IDEXX LABORATORIES INC /DE
Form 10-Q
August 01, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

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: 000-19271

IDEXX LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	01-0393723
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

ONE IDEXX DRIVE, WESTBROOK, MAINE 04092

(Address of principal executive offices) (ZIP Code)

207-556-0300
(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, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Emerging growth company
Smaller reporting company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares outstanding of the registrant's Common Stock, $0.10 par value per share, was 87,275,817 on July 25, 2017.

GLOSSARY OF TERMS AND SELECTED ABBREVIATIONS

In order to aid the reader, we have included certain terms and abbreviations used throughout this Quarterly Report on Form 10-Q below:

Term/ Abbreviation	Definition
AOCI	Accumulated other comprehensive income or loss
ASU 2016-09	Accounting Standards Update ("ASU") ASU 2016-09, "Compensation – Stock Compensation (Topic 781): Improvements to Employee Share-Based Payment Accounting"
CAG	Companion Animal Group, a reporting segment that provides to veterinarians diagnostic capabilities and information management solutions that enhance the health and well-being of pets
Credit Facility	Our $850 million five-year unsecured revolving credit facility under an amended and restated credit agreement that was executed in December 2015
EPS	Earnings per share. If not specifically stated, EPS refers to earnings per share on a diluted basis
EU	European Union
FASB	Financial Accounting Standards Board
LPD	Livestock, Poultry and Dairy, a reporting segment that provides diagnostic products and services for livestock and poultry health and to ensure the quality and safety of milk and improve bovine efficiency
OCI	Other comprehensive income or loss
OPTI Medical	OPTI Medical Systems, Inc., a wholly-owned subsidiary of IDEXX Laboratories Inc., supplies dry slide electrolyte consumables and instruments for the human point-of-care medical diagnostics market, also referred to as OPTI
R&D	Research and Development
SEC	U.S. Securities and Exchange Commission
Senior Notes Agreement	Private placement senior notes having an aggregate principal amount of approximately $600 million, referred to as senior notes
U.S. GAAP	Accounting principles generally accepted in the United States of America
Water	Water, a reporting segment that provides water quality products around the world

IDEXX LABORATORIES, INC.

Quarterly Report on Form 10-Q

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PART I— FINANCIAL INFORMATION

Item 1. Financial Statements.

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

(Unaudited)

	June 30, 2017	December 31, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 165,975	$ 154,901
Marketable securities	256,923	236,949
Accounts receivable, net of reserves of $4,783 in 2017 and $4,523 in 2016	240,262	204,494
Inventories	169,693	158,034
Other current assets	85,805	91,206
Total current assets	918,658	845,584
Long-Term Assets:		
Property and equipment, net	364,779	357,422
Goodwill	196,670	178,228
Intangible assets, net	46,089	46,155
Other long-term assets	110,941	103,315
Total long-term assets	718,479	685,120
TOTAL ASSETS	$ 1,637,137	$ 1,530,704
LIABILITIES AND STOCKHOLDERS’ DEFICIT		
Current Liabilities:		
Accounts payable	$ 58,606	$ 60,057
Accrued liabilities	210,181	236,131
Line of credit	704,000	611,000
Current portion of deferred revenue	28,706	27,380
Total current liabilities	1,001,493	934,568
Long-Term Liabilities:		
Deferred income tax liabilities	37,503	39,287
Long-term debt	600,891	593,110
Long-term deferred revenue, net of current portion	34,127	33,015
Other long-term liabilities	49,230	38,937

Total long-term liabilities	721,751	704,349
Total liabilities	1,723,244	1,638,917
Commitments and Contingencies (Note 14)		
Stockholders’ Deficit:		
Common stock, $0.10 par value: Authorized: 120,000 shares; Issued: 103,951 shares in 2017 and 103,341 shares in 2016	10,395	10,334
Additional paid-in capital	1,046,473	1,011,895
Deferred stock units: Outstanding: 229 units in 2017 and 231 units in 2016	5,931	5,514
Retained earnings	694,777	540,401
Accumulated other comprehensive loss	(38,388)	(43,053)
Treasury stock, at cost: 16,504 shares in 2017 and 15,367 shares in 2016	(1,805,523)	(1,633,443)
Total IDEXX Laboratories, Inc. stockholders’ deficit	(86,335)	(108,352)
Noncontrolling interest	228	139
Total stockholders’ deficit	(86,107)	(108,213)
TOTAL LIABILITIES AND STOCKHOLDERS’ DEFICIT	$ 1,637,137	$ 1,530,704

