U.S. Treasury yield curve. The expected life of options is reflective of our historical experience, vesting schedules and contractual terms. The expected dividend yield of stock represents our best estimate of the expected future dividend yield. The expected volatility of stock is derived by referring to our historical stock prices over a time frame similar to that of the expected life of the grant. An estimated forfeiture rate of 1.46% and 1.44% was applied in fiscal 2015 and 2014, respectively. This rate is calculated based upon historical activity and represents an estimate of the granted options not expected to vest. If actual forfeitures differ from this calculated rate, we may be required to make additional adjustments to compensation expense in future periods. The assumptions used above are reviewed at the time of each significant option grant, or at least annually.

A summary of share option activity is as follows:

| Number of | Weighted | Average | Aggregate |
|-----------|----------|---------|-----------|
|-----------|----------|---------|-----------|

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| | Options | Average Exercise Price | Remaining Contractual Term | Intrinsic Value |
|-----------------------------------|------------|------------------------------|----------------------------------|--------------------|
| Outstanding at March 31, 2014 | 2,396,986 | \$31.06 | | |
| Granted | 377,532 | 53.39 | | |
| Exercised | (317,163) | 27.55 | | |
| Forfeited | (32,856) | 41.09 | | |
| Canceled | (8,262) | 20.69 | | |
| Outstanding at September 30, 2014 | 2,416,237 | \$34.91 | 6.0 years | \$46,028 |
| Exercisable at September 30, 2014 | 1,692,287 | \$30.10 | 4.8 years | \$40,384 |

We estimate that 710,899 of the non-vested stock options outstanding at September 30, 2014 will ultimately vest.

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

The aggregate intrinsic value in the table above represents the total pre-tax difference between the \$53.96 closing price of our common shares on September 30, 2014 over the exercise prices of the stock options, multiplied by the number of options outstanding or outstanding and exercisable, as applicable. The aggregate intrinsic value is not recorded for financial accounting purposes and the value changes daily based on the daily changes in the fair market value of our common shares.

The total intrinsic value of stock options exercised during the first half of fiscal 2015 and fiscal 2014 was \$8,245 and \$6,518, respectively. Net cash proceeds from the exercise of stock options were \$8,686 and \$9,159 for the first half of fiscal 2015 and fiscal 2014, respectively. The tax benefit from shared-based compensation was \$4,505 and \$1,462 for the first half of fiscal 2015 and fiscal 2014, respectively.

The weighted average grant date fair value of stock option grants was \$13.41 and \$10.59 for the first half of fiscal 2015 and fiscal 2014, respectively.

Stock appreciation rights (“SARS”) carry generally the same terms and vesting requirements as stock options except that they are settled in cash upon exercise and therefore, are classified as liabilities. The fair value of the outstanding SARS as of September 30, 2014 and 2013 was \$1,506 and \$1,078, respectively. The fair value of outstanding SARs is revalued at each reporting date and the related liability and expense are adjusted appropriately.

A summary of the non-vested restricted share activity is presented below:

| | Number of Restricted Shares | Number of Restricted Share Units | Weighted-Average Grant Date Fair Value |
|----------------------------------|-----------------------------------|--|--|
| Non-vested at March 31, 2014 | 931,018 | 14,976 | \$36.60 |
| Granted | 263,815 | 36,226 | 53.55 |
| Vested | (289,536 |) (17,183 |) 34.38 |
| Canceled | (33,765 |) (1,520 |) 40.81 |
| Non-vested at September 30, 2014 | 871,532 | 32,499 | \$42.81 |

Restricted shares granted are valued based on the closing stock price at the grant date. The value of restricted shares that vested during the first half of fiscal 2015 was \$10,544.

Restricted share units carry generally the same terms and vesting requirements as restricted stock except that they may be settled in stock or cash upon vesting. Those that are settled in cash are classified as liabilities. The fair value of outstanding cash-settled restricted share units as of September 30, 2014 and March 31, 2014 was \$256 and \$1,259, respectively. The fair value of each cash-settled restricted share unit is revalued at each reporting date and the related liability and expense are adjusted appropriately.

As of September 30, 2014, there was a total of \$32,202 in unrecognized compensation cost related to nonvested share-based compensation granted under our share-based compensation plans. We expect to recognize the cost over a weighted average period of 2.46 years.

14. Financial and Other Guarantees

We generally offer a limited parts and labor warranty on capital equipment. The specific terms and conditions of those warranties vary depending on the product sold and the countries where we conduct business. We record a liability for the estimated cost of product warranties at the time product revenues are recognized. The amounts we expect to incur on behalf of our Customers for the future estimated cost of these warranties are recorded as a current liability on the accompanying Consolidated Balance Sheets. Factors that affect the amount of our warranty liability include the number and type of installed units, historical and anticipated rates of product failures, and material and service costs per claim. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary.

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

Changes in our warranty liability during the first half of fiscal 2015 were as follows:

| | | |
|-------------------------------------|---------|---|
| Balance, March 31, 2014 | \$7,765 | |
| Warranties issued during the period | 3,003 | |
| Settlements made during the period | (4,497 |) |
| Balance, September 30, 2014 | \$6,271 | |

We also sell product maintenance contracts to our Customers. These contracts range in terms from one to five years and require us to maintain and repair the product over the maintenance contract term. We initially record amounts due from Customers under these contracts as a liability for deferred service contract revenue on the accompanying Consolidated Balance Sheets within “Accrued expenses and other.” The liability recorded for such deferred service revenue was \$33,144 and \$31,079 as of September 30, 2014 and March 31, 2014, respectively. Such deferred revenue is then amortized on a straight-line basis over the contract term and recognized as service revenue on our accompanying Consolidated Statements of Income. The activity related to the liability for deferred service contract revenues is excluded from the table presented above.

15. Forward and Swap Contracts

From time to time, we enter into forward contracts to hedge potential foreign currency gains and losses that arise from transactions denominated in foreign currencies, including inter-company transactions. We may also enter into commodity swap contracts to hedge price changes in a certain commodity that impacts raw materials included in our cost of revenues. We do not use derivative financial instruments for speculative purposes. These contracts are not designated as hedging instruments and do not receive hedge accounting treatment; therefore, changes in their fair value are not deferred but are recognized immediately in the Consolidated Statements of Income. At September 30, 2014, we held foreign currency forward contracts to buy 34 million Mexican pesos, and 12 million Canadian dollars. At September 30, 2014, we held commodity swap contracts to buy 300.3 thousand pounds of nickel.

| Balance Sheet Location | Asset Derivatives | | Liability Derivatives | |
|----------------------------|-------------------------------------|---------------------------------|-------------------------------------|---------------------------------|
| | Fair Value at September 30, 2014 | Fair Value at March 31, 2014 | Fair Value at September 30, 2014 | Fair Value at March 31, 2014 |
| Prepaid & Other | \$68 | \$167 | \$— | \$— |
| Accrued expenses and other | \$— | \$— | \$276 | \$67 |

The following table presents the impact of derivative instruments and their location within the Consolidated Statements of Income:

| Location of gain (loss) recognized in income | Amount of gain (loss) recognized in income | | | |
|--|--|---------|-----------------------|----------|
| | Three Months Ended | | Six Months Ended | |
| | September 30, 2014 | 2013 | September 30, 2014 | 2013 |
| Selling, general and administrative | \$(426 |) \$162 | \$(147 |) \$(571 |

Foreign currency forward
contracts

| | | | | | |
|--------------------------|------------------|----------|-----|-------|---------|
| Commodity swap contracts | Cost of revenues | \$(347) | \$— | \$314 | \$(57) |
|--------------------------|------------------|----------|-----|-------|---------|

16. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. We estimate the fair value of financial assets and liabilities using available market information and generally accepted valuation methodologies. The inputs used to measure fair value are classified into three tiers. These tiers include Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable;

17

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring the entity to develop its own assumptions. The following table shows the fair value of our financial assets and liabilities at September 30, 2014 and March 31, 2014:

| | Carrying Value | | Fair Value Measurements at September 30, 2014 and March 31, 2014 Using | | | | | |
|--|----------------|------------|--|---------------------|-------------------------------------|---------------------|---------------------------------|---------------------|
| | | | Quoted Prices in Active Markets for Identical Assets | | Significant Other Observable Inputs | | Significant Unobservable Inputs | |
| | September 30 | March 31 | Level 1 September 30 | Level 1 March 31 | Level 2 September 30 | Level 2 March 31 | Level 3 September 30 | Level 3 March 31 |
| Assets: | | | | | | | | |
| Cash and cash equivalents (1) | \$ 147,413 | \$ 152,802 | \$ 131,075 | \$ 137,189 | \$ 16,338 | \$ 15,613 | \$— | \$— |
| Forward and swap contracts (2) | 68 | 167 | — | — | 68 | 167 | — | — |
| Investments (3) | 3,435 | 3,397 | 3,435 | 3,397 | — | — | — | — |
| Liabilities: | | | | | | | | |
| Forward and swap contracts (2) | \$ 276 | \$ 67 | \$— | \$— | \$ 276 | \$ 67 | \$— | \$— |
| Deferred compensation plans (3) | 3,539 | 3,495 | 3,539 | 3,495 | — | — | — | — |
| Long term debt (4) | 619,950 | 493,480 | — | — | 642,075 | 511,690 | — | — |
| Contingent consideration obligations (5) | 6,688 | 9,887 | — | — | — | — | 6,688 | 9,887 |

(1) Money market fund holdings are classified as level two as active market quoted prices are not available.

(2) The fair values of forward and swap contracts are based on period-end forward rates and reflect the value of the amount that we would pay or receive for the contracts involving the same notional amounts and maturity dates.

(3) We maintain a frozen domestic non-qualified deferred compensation plan covering certain employees, which allowed for the deferral of payment of previously earned compensation for an employee-specified term or until retirement or termination. Amounts deferred can be allocated to various hypothetical investment options (compensation deferrals have been frozen under the plan). We hold investments to satisfy the future obligations of the plan. Changes in the value of the investment accounts are recognized each period based on the fair value of the underlying investments. Employees who made deferrals are entitled to receive distributions of their hypothetical account balances (amounts deferred, together with earnings (losses)).

