

INVERNESS MEDICAL INNOVATIONS INC

Form 10-Q

August 07, 2009

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**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**

**For the quarterly period ended June 30, 2009**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**COMMISSION FILE NUMBER 001-16789**

**INVERNESS MEDICAL INNOVATIONS, INC.**

**(Exact Name Of Registrant As Specified In Its Charter)**

**DELAWARE**

(State or other jurisdiction of incorporation or organization)

**04-3565120**

(I.R.S. Employer Identification No.)

**51 SAWYER ROAD, SUITE 200**

**WALTHAM, MASSACHUSETTS 02453**

(Address of principal executive offices)

**(781) 647-3900**

(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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

**Yes  No**

The number of shares outstanding of the registrant's common stock, par value of \$0.001 per share, as of August 3, 2009 was 80,445,831.



**INVERNESS MEDICAL INNOVATIONS, INC.**  
**REPORT ON FORM 10-Q**  
**For the Quarterly Period Ended June 30, 2009**

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Readers can identify these statements by forward-looking words such as may, could, should, would, intend, will, expect, anticipate, believe, estimate, continue or similar words. There are a number of important factors that could cause actual results of Inverness Medical Innovations, Inc. and its subsidiaries to differ materially from those indicated by such forward-looking statements. These factors include, but are not limited to, the risk factors detailed in Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K, as amended, for the fiscal year ending December 31, 2008 and other risk factors identified herein or from time to time in our periodic filings with the Securities and Exchange Commission. Readers should carefully review these factors as well as the Special Statement Regarding Forward-Looking Statements beginning on page 50 in this Quarterly Report on Form 10-Q and should not place undue reliance on our forward-looking statements. These forward-looking statements are based on information, plans and estimates at the date of this report. We undertake no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.*

*Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to we, us and our refer to Inverness Medical Innovations, Inc. and its subsidiaries.*

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

(unaudited)

(in thousands, except per share amounts)

	<b>Three Months Ended June</b>		<b>Six Months Ended June</b>	
	<b>30,</b>	<b>30,</b>	<b>30,</b>	<b>30,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net product sales and services revenue	\$ 456,710	\$ 396,289	\$ 891,510	\$ 757,650
License and royalty revenue	3,680	4,838	12,740	15,710
<b>Net revenue</b>	460,390	401,127	904,250	773,360
Cost of net product sales and services revenue	219,500	193,267	427,710	381,027
Cost of license and royalty revenue	1,898	1,758	3,346	5,841
<b>Cost of net revenue</b>	221,398	195,025	431,056	386,868
<b>Gross profit</b>	238,992	206,102	473,194	386,492
Operating expenses:				
Research and development	26,038	29,808	53,091	60,733
Sales and marketing	103,249	96,654	202,693	176,690
General and administrative	83,267	76,138	162,819	130,789
Total operating expenses	212,554	202,600	418,603	368,212
<b>Operating income</b>	26,438	3,502	54,591	18,280
Interest expense, including amortization of deferred financing costs and original issue discounts	(23,640)	(29,511)	(41,511)	(55,162)
Other income (expense), net	2,700	(9,135)	(99)	(4,237)
<b>Income (loss) before provision (benefit) for income taxes</b>	5,498	(35,144)	12,981	(41,119)
Provision (benefit) for income taxes	1,985	(7,698)	5,674	(8,578)
Equity earnings (losses) of unconsolidated entities, net of tax	983	(2,902)	3,480	(1,981)
<b>Net income (loss)</b>	4,496	(30,348)	10,787	(34,522)
Preferred stock dividends	(5,693)	(3,107)	(11,213)	(3,107)
<b>Net loss available to common stockholders</b>	\$ (1,197)	\$ (33,455)	\$ (426)	\$ (37,629)
<b>Net loss per common share basic and diluted</b>	\$ (0.02)	\$ (0.43)	\$ (0.01)	\$ (0.49)
	78,775	77,647	78,695	77,446

**Weighted average common shares basic and diluted**

The accompanying notes are an integral part of these consolidated financial statements.