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended June 30, 2017	2016	For the Six Months Ended June 30, 2017	2016
Revenue:				
Product revenue	$ 304,091	$ 284,887	$ 576,056	$ 533,952
Service revenue	204,849	181,682	394,905	350,167
Total revenue	508,940	466,569	970,961	884,119
Cost of Revenue:				
Cost of product revenue	110,330	108,910	213,357	206,541
Cost of service revenue	105,895	97,116	206,698	189,498
Total cost of revenue	216,225	206,026	420,055	396,039
Gross profit	292,715	260,543	550,906	488,080
Expenses:				
Sales and marketing	87,693	76,652	174,937	156,481
General and administrative	55,460	54,317	108,374	103,612
Research and development	26,998	25,412	52,788	50,032
Income from operations	122,564	104,162	214,807	177,955
Interest expense	(9,155)	(8,204)	(17,744)	(16,508)
Interest income	1,176	928	2,259	1,748
Income before provision for income taxes	114,585	96,886	199,322	163,195
Provision for income taxes	29,178	29,680	44,857	49,964
Net income	85,407	67,206	154,465	113,231
Less: Net income attributable to noncontrolling interest	50	4	89	10
Net income attributable to IDEXX Laboratories, Inc. stockholders	$ 85,357	$ 67,202	$ 154,376	$ 113,221
Earnings per Share:				
Basic	$ 0.97	$ 0.75	$ 1.75	$ 1.26
Diluted	$ 0.95	$ 0.74	$ 1.72	$ 1.25
Weighted Average Shares Outstanding:				
Basic	88,004	89,824	88,060	89,874
Diluted	89,878	90,817	89,962	90,858

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$ 85,407	$ 67,206	$ 154,465	$ 113,231
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	7,954	(1,278)	15,968	9,186
Unrealized (loss) gain on net investment hedge	(3,767)	1,307	(4,860)	(917)
Unrealized gain on investments, net of tax expense (benefit) of $49 and $23 in 2017 and $45 and $115 in 2016	125	120	86	325
Unrealized (loss) gain on derivative instruments:				
Unrealized (loss) gain, net of tax (benefit) expense of ($2,287) and ($3,199) in 2017 and $804 and ($639) in 2016	(3,848)	1,825	(5,382)	(1,441)
Less: reclassification adjustment for gains included in net income, net of tax benefit (expense) of ($280) and ($681) in 2017 and $54 and ($116) in 2016	(473)	76	(1,147)	(353)
Unrealized (loss) gain on derivative instruments	(4,321)	1,901	(6,529)	(1,794)
Other comprehensive (loss) gain, net of tax	(9)	2,050	4,665	6,800
Comprehensive income	85,398	69,256	159,130	120,031
Less: comprehensive income attributable to noncontrolling interest	50	4	89	10
Comprehensive income attributable to IDEXX Laboratories, Inc.	$ 85,348	$ 69,252	$ 159,041	$ 120,021

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Six Months Ended June 30, 2017	2016
Cash Flows from Operating Activities:		
Net income	$ 154,465	$ 113,231
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	40,893	38,210
Impairment charge	-	2,228
Provision for uncollectible accounts	825	252
Benefit of deferred income taxes	2,691	1,516
Share-based compensation expense	11,742	9,927
Other	206	1,540
Tax benefit from share-based compensation arrangements (Note 2)	-	(4,791)
Changes in assets and liabilities:		
Accounts receivable	(32,400)	(23,647)
Inventories	(18,850)	214
Other assets and liabilities	(21,426)	(3,994)
Accounts payable	1,422	99
Deferred revenue	1,898	3,088
Net cash provided by operating activities	141,466	137,873
Cash Flows from Investing Activities:		
Purchases of property and equipment	(38,566)	(37,868)
Purchase of marketable securities	(175,522)	(123,809)
Proceeds from the sale and maturities of marketable securities	155,903	108,115
Acquisitions of a business, net of cash acquired	(14,529)	-
Net cash used by investing activities	(72,714)	(53,562)
Cash Flows from Financing Activities:		
Borrowings (repayments) on revolving credit facilities, net	93,000	(15,000)
Debt issue costs	-	(57)
Repurchases of common stock	(170,798)	(76,536)
Proceeds from exercises of stock options and employee stock purchase plans	23,170	17,554
Payment of acquisition-related contingent consideration	-	(2,717)
Shares withheld for statutory tax withholding on restricted stock (Note 2)	(7,459)	(3,732)
Tax benefit from share-based compensation arrangements (Note 2)	-	4,791
Net cash used by financing activities	(62,087)	(75,697)
Net effect of changes in exchange rates on cash	4,409	3,531
Net increase in cash and cash equivalents	11,074	12,145
Cash and cash equivalents at beginning of period	154,901	128,994

Cash and cash equivalents at end of period	$ 165,975	$ 141,139

The accompanying notes are an integral part of these condensed consolidated financial statements.
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IDEXX LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The accompanying condensed consolidated financial statements of IDEXX Laboratories, Inc. and its subsidiaries have been prepared in accordance with U.S. GAAP for interim financial information and with the requirements of Regulation S-X, Rule 10-01 for financial statements required to be filed as a part of this Quarterly Report on Form 10-Q. Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to "IDEXX," the "Company," "we," "our" or "us" refer to IDEXX Laboratories, Inc. and its subsidiaries.