(4) We estimate the fair value of our long-term debt using discounted cash flow analyses, based on our current incremental borrowing rates for similar types of borrowing arrangements.

(5) Contingent consideration obligations arise from prior business acquisitions. The fair values are based on discounted cash flow analyses reflecting the possible achievement of specified performance measures or events and captures the contractual nature of the contingencies, commercial risk, and the time value of money. Contingent consideration obligations are classified in the consolidated balance sheets as accrued expense (short-term) and other liabilities (long-term), as appropriate based on the contractual payment dates.

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The changes in Level 3 assets and liabilities measured at fair value on a recurring basis at September 30, 2014 are summarized as follows:

| | Contingent Consideration | |
|--|-----------------------------|---|
| Balance at March 31, 2014 | \$9,887 | |
| Deductions | (5,061 |) |
| (Gains)/Losses | 2,026 | |
| Foreign currency translation adjustments (1) | (164 |) |
| Balance at September 30, 2014 | \$6,688 | |
| (1) Reported in other comprehensive income (loss). | | |

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

17. Reclassifications Out of Accumulated Other Comprehensive Income (Loss)

Amounts in Accumulated Other Comprehensive Income (Loss) are presented net of the related tax. Foreign Currency Translation is not adjusted for income taxes. Changes in our Accumulated Other Comprehensive Income (Loss) balances, net of tax, for the three and six months ended September 30, 2014 were as follows:

| | Gain (Loss) on Available for Sale Securities (1) | | Defined Benefit Plans (2) | | Foreign Currency Translation | | Total Accumulated Other Comprehensive Income (Loss) | |
|--|--|---------------|------------------------------|---------------|---------------------------------|---------------|--|---------------|
| | Three Months | Six Months | Three Months | Six Months | Three Months | Six Months | Three Months | Six Months |
| Beginning Balance | \$664 | \$561 | \$(2,650) | \$(2,428) | \$11,019 | \$6,348 | \$9,033 | \$4,481 |
| Other Comprehensive Income (Loss) before reclassifications | (74) | (6) | 248 | 495 | (21,362) | (16,691) | (21,188) | (16,202) |
| Amounts reclassified from Accumulated Other Comprehensive Income (Loss) | 30 | 65 | (469) | (938) | — | — | (439) | (873) |
| Net current-period Other Comprehensive Income (Loss) | (44) | 59 | (221) | (443) | (21,362) | (16,691) | (21,627) | (17,075) |
| Balance at September 30, 2014 | \$620 | \$620 | \$(2,871) | \$(2,871) | \$(10,343) | \$(10,343) | \$(12,594) | \$(12,594) |

Details of amounts reclassified from Accumulated Other Comprehensive Income (Loss) are as follows:

(1) Realized gain (loss) on available for sale securities is reported in the interest income and miscellaneous expense line of the Consolidated Statements of Income.

(2) Amortization (gain) of defined benefit pension items is reported in the selling, general and administrative expense line of the Consolidated Statements of Income.

18. Business Acquisitions

On May 9, 2014, we completed the previously announced acquisition of all the outstanding shares of capital stock of Integrated Medical Systems International, Inc. ("IMS") pursuant to a Stock Purchase Agreement dated March 31, 2014. The purchase price was approximately \$165,000, subject to a customary working capital adjustment. In addition, we purchased certain real estate used in the IMS business for approximately \$10,000. IMS has facilities located in Alabama, Florida and Maryland and provides a variety of services including: endoscope repair, surgical instrument management and sterile processing consulting. IMS is being integrated into our Healthcare segment as part of our Specialty Services business. The acquisition was financed through a combination of credit facility borrowings and cash on hand.

We recorded acquisition related costs of \$3,053, before tax, which are reported in selling, general and administrative expense. We anticipate that the acquisition of IMS 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. Intangible assets acquired consist of trade names and Customer relationships, which will be amortized on a straight line basis over their useful lives of up to nine years, with the exception of the IMS trade name which has an indefinite life.

The Consolidated Financial Statements include the operating results of the IMS acquisition from the acquisition date. Pro-forma results of operations for the fiscal 2014 periods have not been presented because the effects of the acquisition were not material to our financial results.

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

Table of Contents

STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Six Months Ended September 30, 2014 and 2013

(dollars in thousands)

| | | |
|-------------------------------|------------|---|
| | IMS | |
| Accounts receivable | \$ 16,594 | |
| Inventory | 8,478 | |
| Property, plant and equipment | 15,074 | |
| Other assets | 842 | |
| Intangible assets | 62,000 | |
| Goodwill | 81,587 | |
| Total assets acquired | 184,575 | |
| Accounts payable | (4,833 |) |
| Current liabilities | (6,837 |) |
| Total liabilities assumed | (11,670 |) |
| Net assets acquired | \$ 172,905 | |

19. Subsequent Events

On October 13, 2014, we announced that we were commencing a "recommended offer" under U.K. law to acquire all outstanding shares of Synergy Health, plc ("Synergy") in a cash and stock transaction valued at £19.50 (\$31.35) per Synergy share, or a total of approximately \$1,900,000 based on STERIS's closing stock price of \$56.38 per share on October 10, 2014. The transaction is subject to certain customary closing conditions, including approvals by STERIS and Synergy shareholders as well as regulatory approvals in the U.S. and U.K., and is anticipated to close by March 31, 2015.

Also on October 13, 2014, we obtained a Bridge Facility from a group of three lenders. Under the Bridge Credit Agreement, the lenders have agreed to provide senior unsecured debt financing, to consist of up to £340 million of commitments, and up to \$1,050,000 of commitments. The proceeds will be used in part to pay the cash portion of the purchase price for the transaction. To the extent that alternative sources of financing to replace the Bridge Credit Agreement are not procured at or prior to the transaction closing, the proceeds of the Bridge Credit Agreement may be used to (i) finance the payment of the cash consideration for the transaction, and related fees and expenses and (ii) to pay or refinance our existing debt and Synergy debt.

20. U.K. Takeover Code Directors' Confirmation

Under Rule 28.1 of the U.K.'s City Code on Takeovers and Mergers (the "Takeover Code") which applies in light of our proposed acquisition of Synergy Health, our directors must provide a so-called "directors' confirmation" in respect of our Consolidated Net Income for the three months ended September 30, 2014 reported in this Quarterly Report on Form 10-Q (the "Net Income Statement") since it constitutes an unaudited profit estimate for the purposes of the Takeover Code. Accordingly, our directors confirm that:

- (i) the Consolidated Statement of Income for the three months ended September 30, 2014, has been properly compiled on the basis of the assumptions contained or referred to in this Quarterly Report; and
- (ii) the basis of accounting used for the purposes of preparing the Consolidated Statement of Income for the three months ended September 30, 2014, is consistent with our accounting policies.

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
STERIS Corporation

We have reviewed the consolidated balance sheets of STERIS Corporation and subsidiaries (“STERIS”) as of September 30, 2014 and 2013, and the related consolidated statements of income and comprehensive income for the three- and six-month periods ended September 30, 2014 and 2013, and the consolidated statements of cash flows for the six-month periods ended September 30, 2014 and 2013. These financial statements are the responsibility of STERIS management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of STERIS Corporation and subsidiaries as of March 31, 2014, and the related consolidated statements of income, comprehensive income, shareholders’ equity and cash flows for the year then ended (not presented herein) and we expressed an unqualified opinion on those consolidated financial statements in our report dated May 29, 2014. In our opinion, the accompanying consolidated balance sheet of STERIS Corporation and subsidiaries as of March 31, 2014 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio
November 4, 2014

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

In Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A"), we explain the general financial condition and the results of operations for STERIS including:

- what factors affect our business;
- what our earnings and costs were in each period presented;
- why those earnings and costs were different from prior periods;
- where our earnings came from;
- how this affects our overall financial condition;
- what our expenditures for capital projects were; and
- where cash will come from to fund future debt principal repayments, growth outside of core operations, repurchase common shares, pay cash dividends and fund future working capital needs.

As you read the MD&A, it may be helpful to refer to information in our consolidated financial statements, which present the results of our operations for the second quarter and first six months of fiscal 2015 and fiscal 2014. It may also be helpful to read the MD&A in our Annual Report on Form 10-K for the year ended March 31, 2014, dated May 29, 2014. In the MD&A, we analyze and explain the period-over-period changes in the specific line items in the Consolidated Statements of Income. Our analysis may be important to you in making decisions about your investments in STERIS.

Financial Measures

In the following sections of the MD&A, we may, at times, refer to financial measures that are not required to be presented in the consolidated financial statements under U.S. GAAP. We sometimes use the following financial measures in the context of this report: backlog; debt-to-total capital; net debt-to-total capital; and days sales outstanding. We define these financial measures as follows:

• **Backlog** – We define backlog as the amount of unfilled capital equipment purchase orders at a point in time. We use this figure as a measure to assist in the projection of short-term financial results and inventory requirements.

• **Debt-to-total capital** – We define debt-to-total capital as total debt divided by the sum of total debt and shareholders' equity. We use this figure as a financial liquidity measure to gauge our ability to borrow and fund growth.

• **Net debt-to-total capital** – We define net debt-to-total capital as total debt less cash ("net debt") divided by the sum of net debt and shareholders' equity. We also use this figure as a financial liquidity measure to gauge our ability to borrow and fund growth.

• **Days sales outstanding ("DSO")** – We define DSO as the average collection period for accounts receivable. It is calculated as net accounts receivable divided by the trailing four quarters' revenues, multiplied by 365 days. We use this figure to help gauge the quality of accounts receivable and expected time to collect.