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**INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except par value)

	<b>June 30, 2009 (unaudited)</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 424,018	\$ 141,324
Restricted cash	142,895	2,748
Marketable securities	1,493	1,763
Accounts receivable, net of allowances of \$14,199 and \$12,835 at June 30, 2009 and December 31, 2008, respectively	287,868	280,608
Inventories, net	207,149	199,131
Deferred tax assets	92,167	104,311
Income tax receivable	5,353	6,406
Receivable from joint venture, net		12,018
Prepaid expenses and other current assets	59,161	74,234
<b>Total current assets</b>	<b>1,220,104</b>	<b>822,543</b>
Property, plant and equipment, net	307,575	284,483
Goodwill	3,125,826	3,046,083
Other intangible assets with indefinite lives	43,003	42,984
Core technology and patents, net	438,308	459,307
Other intangible assets, net	1,180,227	1,169,330
Deferred financing costs, net, and other non-current assets	67,080	46,884
Investments in unconsolidated entities	61,503	68,832
Marketable securities	698	591
Deferred tax assets	18,988	14,323
<b>Total assets</b>	<b>\$ 6,463,312</b>	<b>\$ 5,955,360</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current liabilities:</b>		
Current portion of long-term debt	\$ 18,076	\$ 19,058
Current portion of capital lease obligations	831	451
Accounts payable	121,098	112,704
Accrued expenses and other current liabilities	336,497	233,132
Payable to joint venture, net	3,404	
<b>Total current liabilities</b>	<b>479,906</b>	<b>365,345</b>
<b>Long-term liabilities:</b>		
Long-term debt, net of current portion	1,883,260	1,500,557
Capital lease obligations, net of current portion	1,201	468
Deferred tax liabilities	437,014	462,787
Deferred gain on joint venture	289,359	287,030

Other long-term liabilities	49,247	60,335
<b>Total long-term liabilities</b>	<b>2,660,081</b>	<b>2,311,177</b>
<b>Commitments and contingencies (Note 17)</b>		
<b>Stockholders equity:</b>		
Series B preferred stock, \$0.001 par value (liquidation preference, \$775,618 at June 30, 2009 and \$751,479 at December 31, 2008) Authorized: 2,300 shares Issued and outstanding: 1,939 shares at June 30, 2009 and 1,879 shares at December 31, 2008	682,801	671,501
Common stock, \$0.001 par value Authorized: 150,000 shares Issued and outstanding: 78,984 shares at June 30, 2009 and 78,431 shares at December 31, 2008	79	78
Additional paid-in capital	3,041,129	3,029,694
Accumulated deficit	(382,803)	(393,590)
Accumulated other comprehensive loss	(17,881)	(28,845)
<b>Total stockholders equity</b>	<b>3,323,325</b>	<b>3,278,838</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 6,463,312</b>	<b>\$ 5,955,360</b>

The accompanying notes are an integral part of these consolidated financial statements.



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**INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited)  
(in thousands)

	<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash Flows from Operating Activities:</b>		
Net income (loss)	\$ 10,787	\$ (34,522)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Interest expense related to amortization of deferred financing costs and original issue discounts	3,553	2,948
Non-cash stock-based compensation expense	12,485	12,751
Impairment of inventory	224	2,871
Impairment of long-lived assets	3,150	17,885
Loss on sale of fixed assets	366	165
Equity (earnings) loss of unconsolidated entities, net of tax	(3,480)	1,981
Interest in minority investments	323	114
Depreciation and amortization	145,629	121,687
Deferred and other non-cash income taxes	(9,181)	(18,896)
Other non-cash items	3,772	3,302
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable, net	4,197	(20,027)
Inventories, net	(4,128)	(19,525)
Prepaid expenses and other current assets	8,494	(18,234)
Accounts payable	7,699	22,751
Accrued expenses and other current liabilities	(5,142)	7,761
Other non-current liabilities	1,515	3,769
<b>Net cash provided by operating activities</b>	<b>180,263</b>	<b>86,781</b>
<b>Cash Flows from Investing Activities:</b>		
Purchases of property, plant and equipment	(50,237)	(29,018)
Proceeds from sale of property, plant and equipment	620	186
Cash paid for acquisitions and transactional costs, net of cash acquired	(99,798)	(592,484)
Net cash received from equity method investments	11,455	12,045
Increase in other assets	(3,677)	(6,855)
<b>Net cash used in investing activities</b>	<b>(141,637)</b>	<b>(616,126)</b>
<b>Cash Flows from Financing Activities:</b>		
(Increase) decrease in restricted cash	(140,147)	138,359
Issuance costs associated with preferred stock		(332)
Cash paid for financing costs	(10,840)	(777)
Proceeds from issuance of common stock, net of issuance costs	8,572	11,881
Net proceeds (repayments) on long-term debt	381,709	(7,320)
Net (repayments) proceeds from revolving lines-of-credit	(2,969)	139,848
Tax benefit on exercised stock options	2,055	294