The accompanying condensed consolidated financial statements include the accounts of IDEXX Laboratories, Inc. and our wholly-owned and majority-owned subsidiaries. We do not have any variable interest entities for which we are the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements reflect, in the opinion of our management, all adjustments necessary for a fair statement of our financial position and results of operations. All such adjustments are of a recurring nature. The consolidated balance sheet data at December 31, 2016, was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The results of operations for the three and six months ended June 30, 2017, are not necessarily indicative of the results to be expected for the full year or any future period. These condensed consolidated financial statements should be read in conjunction with this Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, and our Annual Report on Form 10-K for the year ended December 31, 2016, (the “2016 Annual Report”) filed with the SEC.

For the six months ended June 30, 2017, changes in stockholders’ equity included (i) changes in other comprehensive income reflected in the condensed consolidated statements of comprehensive income; (ii) changes in common stock and additional paid-in capital reflected in the condensed consolidated statements of cash flows (including share-based compensation expense, proceeds from exercise of stock options and employee stock purchase plans and repurchases of common stock); (iii) changes in noncontrolling interest; and (iv) changes in net income.

NOTE 2. ACCOUNTING POLICIES

Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and six months ended June 30, 2017 are consistent with those discussed in Note 2 to the consolidated financial statements in our 2016 Annual Report, except as noted below.

New Accounting Pronouncements Adopted

Effective January 1, 2017, we adopted the FASB Accounting Standard Update (“ASU”) 2016-09, “Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” which simplifies several aspects of the accounting for share-based payment transactions, including income tax consequences, recognition of stock compensation award forfeitures, classification of awards as either equity or liabilities, the calculation of diluted shares outstanding and classification on the statement of cash flows.

The following table summarizes the most significant impacts of the new accounting guidance for the three and six months ended June 30, 2017 and 2016, as applicable:

Description of Change:	Impact of Change for the Three Months Ended March 31, 2017 and 2016 if applicable:	Adoption Method:
Tax benefits related to share-based payments at settlement are recorded through the income statement instead of equity	Decreases in income tax expense by approximately $7.1 million for the three months ended June 30, 2017, and approximately $18.3 million for the six months ended June 30, 2017	Prospective (required)
Calculation of diluted shares outstanding under the treasury method will no longer assume that tax benefits related to share-based payments are used to repurchase common stock	Increase in the weighted average diluted shares outstanding by approximately 450,000 shares for both the three and six months ended June 30, 2017	Prospective (required)
An election can be made to reduce share-based compensation expense for forfeitures as they occur instead of estimating forfeitures that are expected to occur	No change to share-based compensation expense, as we have elected to continue to estimate forfeitures that are expected to occur	N/A
Tax benefits related to share-based payments at settlement are classified as operating cash flows instead of financing cash flows	Increases in cash flow from operating activities and decreases in cash flow from financing activities by approximately $18.3 million for the six months ended June 30, 2017	Prospective (elected)
Cash payments to tax authorities for shares withheld to meet employee tax withholding requirements on restricted stock units are classified as financing cash flow instead of operating cash flow	Increases in cash flow from operating activities and decreases in cash flow from financing activities for the six months ended June 30, 2017 and 2016 by approximately $7.5 and $3.7 million, respectively	Retrospective (required)

New Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued Accounting Standard Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606) (the "New Revenue Standard"), which will replace most of the existing revenue recognition guidance within U.S. GAAP. The FASB has also issued several updates to ASU 2014-09. The core principle of ASU 2014-09 is that an entity should recognize revenue for the transfer of goods or services to customers in an amount that it expects to be entitled to receive for those goods or services. In doing so, companies will be required to make certain judgments and estimates, including identifying contract performance obligations, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price among separate performance obligations. Additionally, disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, significant judgments reached in the application of the guidance and assets recognized from the costs to obtain or fulfill a contract will be required. In July 2015, the FASB approved a one-year deferral of the effective date to all annual and interim periods beginning after December 15, 2017. The new guidance permits two methods of adoption: a full retrospective method to each prior reporting period presented or a modified retrospective approach with the cumulative effect of initially applying the guidance recognized at the date of initial application.

