

BOSTON SCIENTIFIC CORP
Form 10-Q
May 09, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2008

Commission File No. 1-11083

BOSTON SCIENTIFIC CORPORATION
(Exact Name of Registrant As Specified in Its Charter)

DELAWARE
(State of Incorporation)

04-2695240
(I.R.S. Employer Identification No.)

ONE BOSTON SCIENTIFIC PLACE, NATICK, MASSACHUSETTS 01760-1537
(Address of Principal Executive Offices)

(508) 650-8000
(Registrant's Telephone Number)

(Former name, former address and former fiscal year, if changed since last report)

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 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)

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.

Class	Shares outstanding as of April 30, 2008
Common Stock, \$.01 par value	1,496,257,958

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PART I
FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in millions, except per share data)	Three Months Ended March 31,	
	2008	2007
Net sales	\$ 2,046	\$ 2,086
Cost of products sold	580	568
Gross profit	1,466	1,518
Selling, general and administrative expenses	661	735
Research and development expenses	244	289
Royalty expense	46	52
Amortization expense	143	155
Purchased research and development	13	5
Restructuring charges	29	
Gain on divestitures	(250)	
Total operating expenses	886	1,236
Operating income	580	282
Other income (expense):		
Interest expense	(131)	(141)
Other, net	13	18
Income before income taxes	462	159
Income tax expense	140	39
Net income	\$ 322	\$ 120
Net income per common share — basic	\$ 0.22	\$ 0.08
Net income per common share — assuming dilution	\$ 0.21	\$ 0.08
Weighted-average shares outstanding		
Basic	1,494.1	1,481.3
Assuming dilution	1,500.1	1,497.8

See notes to the unaudited condensed consolidated financial statements.

BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in millions, except share data)	March 31, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1,739	\$ 1,452
Trade accounts receivable, net	1,496	1,502
Inventories	781	725
Deferred income taxes	873	679
Assets held for sale		1,099
Prepaid expenses and other current assets	352	464
Total current assets	5,241	5,921
Property, plant and equipment, net	1,736	1,735
Investments	321	317
Other assets	143	157
Goodwill and other intangible assets, net	22,905	23,067
	\$ 30,346	\$ 31,197
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current debt obligations	\$ 257	\$ 256
Accounts payable	222	139
Accrued expenses	2,200	2,541
Taxes payable	488	121
Liabilities associated with assets held for sale		39
Other current liabilities	226	154
Total current liabilities	3,393	3,250
Long-term debt	7,311	7,933
Deferred income taxes	2,230	2,284
Other long-term liabilities	2,021	2,633
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$.01 par value - authorized 50,000,000 shares, none issued and outstanding		
Common stock, \$.01 par value - authorized 2,000,000,000 shares and issued 1,495,515,422 shares at March 31, 2008 and 1,491,234,911 shares at December 31, 2007	15	15
Additional paid-in capital	15,830	15,766
Accumulated deficit	(373)	(693)
Other stockholders' (deficit) equity	(81)	9
Total stockholders' equity	15,391	15,097
	\$ 30,346	\$ 31,197

See notes to the unaudited condensed consolidated financial statements.

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BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in millions)	Three Months Ended	
	2008	March 31, 2007
Cash provided by (used for) operating activities	\$ 266	\$ (59)
Investing activities:		
Purchases of property, plant and equipment	(57)	(96)
Proceeds from sales of publicly traded and privately held equity securities and collections of notes receivable	37	14
Payments for acquisitions of businesses, net of cash acquired		(11)
Payments relating to prior period acquisitions	(654)	(200)
Proceeds from business divestitures	1,300	
Payments for investments in companies and acquisitions of certain technologies	(6)	(7)
Cash provided by (used for) investing activities	620	(300)
Financing activities:		
Payments on long-term borrowings	(625)	
Proceeds from issuances of shares of common stock	26	31
Cash (used for) provided by financing activities	(599)	31
Net increase (decrease) in cash and cash equivalents	287	(328)
Cash and cash equivalents at beginning of period	1,452	1,668
Cash and cash equivalents at end of period	\$ 1,739	\$ 1,340
Supplemental Information:		
Stock and stock equivalents issued for acquisitions	\$	\$ 90

See notes to the unaudited condensed consolidated financial statements.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Boston Scientific Corporation have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for fair presentation have been included. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007.

Certain prior year amounts have been reclassified to conform to the current year presentation. See Note N - Segment Reporting for further details.

NOTE B – FAIR VALUE MEASUREMENTS

We adopted Financial Accounting Standards Board (FASB) Statement No. 157, Fair Value Measurements, as of January 1, 2008. Statement No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. Statement No. 157 does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. In February 2008, the FASB released Staff Position No. 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of Statement No. 157 for all nonfinancial assets and nonfinancial liabilities, except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis. In accordance with Staff Position No. 157-2, we have not applied the provisions of Statement No. 157 to the following nonfinancial assets and nonfinancial liabilities:

- Nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination or other new basis event, but not measured at fair value in subsequent reporting periods;
- Reporting units and nonfinancial assets and nonfinancial liabilities measured at fair value for our goodwill impairment test in accordance with FASB Statement No. 142, Goodwill and Other Intangible Assets;
- Indefinite-lived intangible assets measured at fair value for impairment assessment in accordance with Statement No. 142;
- Nonfinancial long-lived assets or asset groups measured at fair value for impairment assessment or disposal under FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets; and
 - Nonfinancial liabilities associated with exit or disposal activities initially measured at fair value under FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities.