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Principal payments on capital lease obligations	(294)	(592)
Other	(75)	
<b>Net cash provided by financing activities</b>	238,011	281,361
Foreign exchange effect on cash and cash equivalents	6,057	486
Net increase (decrease) in cash and cash equivalents	282,694	(247,498)
Cash and cash equivalents, beginning of period	141,324	414,732
<b>Cash and cash equivalents, end of period</b>	\$ 424,018	\$ 167,234
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Interest paid	\$ 35,647	\$ 52,656
Income Taxes paid	\$ 15,387	\$ 5,355
<b>Supplemental Disclosure of Non-cash Activities:</b>		
Note issued for purchase of intangible assets	\$ 1,700	\$
Equipment purchases under capital leases	\$ 1,356	\$ 373
Fair value of stock issued for acquisitions	\$	\$ 673,803
Fair value of stock options exchanged	\$	\$ 20,973

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

**(1) Basis of Presentation of Financial Information**

The accompanying consolidated financial statements of Inverness Medical Innovations, Inc. and its subsidiaries are unaudited. In the opinion of management, the unaudited consolidated financial statements contain all adjustments considered normal and recurring and necessary for their fair presentation. Interim results are not necessarily indicative of results to be expected for the year. These interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these consolidated financial statements do not include all of the information and footnotes necessary for a complete presentation of financial position, results of operations and cash flows. Our audited consolidated financial statements for the year ended December 31, 2008 included information and footnotes necessary for such presentation and were included in our Annual Report on Form 10-K, as amended, filed with the Securities and Exchange Commission on April 10, 2009. These unaudited consolidated financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended December 31, 2008.

Certain reclassifications of prior period amounts have been made to conform to current period presentation. These reclassifications had no effect on net income (loss) or stockholders' equity.

**(2) Cash and Cash Equivalents**

We consider all highly liquid cash investments with original maturities of three months or less at the date of acquisition to be cash equivalents. At June 30, 2009, our cash equivalents consisted of money market funds.

We do not consider restricted cash as part of our cash and cash equivalents balance. We have restricted cash of \$142.9 million and \$2.7 million as of June 30, 2009 and December 31, 2008, respectively. Of the \$142.9 million, \$139.7 million represented a cash escrow established in connection with our previously announced pending acquisition of Concateno, plc.

**(3) Inventories**

Inventories are stated at the lower of cost (first in, first out) or market and are comprised of the following (in thousands):

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
Raw materials	\$ 86,596	\$ 45,161
Work-in-process	60,122	41,651
Finished goods	60,431	112,319
	<b>\$ 207,149</b>	<b>\$ 199,131</b>

**(4) Stock-based Compensation**

In accordance with Statement of Financial Accounting Standards (SFAS) No. 123-R, we recorded stock-based compensation expense in our consolidated statements of operations of \$6.6 million (\$5.3 million, net of tax) and \$12.5 million (\$10.1 million, net of tax) and \$7.2 million (\$5.5 million, net of tax) and \$12.8 million (\$9.9 million, net of tax) for the three and six-month periods ending June 30, 2009 and 2008, respectively, as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Cost of sales	\$ 476	\$ 393	\$ 908	\$ 634
Research and development	1,305	1,086	2,321	2,319
Sales and marketing	979	1,194	1,879	2,008

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General and administrative	3,846	4,518	7,377	7,790
	\$ 6,606	\$ 7,191	\$ 12,485	\$ 12,751

We report excess tax benefits from the exercise of stock options as financing cash flows. For the three and six months ended June 30, 2009, there was \$2.1 million of excess tax benefits generated from option exercises. For the three and six months ended June 30, 2008, there was \$0.3 million of excess tax benefits generated from option exercises.