Since the issuance of ASU 2014-09, we have been preparing for the adoption of the New Revenue Standard. We have been monitoring the activity of the FASB and the Transition Resource Group as it relates to specific industry interpretive guidance and overall interpretations and clarifications. We developed a three-phase adoption plan and have completed Phase I, which included activities such as establishing a transition team and assessing significant revenue streams and representative contracts to determine potential changes to existing accounting policies. We are in Phase II of our adoption plan, during which we will further determine the impact of adoption. Phase II includes activities such as validating and concluding on changes to existing accounting policies, quantifying the effects on our consolidated financial statements, evaluating expanded disclosure requirements and addressing the impact on business processes, systems and internal controls. Phase III of our adoption plan will complete our adoption and implementation of the New Revenue Standard during the first quarter of 2018 and will include activities such as running parallel reporting for impacted areas under the New Revenue Standard and the current standard, recording the accounting adjustments that were identified in Phase II, evaluating and testing modified and newly implemented internal controls over the New Revenue Standard, and revising our financial statements disclosures.

While ASU 2014-09 will not impact the overall economics of our products and services sold under customer incentive programs, we do expect the New Revenue Standard will require us to delay revenue recognition related to certain of our customer incentive programs and to accelerate revenue recognition for certain other customer incentive programs. The volume and mix of future customer incentive programs will affect our assessment of the overall net impact of the New Revenue Standard on our results. We plan to provide an estimate of any impacts, as determined in Phase II of our adoption plan, by October 2017, in connection with our financial reporting for the quarter ending September 30, 2017. We plan to adopt ASU 2014-09, as amended, in the first quarter of 2018 on a modified-retrospective basis.

In February 2017, the FASB issued ASU 2017-05, Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. ASU 2017-05 clarifies the scope and accounting of a financial asset that meets the definition of an “in-substance nonfinancial asset” and defines the term, “in-substance nonfinancial asset.” It also adds guidance for partial sales of nonfinancial assets. The new guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those years. Early adoption is permitted for interim or annual reporting periods beginning after December 15, 2016. The guidance may be applied retrospectively for all periods presented or retrospectively with a cumulative-effect adjustment at the date of adoption. We are currently evaluating the effects of ASU 2017-05 on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting, which provides clarification on accounting for modifications in share-based payment awards. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The adoption of this guidance is not expected to have an impact on our consolidated financial statements or related disclosures unless there are modifications to our share-based payment awards.

For a discussion of other accounting standards that have been issued by the FASB but are not yet effective, refer to the New Accounting Pronouncements Not Yet Adopted section in our Annual Report on Form 10-K for the year ended December 31, 2016.

NOTE 3. ACQUISITIONS

We believe that our acquisitions of businesses and other assets enhance our existing businesses by either expanding our geographic range and customer base or expanding our existing product lines.

On June 15, 2017, we acquired the assets of two software companies that expand our suite of technology applications for the veterinary profession, specifically related to patient referral management and other connectivity needs between practices and other parties. The combined purchase price of $15 million consists of $12 million paid at closing and a $3 million contingent payment to be paid within 36 months on the successful achievement of commercial goals. We are in the process of finalizing the valuation of the acquired assets. Our preliminary fair value estimate of the assets acquired consists of $13.1 million of goodwill, representing synergies within our broader CAG portfolio, $1.2 million of customer relationship intangibles and $0.7 million of technology intangible assets. Goodwill related to these acquisitions is expected to be deductible for income tax purposes. These amounts are subject to change upon finalizing the valuation. The amount of net tangible assets acquired was immaterial. Pro forma information has not been presented for these acquisitions because such information is not material to our financial statements. The results of operations have been included in our CAG segment since the acquisition date.

During the first quarter of 2017, we acquired a reference laboratory in Austria for approximately $1.3 million, with the majority of the acquisition price valued as an intangible asset.

NOTE 4. SHARE-BASED COMPENSATION

The fair value of options, restricted stock units, deferred stock units and employee stock purchase rights awarded during the three and six months ended June 30, 2017, totaled $1.6 million and $29.5 million, respectively, as compared to $1.7 million and $25.7 million for the three and six months ended June 30, 2016, respectively. The total unrecognized compensation expense, net of estimated forfeitures, for unvested share-based compensation awards outstanding at June 30, 2017, was $54.9 million, which will be recognized over a weighted average period of approximately 2.1 years. During the three and six months ended June 30, 2017, we recognized expense of $6.0 million and $11.7 million, respectively, related to share-based compensation.

We determine the assumptions used in the valuation of option awards as of the date of grant. Differences in the expected stock price volatility, expected term or risk-free interest rate may necessitate distinct valuation assumptions at each grant date. As such, we may use different assumptions for options granted throughout the year. Option awards are granted with an exercise price equal to the closing market price of our common stock at the date of grant. We have never paid any cash dividends on our common stock, and we have no intention to pay such a dividend at this time; therefore, we assume that no dividends will be paid over the expected terms of option awards.

The weighted averages of the valuation assumptions used to determine the fair value of each option award on the date of grant and the weighted average estimated fair values were as follows:

For the
Six
Months
Ended