We, at times, may also refer to financial measures which are considered to be "non-GAAP financial measures" under SEC rules. We have presented these financial measures because we believe that meaningful analysis of our financial performance is enhanced by an understanding of certain additional factors underlying that performance. These financial measures should not be considered an alternative to measures required by accounting principles generally accepted in the United States. Our calculations of these measures may differ from calculations of similar measures used by other companies and you should be careful when comparing these financial measures to those of other

companies. Additional information regarding these financial measures, including reconciliations of each non- GAAP financial measure, is available in the subsection of MD&A titled, "Non-GAAP Financial Measures."

Revenues – Defined

As required by Regulation S-X, we separately present revenues generated as either product revenues or service revenues on our Consolidated Statements of Income for each period presented. When we discuss revenues, we may, at times, refer to revenues summarized differently than the Regulation S-X requirements. The terminology, definitions, and applications of terms that we use to describe revenues may be different from terms used by other companies. We use the following terms to describe revenues:

Table of Contents

Revenues – Our revenues are presented net of sales returns and allowances.

Product Revenues – We define product revenues as revenues generated from sales of consumable and capital equipment products.

Service Revenues – We define service revenues as revenues generated from parts and labor associated with the maintenance, repair, and installation of our capital equipment, instrument repair services, and revenues generated from contract sterilization offered through our Isomedix segment.

Capital Revenues – We define capital revenues as revenues generated from sales of capital equipment, which includes steam sterilizers, low temperature liquid chemical sterilant processing systems, including SYSTEM 1 and 1E, washing systems, VHP® technology, water stills, and pure steam generators; surgical lights and tables; and integrated OR.

Consumable Revenues – We define consumable revenues as revenues generated from sales of the consumable family of products, which includes SYSTEM 1 and 1E consumables, V-Pro consumables, gastrointestinal endoscopy accessories, sterility assurance products, skin care products, cleaning consumables, and surgical instruments.

Recurring Revenues – We define recurring revenues as revenues generated from sales of consumable products and service revenues.

General Company Overview and Executive Summary

Our mission is to help our Customers create a healthier and safer world by providing innovative healthcare and life science product and service solutions around the globe. Our dedicated employees around the world work together to supply a broad range of solutions by offering a combination of capital equipment, consumables, and services to healthcare, pharmaceutical, industrial, and governmental Customers.

The bulk of our revenues are derived from the healthcare and pharmaceutical industries. Much of the growth in these industries is driven by the aging of the population throughout the world, as an increasing number of individuals are entering their prime healthcare consumption years, and is dependent upon advancement in healthcare delivery, acceptance of new technologies, government policies, and general economic conditions. In addition, each of our core industries is experiencing specific trends that could increase demand. Within healthcare, there is increased concern regarding the level of hospital-acquired infections around the world. The pharmaceutical industry has been impacted by increased FDA scrutiny of cleaning and validation processes, mandating that manufacturers improve their processes. The aging population increases the demand for medical procedures, which increases the consumption of single use medical devices and surgical kits processed by our Isomedix segment.

We are actively pursuing new opportunities to adapt our proven technologies to meet the changing needs of the global marketplace.

We also are pursuing a strategy of expanding into adjacent markets with acquisitions. On October 13, 2014, the Company commenced a "recommended offer" to acquire Synergy Health plc ("Synergy") in a cash and stock transaction valued at \$1.9 billion. As indicated in the transaction announcement, the combined business is expected to have approximately \$2.6 billion in annual revenues from over 60 countries, approximately 14,000 employees, and will combine STERIS's strong presence in North America with Synergy's strong positions across Europe.

On May 9, 2014, the Company acquired Integrated Medical Systems International, Inc. ("IMS"). IMS has facilities located in Alabama, Florida and Maryland and provides a variety of services, including: endoscope repair, surgical instrument management and sterile processing consulting. IMS will be integrated into our Healthcare segment as part of our Specialty Services business.

Fiscal 2015 second quarter revenues were \$462.7 million representing an increase of 20.6% over the fiscal 2014 second quarter revenues of \$383.8 million, reflecting growth within all three business segments. Fiscal 2015 first half revenues were \$875.4 million representing an increase of 16.5% over the first half of fiscal 2014 revenues of \$751.4 million, reflecting growth within our Healthcare and Isomedix business segments.

Fiscal 2015 second quarter gross margin percentage was 41.9% compared with 40.3% for the fiscal 2014 second quarter, while fiscal 2015 first half gross margin percentage was 41.6% compared with 40.1% for the first half of

fiscal 2014. The improved gross margin percentages in the second quarter and first half of fiscal 2015 were due in part to the positive gross margin impact of favorable product mix and foreign currency. Although our recent acquisitions added value in terms of dollars, they negatively impacted our gross margin percentage, along with rising material costs and inflation.

Fiscal 2015 second quarter operating income was \$53.4 million, compared to fiscal 2014 second quarter operating income of \$50.3 million. Fiscal 2015 first half operating income was \$97.6 million compared to the fiscal 2014 first half operating income of \$91.3 million. These increases in operating income are primarily attributable to the higher gross margin attainment

Table of Contents

as well as the increase in revenues in the fiscal 2015 second quarter and first half of fiscal 2015 over the same fiscal 2014 periods.

Cash flows from operations were \$104.9 million and free cash flow was \$69.2 million in the first six months of fiscal 2015 compared to cash flows from operations of \$80.0 million and free cash flow of \$32.9 million in the first six months of fiscal 2014. The increases in cash flow from operations and free cash flow are primarily due to working capital improvements and lower capital spending in fiscal 2015 over fiscal 2014 (see subsection of MD&A titled, "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). Our debt-to-total capital ratio was 36.8% at September 30, 2014 and 32.2% at March 31, 2014. During the first six months of fiscal 2015, we declared and paid quarterly cash dividends of \$0.44 per common share.

Additional information regarding our financial performance during the fiscal second quarter and first six months of 2015 is included in the subsection below titled "Results of Operations."

Matters Affecting Comparability

International Operations. Since we conduct operations outside of the United States using various foreign currencies, our operating results are impacted by foreign currency movements relative to the U.S. dollar. During the second quarter of fiscal 2015, our revenues were favorably impacted by \$0.7 million, or 0.2%, and income before taxes was unfavorably impacted by \$0.2 million, or 0.5%, as a result of foreign currency movements relative to the U.S. dollar. During the first half of fiscal 2015, our revenues were favorably impacted by \$1.8 million, or 0.2%, and income before taxes was favorably impacted by \$1.9 million, or 2.3%, as a result of foreign currency movements relative to the U.S. dollar.

NON-GAAP FINANCIAL MEASURES

We, at times, refer to financial measures which are considered to be "non-GAAP financial measures" under SEC rules. We, at times, also refer to our results of operations excluding certain transactions or amounts that are non-recurring or are not indicative of future results, in order to provide meaningful comparisons between the periods presented.

These non-GAAP financial measures are not intended to be, and should not be, considered separately from or as an alternative to the most directly comparable GAAP financial measures.

These non-GAAP financial measures are presented with the intent of providing greater transparency to supplemental financial information used by management and the Board of Directors in their financial analysis and operational decision-making. These amounts are disclosed so that the reader has the same financial data that management uses with the belief that it will assist investors and other readers in making comparisons to our historical operating results and analyzing the underlying performance of our operations for the periods presented.

We believe that the presentation of these non-GAAP financial measures, when considered along with our GAAP financial measures and the reconciliation to the corresponding GAAP financial measures, provide the reader with a more complete understanding of the factors and trends affecting our business than could be obtained absent this disclosure. It is important for the reader to note that the non-GAAP financial measure used may be calculated differently from, and therefore may not be comparable to, a similarly titled measure used by other companies.

We define free cash flow as net cash provided by operating activities as presented in the Consolidated Statements of Cash Flows less purchases of property, plant, equipment, and intangibles plus proceeds from the sale of property, plant, equipment, and intangibles, which are also presented in the Consolidated Statements of Cash Flows. We use this as a measure to gauge our ability to fund future debt principal repayments and growth outside of core operations, repurchase common shares, and pay cash dividends. The following table summarizes the calculation of our free cash flow for the six month periods ended September 30, 2014 and 2013:

| (dollars in thousands) | Six Months Ended | |
|---|--------------------|--------------------|
| | September 30, 2014 | September 30, 2013 |
| Net cash flows provided by operating activities | \$ 104,908 | \$ 80,045 |

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| | | | | |
|--|----------|---|----------|---|
| Purchases of property, plant, equipment and intangibles, net | (36,527 |) | (47,110 |) |
| Proceeds from the sale of property, plant, equipment and intangibles | 796 | | 8 | |
| Free cash flow | \$69,177 | | \$32,943 | |

Results of Operations

24

Table of Contents

In the following subsections, we discuss our earnings and the factors affecting them for the second quarter and the first half of fiscal 2015 compared with the same fiscal 2014 periods. We begin with a general overview of our operating results and then separately discuss earnings for our operating segments.