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**INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(unaudited)

Our stock option plans provide for grants of options to employees to purchase common stock at the fair market value of such shares on the grant date of the award. The options generally vest over a four-year period, beginning on the date of grant, with a graded vesting schedule of 25% at the end of each of the four years. We use a Black-Scholes option pricing model to calculate the grant-date fair value of options. The fair value of the stock options granted during the three and six months ended June 30, 2009 and 2008 was calculated using the following weighted-average assumptions:

	<b>Three Months Ended</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>June 30, 2008</b>	<b>2009</b>	<b>2008</b>
<b>Stock Options:</b>				
Risk-free interest rate	2.07%	3.13%	1.92% - 2.07%	2.80% - 3.13%
Expected dividend yield				
Expected term	5.20 years	5.19 years	5.20 years	5.19 years
Expected volatility	44.53%	38.96%	43.97% - 44.53%	37.00% - 38.96%

	<b>Three Months Ended June</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>30, 2008</b>	<b>2009</b>	<b>2008</b>
<b>Employee Stock Purchase Plan:</b>				
Risk-free interest rate	0.28%	3.32%	0.28%	3.32%
Expected dividend yield				
Expected term	181 days	182 days	181 days	182 days
Expected volatility	72.05%	43.31%	72.05%	43.31%

A summary of the stock option activity for the six months ended June 30, 2009 is as follows (in thousands, except price per share and contractual term):

	<b>Options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic value</b>
Options outstanding, January 1, 2009	10,155	\$ 32.65		
Granted	740	\$ 35.25		
Exercised	(399)	\$ 14.48		
Canceled/expired /forfeited	(301)	\$ 36.72		
Options outstanding, June 30, 2009	10,195	\$ 33.54	6.53 years	\$ 72,334
Options exercisable, June 30, 2009	5,900	\$ 28.51	4.95 years	\$ 59,864

The weighted average grant-date fair value under a Black-Scholes option pricing model of options granted during the six months ended June 30, 2009 and 2008 was \$14.27 per share and \$12.38 per share, respectively. The total intrinsic value of options exercised during the three and six months ended June 30, 2009 was \$4.5 million and \$5.3 million, respectively.

As of June 30, 2009, there was \$59.6 million of total unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a remaining weighted-average vesting period of 1.63 years.

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**INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(unaudited)

**(5) Net Loss Per Common Share**

The following table sets forth the computation of basic and diluted net loss per common share (in thousands, except per share amounts):

	<b>Three Months June</b>		<b>Six Months Ended June</b>	
	<b>2009</b>	<b>30, 2008</b>	<b>2009</b>	<b>30, 2008</b>
<b>Net income (loss) per common share - basic and diluted:</b>				
<b>Numerator:</b>				
Net income (loss)	\$ 4,496	\$ (30,348)	\$ 10,787	\$ (34,522)
Less: Preferred stock dividends	5,693	3,107	11,213	3,107
Net loss available to common stockholders	\$ (1,197)	\$ (33,455)	\$ (426)	\$ (37,629)
<b>Denominator:</b>				
Weighted average common shares outstanding	78,775	77,647	78,695	77,446
Net loss per common share basic and diluted	\$ (0.02)	\$ (0.43)	\$ (0.01)	\$ (0.49)

We had the following potential dilutive securities outstanding on June 30, 2009: options and warrants to purchase an aggregate of 10.7 million shares of common stock at a weighted average exercise price of \$33.00 per share; \$150.0 million of 3% senior subordinated convertible notes, convertible at \$43.98 per share; \$1.7 million of subordinated convertible promissory notes, conver