Revenues. The following tables compare our revenues for the three and six months ended September 30, 2014 to the revenues for the three and six months ended September 30, 2013:

| (dollars in thousands) | Three Months Ended September 30, | | | Percent | |
|---------------------------------|----------------------------------|-----------|-----------|---------|---|
| | 2014 | 2013 | Change | Change | |
| Total revenues | \$462,729 | \$383,762 | \$78,967 | 20.6 | % |
| Revenues by type: | | | | | |
| Capital equipment revenues | 143,488 | 135,303 | 8,185 | 6.0 | % |
| Consumable revenues | 113,357 | 100,006 | 13,351 | 13.4 | % |
| Service revenues | 205,884 | 148,453 | 57,431 | 38.7 | % |
| Revenues by geography: | | | | | |
| United States revenues | 365,482 | 297,650 | 67,832 | 22.8 | % |
| International revenues | 97,247 | 86,112 | 11,135 | 12.9 | % |
| | | | | | |
| (dollars in thousands) | Six Months Ended September 30, | | | Percent | |
| | 2014 | 2013 | Change | Change | |
| Total revenues | \$875,372 | \$751,414 | \$123,958 | 16.5 | % |
| Revenues by type: | | | | | |
| Capital equipment revenues | 263,883 | 259,197 | 4,686 | 1.8 | % |
| Consumable revenues | 223,402 | 199,040 | 24,362 | 12.2 | % |
| Service revenues | 388,087 | 293,177 | 94,910 | 32.4 | % |
| Revenues by geography: | | | | | |
| United States revenues | 682,833 | 586,003 | 96,830 | 16.5 | % |
| International revenues | 192,539 | 165,411 | 27,128 | 16.4 | % |
| Quarter over Quarter Comparison | | | | | |

Revenues increased \$79.0 million, or 20.6%, to \$462.7 million for the quarter ended September 30, 2014, as compared to \$383.8 million for the same quarter in the prior year. This increase is attributable to our recent acquisitions and growth within all three business segments. Capital equipment revenues increased 6.0% in the fiscal 2015 second quarter over the fiscal 2014 second quarter. This increase is primarily attributable to growth within the North America, Asia Pacific, and Europe, Middle East, and Africa ("EMEA") regions. Consumable revenues increased 13.4% for the quarter ended September 30, 2014, as compared to the prior year quarter, driven largely by growth within the North America, EMEA, Asia Pacific and Latin America regions. Service revenues increased 38.7% in the second quarter of fiscal 2015 primarily driven by the fiscal 2015 acquisition of IMS, and growth within the North America, EMEA, and Asia Pacific regions including an increase of 9.4% in the Isomedix business segment. United States revenues increased \$67.8 million, or 22.8%, to \$365.5 million for the quarter ended September 30, 2014, as compared to \$297.7 million for the same prior year quarter. This increase reflects growth in all three business segments, growth in capital equipment and consumable revenues, and growth in service revenue, attributable largely to the fiscal 2015 acquisition of IMS.

Table of Contents

International revenues increased \$11.1 million, or 12.9%, to \$97.2 million for the quarter ended September 30, 2014, as compared to \$86.1 million for the same prior year quarter. This increase reflects revenue growth within the EMEA and Asia Pacific regions, partially offset by a decline in the Latin America region.

First Half over First Half Comparison

Revenues increased \$124.0 million or 16.5% to \$875.4 million for the first half of fiscal 2015, as compared to \$751.4 million for the same prior year period. This increase is attributable to our recent acquisitions and growth within the Healthcare and Isomedix segments which was partially offset by a small decrease within the Life Sciences segment. Capital equipment revenues for the first half of fiscal 2015 increased \$4.7 million or 1.8% compared to the prior year period, reflecting growth within the Healthcare segment which was partially offset by a decline in the Life Sciences segment. Consumable revenues for the first half of fiscal 2015 increased 12.2% over the first half of fiscal 2014 driven by growth of 12.8% and 10.0% within the Healthcare and Life Sciences business segments, respectively. Service revenues during the first half of fiscal 2015 increased 32.4% over the first half of fiscal 2014 primarily driven by the fiscal 2015 acquisition of IMS, and growth of 7.7% in the Isomedix business segment.

United States revenues for the first half of fiscal 2015 were \$682.8 million, an increase of \$96.8 million or 16.5% over the the first half of fiscal 2014 revenues of \$586.0 million. These increases reflect growth in all three business segments, growth in consumable revenue, and growth in service revenue, attributable largely to the fiscal 2015 acquisition of IMS.

International revenues for the first half of fiscal 2015 were \$192.5 million, an increase of 16.4% over the first half of fiscal 2014 revenues of \$165.4 million. This increase reflects revenue growth in the EMEA and Asia Pacific regions, partially offset by declines in Canada and the Latin America region.

Revenues by segment are further discussed in the section of MD&A titled, "Business Segment Results of Operations."

Gross Profit. The following tables compare our gross profit for the three and six months ended September 30, 2014 to the three and six months ended September 30, 2013:

| (dollars in thousands) | Three Months Ended September 30, | | Change | Percent Change | |
|-------------------------------|----------------------------------|------------|-----------|----------------|---|
| | 2014 | 2013 | | | |
| Gross profit: | | | | | |
| Product | \$ 113,854 | \$ 101,680 | \$ 12,174 | 12.0 | % |
| Service | 80,138 | 52,826 | 27,312 | 51.7 | % |
| Total gross profit | \$ 193,992 | \$ 154,506 | \$ 39,486 | 25.6 | % |
| Gross profit percentage: | | | | | |
| Product | 44.3 | % 43.2 | % | | |
| Service | 38.9 | % 35.6 | % | | |
| Total gross profit percentage | 41.9 | % 40.3 | % | | |

| (dollars in thousands) | Six Months Ended September 30, | | Change | Percent Change | |
|-------------------------------|--------------------------------|------------|-----------|----------------|---|
| | 2014 | 2013 | | | |
| Gross profit: | | | | | |
| Product | \$ 214,319 | \$ 195,070 | \$ 19,249 | 9.9 | % |
| Service | 149,766 | 106,282 | 43,484 | 40.9 | % |
| Total gross profit | \$ 364,085 | \$ 301,352 | \$ 62,733 | 20.8 | % |
| Gross profit percentage: | | | | | |
| Product | 44.0 | % 42.6 | % | | |
| Service | 38.6 | % 36.3 | % | | |
| Total gross profit percentage | 41.6 | % 40.1 | % | | |

Our gross profit percentage is affected by the volume, pricing, and mix of sales of our products and services, as well as the costs associated with the products and services that are sold. Gross profit percentage for the second quarter of fiscal 2015 amounted to 41.9% as compared to the second quarter of fiscal 2014 gross profit percentage of 40.3%. The gross profit

Table of Contents

percentage increased 160 basis points in the second quarter of fiscal 2015 over fiscal 2014. Although our recent acquisitions added value in terms of dollars, they negatively impacted our gross margin percentage by approximately 10 basis points. Rising material costs and inflation also negatively impacted our gross margin percentage by approximately 10 and 30 basis points, respectively. Our gross profit percentage was impacted by the positive impact of foreign currency (20 basis points) and favorable product mix and other (190 basis points).

Gross profit percentage for the first half of fiscal 2015 was 41.6% compared to the gross profit percentage in the first half of fiscal 2014 of 40.1%. The gross profit percentage increased 150 basis points in the first half of fiscal 2015 over fiscal 2014. Although our recent acquisitions added value in terms of dollars, they negatively impacted our gross margin percentage by approximately 40 basis points. Rising material costs and inflation also negatively impacted our gross margin percentage by approximately 10 basis points each. Our gross profit percentage was impacted by the positive impact of foreign currency (20 basis points) and favorable product mix and other (190 basis points).

Operating Expenses. The following tables compare our operating expenses for the three and six months ended September 30, 2014 to the three and six months ended September 30, 2013:

| (dollars in thousands) | Three Months Ended September 30, | | Change | Percent Change | |
|--------------------------------------|----------------------------------|-----------|----------|----------------|----|
| | 2014 | 2013 | | | |
| Operating expenses: | | | | | |
| Selling, general, and administrative | \$126,292 | \$90,661 | \$35,631 | 39.3 | % |
| Research and development | 13,006 | 13,527 | (521) | (3.9) |)% |
| Restructuring expenses | 1,271 | 18 | 1,253 | NM | |
| Total operating expenses | \$140,569 | \$104,206 | \$36,363 | 34.9 | % |
| NM - Not meaningful. | | | | | |

| (dollars in thousands) | Six Months Ended September 30, | | Change | Percent Change | |
|--------------------------------------|--------------------------------|-----------|----------|----------------|---|
| | 2014 | 2013 | | | |
| Operating expenses: | | | | | |
| Selling, general, and administrative | \$239,980 | \$184,590 | \$55,390 | 30.0 | % |
| Research and development | 25,415 | 25,380 | 35 | 0.1 | % |
| Restructuring expenses | 1,099 | 70 | 1,029 | NM | |
| Total operating expenses | \$266,494 | \$210,040 | \$56,454 | 26.9 | % |

Significant components of total selling, general, and administrative expenses ("SG&A") are compensation and benefit costs, fees for professional services, travel and entertainment, facilities costs, and other general and administrative expenses. SG&A increased 39.3% in the second quarter of fiscal 2015 over the second quarter of fiscal 2014, and increased 30.0% in the first half of fiscal 2015 over the first half of fiscal 2014. These increases are primarily attributable to the addition of operating expenses incurred within our recently acquired businesses. Also, during the second quarter of fiscal 2015, we adopted a new branding strategy as part of the integration of IMS into the Specialty Services business for surgical instrument and endoscope repair services. The Spectrum Surgical Instruments Corp. ("Spectrum") trade-name will be used solely for Specialty Services product revenues going forward. We have estimated the fair value of the Spectrum trade-name using the relief from royalty method and concluded that the carrying value of the trade-name exceeded its fair value. As a result, an impairment charge of approximately \$5.6 million was recorded to reduce the carrying value of the intangible asset.

For the three month period ended September 30, 2014, research and development expenses decreased 3.9% over the same prior year period. For the first half of fiscal 2015, research and development expenses were \$25.4 million, representing an increase of 0.1% compared to the same fiscal 2014 period. Research and development expenses are influenced by the number and timing of in-process projects and labor hours and other costs associated with these projects. Our research and development initiatives continue to emphasize new product development, product improvements, and the development of new technological platform innovations. During fiscal 2015, our investments in research and development continued to be focused on, but were not limited to, enhancing capabilities of sterile

processing combination technologies, surgical products and accessories, and devices and support accessories used in gastrointestinal endoscopy procedures.

Fiscal 2014 Restructuring Plan. During the fourth quarter of fiscal 2014, we adopted and announced a targeted restructuring plan primarily focused on the closure of our Hopkins manufacturing facility located in Mentor, Ohio (the "Fiscal 2014 Restructuring Plan"). As a result of this plan, we will transfer operations located at Hopkins to other North American locations.

Table of Contents

We believe that by closing the operations at Hopkins we will more effectively utilize our existing North American manufacturing network while reducing operating costs.

Since the inception of the Restructuring Plan we have incurred pre-tax expenses totaling \$20,880 related to these actions, of which \$13,186 was recorded as restructuring expenses and \$7,694 was recorded in cost of revenues, with restructuring expenses of \$18,808, \$745, and \$1,327 related to the Healthcare, Life Sciences and Isomedix segments, respectively. We do not expect to incur any significant additional 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 and first half of fiscal 2015:

| (dollars in thousands) | Fiscal 2014 Restructuring Plan | |
|--|---|---|
| | Three months ended September 30, (1) | Six months ended September 30, (2) |
| Severance and other compensation related costs | \$1,176 | \$980 |
| Asset impairment and accelerated depreciation | — | (38) |
| Lease termination obligation and other | 95 | 157 |
| Product rationalization | (336) | (450) |
| Total restructuring expenses | \$935 | \$649 |

(1) Includes \$(336) in expense recorded to cost to revenues on Consolidated Statements of Income.

(2) Includes \$(450) in expense recorded to cost to revenues on Consolidated Statements of Income.

Pre-tax restructuring expenses of \$18 and \$70 incurred during the second quarter and first half of fiscal 2014, respectively, related to previously announced restructuring plans.

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 restructuring liability balances and activity:

| (dollars in thousands) | Fiscal 2014 Restructuring Plan | | | September 30, 2014 |
|---|--------------------------------|---------------|--------------|-----------------------|
| | March 31, 2014 | Provision (1) | Payments (1) | |
| Severance and termination benefits | \$6,389 | \$980 | \$(2,509) | \$4,860 |
| Lease termination obligations and other | 1,589 | 18 | (1,101) | 506 |
| Total | \$7,978 | \$998 | \$(3,610) | \$5,366 |

(1) Certain amounts reported include the impact of foreign currency movements relative to the U.S. dollar.

Non-Operating Expenses, Net. Non-operating expenses, net consists of interest expense on debt, offset by interest earned on cash, cash equivalents, short-term investment balances, and other miscellaneous expense. The following table compares our non-operating expenses, net for the three and six month periods ended September 30, 2014 and September 30, 2013:

| (dollars in thousands) | Three Months Ended September 30, | | Change |
|---|----------------------------------|---------|--------|
| | 2014 | 2013 | |
| Non-operating expenses, net: | | | |
| Interest expense | \$4,948 | \$4,869 | \$79 |
| Interest income and miscellaneous expense | (36) | (227) | 191 |
| Non-operating expenses, net | \$4,912 | \$4,642 | \$270 |

Table of Contents

| (dollars in thousands) | Six Months Ended September 30, | | Change |
|---|--------------------------------|---------|----------|
| | 2014 | 2013 | |
| Non-operating expenses, net: | | | |
| Interest expense | \$9,630 | \$9,856 | \$(226) |
| Interest income and miscellaneous expense | (256) | (475) |) 219 |
| Non-operating expenses, net | \$9,374 | \$9,381 | \$(7) |

Interest expense for the three month period ended September 30, 2014, essentially remained flat over the prior year period. Interest expense for the six month period ended September 30, 2014, decreased due to favorable interest rates on outstanding borrowings. Interest income and miscellaneous expense is immaterial.

Income Tax Expense. The following table compares our income tax expense and effective income tax rates for the three and six months ended September 30, 2014 to the three and six months ended September 30, 2013:

| (dollars in thousands) | Three Months Ended September 30, | | Change | Percent Change |
|---------------------------|----------------------------------|----------|---------|----------------|
| | 2014 | 2013 | | |
| Income tax expense | \$17,507 | \$15,915 | \$1,592 | 10.0% |
| Effective income tax rate | 36.1 | % 34.9 | % | |

| (dollars in thousands) | Six Months Ended September 30, | | Change | Percent Change |
|---------------------------|--------------------------------|----------|----------|----------------|
| | 2014 | 2013 | | |
| Income tax expense | \$32,676 | \$19,871 | \$12,805 | 64.4% |
| Effective income tax rate | 37.0 | % 24.3 | % | |

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 continuing operations for the three and six months ended September 30, 2014 were 36.1% and 37.0% compared with 34.9% and 24.3% for the same prior year periods. During the first half of fiscal 2015, we were unfavorably impacted by pretax losses in jurisdictions for which no tax benefit is recognized. Conversely, during the first half of fiscal 2014, we benefited from the recognition of previously unrecognized tax benefits due to the settlement of a federal tax examination.

We record income tax expense during interim periods based on our estimate of the annual effective income tax rate, adjusted each quarter for discrete items. We analyze various factors to determine the estimated annual effective income tax rate, 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 carryforwards, and available tax planning alternatives.

Business Segment Results of Operations. We operate in three reportable business segments: Healthcare, Life Sciences, and Isomedix. Corporate and other, which is presented separately, contains the Defense and Industrial business unit plus costs that are associated with being a publicly traded company and certain other corporate costs. These costs include executive office costs, Board of Directors compensation, shareholder services and investor relations, external audit fees, and legacy pension and post-retirement benefit costs. Our Annual Report on Form 10-K for the year ended March 31, 2014, dated May 29, 2014, provides additional information regarding each business segment. The following table compares business segment revenues for the three and six months ended September 30, 2014 and September 30, 2013:

Table of Contents

| (dollars in thousands) | Three Months Ended September 30, | | Change | Percent Change | |
|---------------------------|----------------------------------|-----------|-----------|----------------|----|
| | 2014 | 2013 | | | |
| Revenues: | | | | | |
| Healthcare | \$351,169 | \$277,332 | \$73,837 | 26.6 | % |
| Life Sciences | 59,148 | 58,382 | 766 | 1.3 | % |
| Isomedix | 51,850 | 47,411 | 4,439 | 9.4 | % |
| Total reportable segments | 462,167 | 383,125 | 79,042 | 20.6 | % |
| Corporate and other | 562 | 637 | (75) | (11.8) |)% |
| Total Revenues | \$462,729 | \$383,762 | \$78,967 | 20.6 | % |
| | | | | | |
| (dollars in thousands) | Six Months Ended September 30, | | Change | Percent Change | |
| | 2014 | 2013 | | | |
| Revenues: | | | | | |
| Healthcare | \$653,979 | \$536,220 | \$117,759 | 22.0 | % |
| Life Sciences | 117,762 | 118,297 | (535) | (0.5) |)% |
| Isomedix | 103,043 | 95,635 | 7,408 | 7.7 | % |
| Total reportable segments | 874,784 | 750,152 | 124,632 | 16.6 | % |
| Corporate and other | 588 | 1,262 | (674) | (53.4) |)% |
| Total Revenues | \$875,372 | \$751,414 | \$123,958 | 16.5 | % |

Healthcare revenues increased \$73.8 million, or 26.6%, to \$351.2 million for the quarter ended September 30, 2014, as compared to \$277.3 million for the same prior year quarter. Healthcare revenues for the first half of fiscal 2015 increased \$117.8 million, or 22.0% to \$654.0 million, as compared to \$536.2 million for the first half of fiscal 2014. These increases are primarily attributable to the fiscal 2015 acquisition of IMS, and growth in capital equipment, consumable and service revenues. At September 30, 2014, the Healthcare segment's backlog amounted to \$117.2 million, decreasing \$16.2 million, or 12.1%, compared to the backlog of \$133.4 million at September 30, 2013. This decrease is partially the result of our success in reducing our manufacturing lead times allowing us to fulfill orders on a timelier basis. Healthcare backlog at September 30, 2014 increased \$6.9 million, or 6.2%, compared to the backlog of \$110.3 million at March 31, 2014.

Life Sciences revenues increased \$0.8 million, or 1.3%, to \$59.1 million for the quarter ended September 30, 2014, as compared to \$58.4 million for the same prior year quarter. This increase is attributable to growth in consumable revenues of 13.6% and service revenues of 4.1%, over the same fiscal 2014 period. Life Science revenues for the first half of fiscal 2015 decreased \$0.5 million or 0.5% to \$117.8 million as compared to \$118.3 million for the first half of fiscal 2014. Year over year growth of 10.0%, and 6.2% of consumable and service revenues, respectively, were not large enough to offset a 16.6% decline in capital equipment revenues. At September 30, 2014, Life Sciences backlog amounted to \$46.1 million, decreasing \$1.7 million, or 3.6%, compared to the backlog of \$47.8 million at September 30, 2013. Life Sciences backlog at September 30, 2014 increased by \$1.7 million, or 3.8%, compared to the backlog of \$44.4 million at March 31, 2014.

Isomedix segment revenues increased \$4.4 million, or 9.4%, to \$51.9 million for the quarter ended September 30, 2014, as compared to \$47.4 million for the same prior year quarter. Isomedix segment revenues for the first half of fiscal 2015 increased \$7.4 million, or 7.7%, to \$103.0 million as compared to \$95.6 million for the first half of fiscal 2014. Revenues were favorably impacted by increased demand from our core medical device Customers.

The following tables compare our business segment operating results for the three and six months ended September 30, 2014 to the three and six months ended September 30, 2013:

| (dollars in thousands) | Three Months Ended September 30, | | Change | Percent Change | |
|------------------------|----------------------------------|----------|---------|----------------|----|
| | 2014 | 2013 | | | |
| Operating income: | | | | | |
| Healthcare | \$29,943 | \$25,926 | \$4,017 | 15.5 | % |
| Life Sciences | 13,048 | 14,041 | (993) | (7.1) |)% |

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| | | | | | |
|---------------------------|----------|----------|---------|---------|----|
| Isomedix | 14,399 | 13,712 | 687 | 5.0 | % |
| Total reportable segments | 57,390 | 53,679 | 3,711 | 6.9 | % |
| Corporate and other | (3,967 |) (3,379 |) (588 |) (17.4 |)% |
| Total operating income | \$53,423 | \$50,300 | \$3,123 | 6.2 | % |

30

Table of Contents

| (dollars in thousands) | Six Months Ended | | Change | Percent Change | |
|---------------------------|--------------------|----------|---------|----------------|----|
| | September 30, 2014 | 2013 | | | |
| Operating Income: | | | | | |
| Healthcare | \$47,909 | \$40,873 | \$7,036 | 17.2 | % |
| Life Sciences | 24,993 | 26,580 | (1,587) | (6.0) |)% |
| Isomedix | 30,590 | 28,430 | 2,160 | 7.6 | % |
| Total reportable segments | 103,492 | 95,883 | 7,609 | 7.9 | % |
| Corporate and other | (5,901) | (4,571) | (1,330) | (29.1) |)% |
| Total Operating Income | \$97,591 | \$91,312 | \$6,279 | 6.9 | % |

Segment operating income is calculated as the segment's gross profit less direct expenses and indirect cost allocations, which results in the full allocation of all distribution and research and development expenses, and the partial allocation of corporate costs. Corporate cost allocations are based on each segment's percentage of revenues, headcount, or other variables in relation to those of the total company. In addition, the Healthcare segment is responsible for the management of all but one manufacturing facility and uses standard cost to sell products to the Life Sciences segment. Corporate and other includes the revenues, gross profit and direct expenses of the Defense and Industrial business unit, as well as certain unallocated corporate costs related to being a publicly traded company and legacy pension and post-retirement benefits, as previously discussed.

The Healthcare segment's operating income increased \$4.0 million to \$29.9 million for the second quarter of fiscal 2015 as compared to \$25.9 million in the same prior year period. The Healthcare segment's operating income for the first half of fiscal 2015 increased \$7.0 million to \$47.9 million as compared to \$40.9 million for the first half of fiscal 2014. The increases in operating income in the fiscal 2015 second quarter and first half over the same fiscal 2014 periods was primarily driven by our recent acquisitions, increased volume, favorable foreign currency, and favorable product mix, which was somewhat offset by the Spectrum trade name impairment and rising material costs.

The Life Sciences business segment's operating income decreased \$1.0 million or 7.1% to \$13.0 million for the second quarter of fiscal 2015 as compared to \$14.0 million for the same prior year period. The Life Sciences business segment's operating income for the first half of fiscal 2015 decreased by \$1.6 million or 6.0% to \$25.0 million as compared to \$26.6 million in the first half of fiscal 2014. The segment's operating margin was 22.1% for the second quarter of fiscal 2015 compared to 24.1% for the second quarter of fiscal 2014. The segment's operating margin was 21.2% for the first half of fiscal 2015 compared to 22.5% for the first half of fiscal 2014. The decreases in operating margins in both the second quarter and the first half of fiscal 2015 were primarily attributable to increased corporate expenses relating to incentive compensation that were allocated to the segment in the fiscal 2015 periods over the same prior year periods.

The Isomedix segment's operating income increased \$0.7 million or 5.0% to \$14.4 million for the second quarter of fiscal 2015 as compared to \$13.7 million for the same prior year period. The Isomedix segment's operating income for the first half of fiscal 2015 increased \$2.2 million or 7.6% to \$30.6 million as compared to \$28.4 million in the first half of fiscal 2014. The Isomedix operating margin was 27.8% for the second quarter of fiscal 2015 compared to 28.9% in the same prior year period; while the operating margin was 29.7% in the first half of fiscal 2015 compared to 29.7% in the first half of fiscal 2014. The segment's operating margin improvement in the fiscal 2015 periods reflects the benefit of increased volumes, which was partially offset by higher quality and regulatory expenses and additional corporate expenses relating to incentive compensation that were allocated to the segment in the fiscal 2015 periods over the same prior year periods.

Liquidity and Capital Resources

The following table summarizes significant components of our cash flows for the six months ended September 30, 2014 and 2013:

Table of Contents

| (dollars in thousands) | Six Months Ended September 30, | |
|---|--------------------------------|------------|
| | 2014 | 2013 |
| Operating activities: | | |
| Net income | \$55,541 | \$62,060 |
| Non-cash items | 49,078 | 45,163 |
| Changes in operating assets and liabilities | 289 | (27,178) |
| Net cash provided by operating activities | \$104,908 | \$80,045 |
| Investing activities: | | |
| Purchases of property, plant, equipment, and intangibles, net | \$(36,527) | \$(47,110) |
| Proceeds from the sale of property, plant, equipment, and intangibles | 796 | 8 |
| Investments in businesses, net of cash acquired | (179,380) | (115) |
| Net cash used in investing activities | \$(215,111) | \$(47,217) |
| Financing activities: | | |
| Payments on long-term obligations | \$— | \$(30,000) |
| Deferred financing fees and debt issuance costs | — | (43) |
| Proceeds under credit facilities, net | 126,470 | 46,230 |
| Repurchases of common shares | (5,440) | (18,653) |
| Cash dividends paid to common shareholders | (26,118) | (23,644) |
| Stock option and other equity transactions, net | 8,686 | 9,159 |
| Tax benefit from share-based compensation | 4,505 | 1,462 |
| Net cash provided by (used in) in financing activities | \$108,103 | \$(15,489) |
| Debt-to-total capital ratio | 36.8 | % 34.0 |
| Free cash flow | \$69,177 | \$32,943 |

Net Cash Provided By Operating Activities – The net cash provided by our operating activities was \$104.9 million for the first six months of fiscal 2015 as compared with \$80.0 million for the first six months of fiscal 2014. The increase in net cash provided by operating activities in fiscal 2015 is primarily due to working capital improvements.

Net Cash Used In Investing Activities – The net cash we used in investing activities totaled \$215.1 million for the first six months of fiscal 2015 compared with \$47.2 million for the first six months of fiscal 2014. The following discussion summarizes the significant changes in our investing cash flows for the first six months of fiscal 2015 and fiscal 2014:

Purchases of property, plant, equipment, and intangibles, net – Capital expenditures were \$36.5 million for the first six months of fiscal 2015 as compared to \$47.1 million during the same prior year period.

Investments in businesses, net of cash acquired – During the first half of fiscal 2015, we used \$173.6 million of cash for the acquisition of IMS and related realty. For more information on this acquisition refer to note 18 to our consolidated financial statements titled, "Business Acquisitions". During the first quarter of fiscal 2015, we also paid a working capital settlement of \$0.8 million and deferred consideration of \$5.0 million for the fiscal 2014 acquisition of Eschmann Holdings Ltd. For more information on this acquisition refer to our Annual Report on Form 10-K for the year ended March 31, 2014, dated May 29, 2014.

Net Cash Provided By (Used In) Financing Activities – The net cash provided by financing activities amounted to \$108.1 million for the first six months of fiscal 2015 compared with net cash used in financing activities of \$15.5 million for the first six months of fiscal 2014. The following discussion summarizes the significant changes in our financing cash flows for the first six months of fiscal 2015 and fiscal 2014:

Payments on long term obligations- During the second quarter of fiscal 2014 we repaid \$30.0 million for the senior notes issued in August 2008, which matured in August 2013.

Proceeds under credit facilities, net - At September 30, 2014, we had \$280.0 million of debt outstanding under our credit facilities, reflecting net borrowings of \$126.5 million. At September 30, 2013, we had \$128.5 million of debt outstanding under our revolving credit facility, reflecting net borrowings of \$46.2 million.

Repurchases of common shares – During the first six months of fiscal 2015, we obtained 137,183 of our common shares in connection with stock based compensation awards for an aggregate amount of \$5.4 million. During the same period in fiscal 2014, we paid for the repurchase of 411,795 of our common shares. We also obtained 32,008 of our common shares in connection with stock based compensation award programs for an aggregate amount of \$18.7 million.

Table of Contents

Cash dividends paid to common shareholders – During the first six months of fiscal 2015, we paid total cash dividends of \$26.1 million, or \$0.44 per outstanding common share. During the first six months of fiscal 2014, we paid total cash dividends of \$23.6 million, or \$0.40 per outstanding common share.

Stock option and other equity transactions, net – We receive cash for issuing common shares under our various employee stock option programs. During the first six months of fiscal 2015 and fiscal 2014, we received cash proceeds totaling \$8.7 million and \$9.2 million, respectively, under these programs.

Tax benefit from share-based compensation – During the first six months of fiscal 2015, we received a total tax benefit from share based compensation of \$4.5 million. During the first six months of fiscal 2014, we received a total tax benefit from share based compensation of \$1.5 million. The increase in the first six months of fiscal 2015 over the same prior year period was primarily due to an increase in both the quantity and value of restricted shares vesting and stock options exercised.

Cash Flow Measures. Free cash flow was \$69.2 million in the first six months of fiscal 2015 compared to \$32.9 million in the prior year first six months (see the subsection above titled "Non-GAAP Financial Measures", for additional information and related reconciliation of cash flows from operations to free cash flow). The increase in free cash flow is primarily due to working capital improvements and lower capital spending in fiscal 2015 over fiscal 2014. Our debt-to-total capital ratio was 36.8% at September 30, 2014 and 34.0% at September 30, 2013.

Sources of Credit and Contractual and Commercial Commitments. Information related to our sources of credit and contractual and commercial commitments is included in our Annual Report on Form 10-K for the year ended March 31, 2014, dated May 29, 2014. Our commercial commitments were approximately \$46.5 million at September 30, 2014, reflecting a net decrease of \$3.1 million in surety bonds and other commercial commitments from March 31, 2014. Our outstanding borrowing under our credit facilities was \$280.0 million as of September 30, 2014. There were no letters of credit outstanding under the credit facilities at September 30, 2014.

Cash Requirements. We intend to use our existing cash and cash equivalent balances and cash generated from operations for short-term and long-term capital expenditures and our other liquidity needs. In addition, in light of cash needs relating to our proposed recently announced Synergy acquisition (see note 19 to our consolidated financial statements titled, "Subsequent Events") and other cash requirements, it will be necessary to replace our existing bank credit facilities with expanded credit facilities, including increased bank and/or additional private placement debt. Our capital requirements depend on many uncertain factors, including our rate of sales growth, our Customers' acceptance of our products and services, the costs of obtaining adequate manufacturing capacities, the timing and extent of our research and development projects, changes in our operating expenses and other factors. To the extent that existing and anticipated sources of cash are not sufficient to fund our future activities, we may need to raise additional funds through additional borrowings or the sale of equity securities. We have a short-term Bridge Facility available to us should the referenced acquisition close without or with insufficient permanent financing in place. But regardless of whether the acquisition closes, we may need to obtain expanded permanent credit availability, and there can be no assurance that we will be able to obtain all the additional funds needed on terms favorable to us, or at all.

Critical Accounting Policies, Estimates, and Assumptions

Information related to our critical accounting policies, estimates, and assumptions is included in our Annual Report on Form 10-K for the year ended March 31, 2014, dated May 29, 2014. Our critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2014.

Contingencies

We are, and will likely continue to be, involved in a number of legal proceedings, government investigations, and claims, which we believe generally arise in the course of our business, given our size, history, complexity, and the nature of our business, products, Customers, regulatory environment, and industries in which we participate. These legal proceedings, investigations and claims generally involve a variety of legal theories and allegations, including,

without limitation, personal injury (e.g., slip and falls, burns, vehicle accidents), product liability or regulation (e.g., based on product operation or claimed malfunction, failure to warn, failure to meet specification, or failure to comply with regulatory requirements), product exposure (e.g., claimed exposure to chemicals, asbestos, contaminants, radiation), property damage (e.g., claimed damage due to leaking equipment, fire, vehicles, chemicals), commercial claims (e.g., breach of contract, economic loss, warranty, misrepresentation), financial (e.g., taxes, reporting), employment (e.g., wrongful termination, discrimination, benefits matters), and other claims for damage and relief.

Table of Contents

We record a liability for such contingencies to the extent we conclude that their occurrence is both probable and estimable. We consider many factors in making these assessments, including the professional judgment of experienced members of management and our legal counsel. We have made estimates as to the likelihood of unfavorable outcomes and the amounts of such potential losses. In our opinion, the ultimate outcome of these proceedings and claims is not anticipated to have a material adverse effect on our consolidated financial position, results of operations, or cash flows. However, the ultimate outcome of proceedings, government investigations, and claims is unpredictable and actual results could be materially different from our estimates. We record expected recoveries under applicable insurance contracts when we are assured of recovery. Refer to Part II, Item 1, "Legal Proceedings" for additional information.

We are subject to taxation from United States federal, state and local, and foreign jurisdictions. Tax positions are settled primarily through the completion of audits within each individual tax jurisdiction or the closing of a statute of limitation. Changes in applicable tax law or other events may also require us to revise past estimates. The IRS routinely conducts audits of our federal income tax returns. We are no longer subject to United States federal examinations for years before fiscal 2014 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 2010. We remain subject to tax authority audits in various other jurisdictions in which we operate. If we prevail in matters for which accruals have been recorded, or are required to pay amounts in excess of recorded accruals, our effective income tax rate in a given financial statement period could be materially impacted. Additional information regarding our commitments and contingencies is included in note 9 to our consolidated financial statements titled, "Commitments and Contingencies."

International Operations

Since we conduct operations outside of the United States using various foreign currencies, our operating results are impacted by foreign currency movements relative to the U.S. dollar. During the second quarter of fiscal 2015, our revenues were favorably impacted by \$0.7 million, or 0.2%, and income before taxes was unfavorably impacted by \$0.2 million, or 0.5%, as a result of foreign currency movements relative to the U.S. dollar. During the first half of fiscal 2015, our revenues were favorably impacted by \$1.8 million, or 0.2%, and income before taxes was favorably impacted by \$1.9 million, or 2.3%, as a result of foreign currency movements relative to the U.S. dollar.

Forward-Looking Statements

This Form 10-Q may contain statements concerning certain trends, expectations, forecasts, estimates, or other forward-looking information affecting or relating to Synergy Health plc ("Synergy") or STERIS or its industry, products or activities that are intended to qualify for the protections afforded "forward-looking statements" under the Private Securities Litigation Reform Act of 1995 and other laws and regulations. Forward-looking statements speak only as to the date of this report, and may be identified by the use of forward-looking terms such as "may," "will," "expects," "believes," "anticipates," "plans," "estimates," "projects," "targets," "forecasts," "outlook," "impact," "potential," "confidence," "improve," "optimistic," "deliver," "comfortable," "trend", and "seeks," or the negative of such terms or other variations on such terms or comparable terminology. Many important factors could cause actual results to differ materially from those in the forward-looking statements including, without limitation, disruption of production or supplies, changes in market conditions, political events, pending or future claims or litigation, competitive factors, technology advances, actions of regulatory agencies, and changes in laws, government regulations, labeling or product approvals or the application or interpretation thereof. Other risk factors are described herein and in STERIS and Synergy's other securities filings, including Item 1A of STERIS's Annual Report on Form 10-K for the year ended March 31, 2014 dated May 29, 2014 and in Synergy's annual report and accounts for the year ended 30 March 2014 (section headed "principal risks and uncertainties"). Many of these important factors are outside STERIS's or Synergy's control. No assurances can be provided as to any result or the timing of any outcome regarding matters described herein or otherwise with respect to any regulatory action, administrative proceedings, government

investigations, litigation, warning letters, consent decree, cost reductions, business strategies, earnings or revenue trends or future financial results. References to products and the consent decree are summaries only and should not be considered the specific terms of the decree or product clearance or literature. Unless legally required, STERIS and Synergy do not undertake to update or revise any forward-looking statements even if events make clear that any projected results, express or implied, will not be realized. Other potential risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements include, without limitation, (a) the potential for increased pressure on pricing or costs that leads to erosion of profit margins, (b) the possibility that market demand will not develop for new technologies, products or applications or services, or business initiatives will take longer, cost more or produce lower benefits than anticipated, (c) the possibility that application of or compliance with laws, court rulings, certifications, regulations, regulatory actions, including without limitation those relating to FDA warning notices or letters, government investigations, the outcome of any pending FDA requests, inspections or submissions, or other requirements or standards may delay, limit or prevent new product introductions, affect the production and marketing of existing products or services or otherwise affect Company performance, results, prospects or value, (d) the potential of

Table of Contents

international unrest, economic downturn or effects of currencies, tax assessments, adjustments or anticipated rates, raw material costs or availability, benefit or retirement plan costs, or other regulatory compliance costs, (e) the possibility of reduced demand, or reductions in the rate of growth in demand, for products and services, (f) the possibility that anticipated growth, cost savings, new product acceptance, performance or approvals, or other results may not be achieved, or that transition, labor, competition, timing, execution, regulatory, governmental, or other issues or risks associated with STERIS and Synergy's businesses, industry or initiatives including, without limitation, the consent decree or those matters described in STERIS's Form 10-K for the year ended March 31, 2014 and other securities filings, may adversely impact Company performance, results, prospects or value, (g) the possibility that anticipated financial results or benefits of recent acquisitions, or of STERIS's restructuring efforts will not be realized or will be other than anticipated, (h) the effects of the contractions in credit availability, as well as the ability of STERIS and Synergy's Customers and suppliers to adequately access the credit markets when needed, (i) the receipt of approval of both STERIS's shareholders and Synergy's shareholders for the proposed transaction with Synergy (the "Synergy transaction"), (j) the regulatory approvals required for the Synergy transaction not being obtained on the terms expected or on the anticipated schedule, (k) the parties' ability to meet expectations regarding the timing, completion and accounting and tax treatments of the Synergy transaction, (l) the possibility that the parties may be unable to achieve expected synergies and operating efficiencies in connection with the Synergy transaction within the expected time-frames or at all and to successfully integrate Synergy's operations into those of STERIS, (m) the integration of Synergy's operations into those of STERIS being more difficult, time-consuming or costly than expected, (n) operating costs, Customer loss and business disruption (including, without limitations, difficulties in maintaining relationships with employees, Customers, clients or suppliers) being greater than expected following the Synergy transaction, (o) the retention of certain key employees of Synergy being difficult, (p) changes in tax laws or interpretations that could increase the consolidated tax liabilities of Synergy and STERIS, including, if the transaction is consummated, changes in tax laws that would result in the new parent UK holding company being treated as a domestic corporation for United States federal tax purposes, and (q) those risks described in STERIS's Annual Report on Form 10-K for the year ended March 31, 2014, and other securities filings.

Disclosure Requirements Relating to the Acquisition of Synergy Health plc of the U.K. Takeover Code (the "Code")

Under Rule 8.3(a) of the Code, any person who is interested in 1% or more of any class of relevant securities of an offeree company or of any securities exchange offeror (being any offeror other than an offeror in respect of which it has been announced that its offer is, or is likely to be, solely in cash) must make an Opening Position Disclosure following the commencement of the offer period and, if later, following the announcement in which any securities exchange offeror is first identified. An Opening Position Disclosure must contain details of the person's interests and short positions in, and rights to subscribe for, any relevant securities of each of (i) the offeree company and (ii) any securities exchange offeror(s). An Opening Position Disclosure by a person to whom Rule 8.3(a) applies must be made by no later than 3.30 pm (London time) on the 10th business day following the commencement of the offer period and, if appropriate, by no later than 3.30 pm (London time) on the 10th business day following the announcement in which any securities exchange offeror is first identified. Relevant persons who deal in the relevant securities of the offeree company or of a securities exchange offeror prior to the deadline for making an Opening Position Disclosure must instead make a Dealing Disclosure.

Under Rule 8.3(b) of the Code, any person who is, or becomes, interested in 1% or more of any class of relevant securities of the offeree company or of any securities exchange offeror must make a Dealing Disclosure if the person deals in any relevant securities of the offeree company or of any securities exchange offeror. A Dealing Disclosure must contain details of the dealing concerned and of the person's interests and short positions in, and rights to subscribe for, any relevant securities of each of (i) the offeree company and (ii) any securities exchange offeror, save to the extent that these details have previously been disclosed under Rule 8. A Dealing Disclosure by a person to whom Rule 8.3(b) applies must be made by no later than 3.30 pm (London time) on the business day following the

date of the relevant dealing.

If two or more persons act together pursuant to an agreement or understanding, whether formal or informal, to acquire or control an interest in relevant securities of an offeree company or a securities exchange offeror, they will be deemed to be a single person for the purpose of Rule 8.3.

Opening Position Disclosures must also be made by the offeree company and by any offeror and Dealing Disclosures must also be made by the offeree company, by any offeror and by any persons acting in concert with any of them (see Rules 8.1, 8.2 and 8.4).

Details of the offeree and offeror companies in respect of whose relevant securities Opening Position Disclosures and Dealing Disclosures must be made can be found in the Disclosure Table on the Takeover Panel's website at www.thetakeoverpanel.org.uk, including details of the number of relevant securities in issue, when the offer period commenced and when any offeror was first identified. You should contact the Panel's Market Surveillance Unit on +44 (0)20 7638 0129 if

35

Table of Contents

you are in any doubt as to whether you are required to make an Opening Position Disclosure or a Dealing Disclosure.

Availability of Securities and Exchange Commission Filings

We make available free of charge on or through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports as soon as reasonably practicable after we file such material with, or furnish such material to, the Securities Exchange Commission ("SEC.") You may access these documents on the Investor Relations page of our website at <http://www.steris-ir.com>. The information on our website is not incorporated by reference into this report. You may also obtain copies of these documents by visiting the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549, or by accessing the SEC's website at <http://www.sec.gov>. You may obtain information on the Public Reference Room by calling the SEC at 1-800-SEC-0330.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the ordinary course of business, we are subject to interest rate, foreign currency, and commodity risks. Information related to these risks and our management of these exposures is included in Part II, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk," in our Annual Report on Form 10-K for the year ended March 31, 2014, dated May 29, 2014. Our exposures to market risks have not changed materially since March 31, 2014.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision of and with the participation of our management, including the Principal Executive Officer ("PEO") and Principal Financial Officer ("PFO"), we evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as of the end of the period covered by this Quarterly Report. Based on that evaluation, including the assessment and input of our management, the PEO and PFO concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934, that occurred during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are, and will likely continue to be, involved in a number of legal proceedings, government investigations, and claims, which we believe generally arise in the course of our business, given our size, history, complexity, and the nature of our business, products, Customers, regulatory environment, and industries in which we participate. These legal proceedings, investigations and claims generally involve a variety of legal theories and allegations, including, without limitation, personal injury (e.g., slip and falls, burns, vehicle accidents), product liability or regulation (e.g., based on product operation or claimed malfunction, failure to warn, failure to meet specification, or failure to comply with regulatory requirements), product exposure (e.g., claimed exposure to chemicals, asbestos, contaminants, radiation), property damage (e.g., claimed damage due to leaking equipment, fire, vehicles, chemicals), commercial claims (e.g., breach of contract, economic loss, warranty, misrepresentation), financial (e.g., taxes, reporting), employment (e.g., wrongful termination, discrimination, benefits matters), and other claims for damage and relief. We believe we have adequately reserved for our current litigation and claims that are probable and estimable, and further believe that the ultimate outcome of these pending lawsuits and claims will not have a material adverse effect on our consolidated financial position or results of operations taken as a whole. Due to their inherent uncertainty, however, there can be no assurance of the ultimate outcome or effect of current or future litigation, investigations, claims or other proceedings (including without limitation the FDA-related matters discussed below). For certain types of claims, we presently maintain insurance coverage for personal injury and property damage and other liability coverages in amounts and with deductibles that we believe are prudent, but there can be no assurance that these coverages will be applicable or adequate to cover adverse outcomes of claims or legal proceedings against us.

In April 2010, after ongoing discussions with the FDA regarding a 2008 warning letter relating to our SYSTEM 1® sterile processor and related sterilant, we reached agreement with the FDA on the terms of a consent decree (“Consent Decree”). The Consent Decree was approved the same month by the U.S. District Court for the Northern District of Ohio. In general, among other matters, the Consent Decree restricts further sales of SYSTEM 1 processors in the U.S., prohibits the sale of liquid chemical sterilization or disinfection products in the U.S. that do not have FDA clearance, describes various process and compliance matters, and defines penalties in the event of violation of the Consent Decree.

On May 31, 2012, our Albert Browne Limited subsidiary received a warning letter from the FDA regarding chemical indicators manufactured in the United Kingdom. These devices are intended for the monitoring of certain sterilization and other processes. The FDA warning letter states that the agency has concerns regarding operational business processes. We do not believe that the FDA’s concerns are related to product performance, or that they result from Customer complaints. We have reviewed our processes with the agency and finalized our remediation measures, and are awaiting FDA reinspection. We do not currently believe that the impact of this event will have a material adverse effect on our financial results.

On May 23, 2014, the Company received a warning letter from the FDA regarding an inspection that the FDA concluded on January 8, 2014 at our STERIS Isomedix Services facility located in Libertyville, Illinois. The facility primarily provides microbial reduction services for certain medical device Customers. Among other matters, the FDA warning letter asserts that certain processes and procedures observed during the inspection did not conform to current Good Manufacturing Practices for medical devices as required by Title 21 CFR Part 820 and, as a result, that certain devices processed at the subject facility are adulterated within the meaning of the Federal Food, Drug and Cosmetic Act. Since the inspection, the Company has provided detailed responses to the FDA regarding its corrective actions, and has continued to work diligently to remediate the FDA’s concerns. We do not believe that this inspection was a result of Customer complaints and there have been no reports of patient injury. We do not expect this situation to have a material adverse effect on our operations or financial condition.

Other civil, criminal, regulatory or other proceedings involving our products or services could possibly result in judgments, settlements or administrative or judicial decrees requiring us, among other actions, to pay damages or fines

or effect recalls, or be subject to other governmental, Customer or other third party claims or remedies, which could materially affect our business, performance, prospects, value, financial condition, and results of operations. For additional information regarding these matters, see the following portions of our Annual Report on Form 10-K for the fiscal year ended March 31, 2014: “Business - Information with respect to our Business in General - Government Regulation”, and the “Risk Factor” titled: “We may be adversely affected by product liability claims or other legal actions or regulatory or compliance matters, including the Consent Decree” and the “Risk Factor” titled “Compliance with the Consent Decree may be more costly and burdensome than anticipated. From time to time, STERIS is also involved in legal proceedings as a plaintiff involving contract, patent protection, and other claims asserted by us. Gains, if any, from these proceedings are recognized when they are realized.

Table of Contents

Additional information regarding our contingencies is included in Item 7 of Part II, titled "Management's Discussion and Analysis of Financial Conditions and Results of Operations, of our Annual Report on Form 10-K for the year ended March 31, 2014, dated May 29, 2014, and in this Form 10-Q in note 9 to our consolidated financial statements titled "Commitments and Contingencies."

ITEM 1A. RISK FACTORS

We believe there have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014, dated May 29, 2014, that would materially affect our business, results of operations, or financial condition.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the second quarter of fiscal 2015, we obtained 11,185 of our common shares in connection with stock based compensation award programs. We did not repurchase any of our shares during the second quarter of fiscal 2015. When we do make repurchases, they are made pursuant to a single repurchase program which was approved by our Board of Directors and announced on March 14, 2008, authorizing the repurchase of up to \$300.0 million of our common shares. As of September 30, 2014, \$86.9 million in common shares remained authorized for repurchase under this authorization. This common share repurchase authorization does not have a stated maturity date. The following table summarizes the common shares repurchase activity during the second quarter of fiscal 2015 under our common share repurchase program:

| | (a) Total Number of Shares Purchased | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans | (d) Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans at Period End |
|----------------|---|--|--|--|
| July 1-31 | — | \$ — | — | \$86,939 |
| August 1-31 | — | — | — | 86,939 |
| September 1-30 | — | — | — | 86,939 |
| Total | — | (1) \$ — | (1) — | \$86,939 |

Does not include 21 shares purchased during the quarter at an average price of \$54.48 per share by the STERIS (1) Corporation 401(k) Plan on behalf of certain executive officers of the Company who may be deemed to be affiliated purchasers.

Table of Contents

ITEM 6. EXHIBITS

Exhibits required by Item 601 of Regulation S-K

| Exhibit Number | Exhibit Description |
|----------------|--|
| 3.1 | 1992 Amended Articles of Incorporation of STERIS Corporation, as amended on May 14, 1996, November 6, 1996, and August 6, 1998 (filed as Exhibit 3.1 to Form 10-K filed for the fiscal year ended March 31, 2000 (Commission File No. 1-14643), and incorporated herein by reference). |
| 3.2 | Amended and Restated Regulations of STERIS Corporation, as amended on July 26, 2007 (filed as Exhibit 3.2 to Form 10-Q for the fiscal quarter ended June 30, 2007 (Commission File No. 1-14643), and incorporated herein by reference). |
| 4.1 | Specimen Form of Common Stock Certificate (filed as Exhibit 4.1 to Form 10-K filed for the fiscal year ended March 31, 2002 (Commission File No. 1-14643), and incorporated herein by reference). |
| 15.1 | Letter Re: Unaudited Interim Financial Information. |
| 31.1 | Certification of the Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant Section 906 of the Sarbanes-Oxley Act of 2002. |
| EX-101 | Instance Document. |
| EX-101 | Schema Document. |
| EX-101 | Calculation Linkbase Document. |
| EX-101 | Definition Linkbase Document. |
| EX-101 | Labels Linkbase Document. |
| EX-101 | Presentation Linkbase Document. |

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

STERIS Corporation

/S/ MICHAEL J. TOKICH

Michael J. Tokich

Senior Vice President, Chief Financial Officer and Treasurer

November 4, 2014

40

Table of Contents

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