We will be required to apply the provisions of Statement No. 157 to these nonfinancial assets and nonfinancial liabilities as of January 1, 2009 and are currently evaluating the impact of the application of Statement No. 157 as it pertains to these items. The application of Statement No. 157 for financial assets and financial liabilities did not have a material impact on our financial position, results of operations or cash flows.

On a recurring basis, we measure certain financial assets and financial liabilities at fair value, including our money market funds and U.S. Treasury securities, available-for-sale investments, interest rate derivative instruments and foreign currency derivative contracts. Statement No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a

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market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. We base fair value upon quoted market prices, where available. Where quoted market prices or other observable inputs are not available, we apply valuation techniques to estimate fair value.

Statement No. 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The categorization of financial assets and financial liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The three levels of the hierarchy are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted market prices for identical assets or liabilities.
- Level 2 – Inputs to the valuation methodology are other observable inputs, including quoted market prices for similar assets or liabilities and market-corroborated inputs.
- Level 3 – Inputs to the valuation methodology are unobservable inputs based on management's best estimate of inputs market participants would use in pricing the asset or liability at the measurement date, including assumptions about risk.

Our money market funds and U.S. Treasury securities, as well as available-for-sale investments carried at fair value are generally classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. However, certain of our available-for-sale investments are subject to lock-up agreements for a period of time. We use an option pricing model to determine the liquidity discount associated with these lock-up restrictions as part of our fair value measurement within the framework of Statement No. 157. Available-for-sale investments with such restrictions are generally classified within Level 3 of the fair value hierarchy.

Our cost method investments are recorded at fair value only when impairment charges are recorded for other-than-temporary declines in value and are determined using fair value criteria within the framework of Statement No. 157. As the inputs utilized for the impairment assessment are not based on observable market data, these cost method investments are classified within Level 3 of the fair value hierarchy on a non-recurring basis.

We recognize all derivative financial instruments in our consolidated financial statements at fair value in accordance with FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. We determine the fair value of these instruments using the framework prescribed by Statement No. 157 by considering the estimated amount we would receive to terminate these agreements at the reporting date and by taking into account current interest rates, the creditworthiness of the counterparty for assets, and our creditworthiness for liabilities. In certain instances, we may utilize financial models to measure fair value. Generally, we use inputs that include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; other observable inputs for the asset or liability; and inputs derived principally from, or corroborated by, observable market data by correlation or other means. We have classified our derivative assets and liabilities within Level 2 of the fair value hierarchy because these observable inputs are available for substantially the full term of our derivative instruments.

Fair Value Measured on a Recurring Basis

Financial assets and financial liabilities measured at fair value on a recurring basis consist of the following as of March 31, 2008:

(in millions)	Quoted Market Prices for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets				
Money market funds and U.S. Treasury securities	\$ 912			\$ 912
Available-for-sale investments	11		\$ 24	35
Currency exchange contracts		\$ 12		12
	\$ 923	\$ 12	\$ 24	\$ 959
Liabilities				
Currency exchange contracts		\$ 233		\$ 233
Interest rate swap contracts		41		41
	\$	\$ 274	\$	\$ 274

For assets measured at fair value using significant unobservable inputs (Level 3), the following table summarizes the change in balances during the three months ended March 31, 2008:

(in millions)	Available-for-sale investments with restrictions
Balance at January 1, 2008	\$ 30
Net transfers in (out) of Level 3	40
Net (sales) purchases	(25)
Change in unrealized gains/losses related to market prices	(17)
Change in unrealized gains/losses related to liquidity discounts	(4)
Balance at March 31, 2008	\$ 24

Unrealized gains/losses are included in other comprehensive income in our accompanying unaudited condensed consolidated balance sheets.

Fair Value Measured on a Non-Recurring Basis

In the first quarter of 2008, we recorded impairment charges on certain of our cost method investments and adjusted the carrying amount of those investments to fair value, as we deemed the decline in the value of those assets to be other-than-temporary. These cost method investments fall within Level 3 of the fair value hierarchy, due to the use of significant unobservable inputs to determine fair value, as the investments are in privately held entities without quoted market prices. To determine the fair value of those investments, we used all available financial information related to the entities, including information based on recent third-party equity investments in these entities. The following table summarizes changes to the carrying amount of these investments during the three months ended March 31, 2008.

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Balance at January 1, 2008	\$	24
Less: other-than-temporary impairments		14
Balance at March 31, 2008	\$	10

Statement No. 159

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115, which allows an entity to elect to record financial assets and financial liabilities at fair value upon their initial recognition on a contract-by-contract basis. We adopted Statement No. 159 as of January 1, 2008 and did not elect the fair value option for our eligible financial assets and financial liabilities.

NOTE C – SUPPLEMENTAL BALANCE SHEET INFORMATION

The following are the components of various balance sheet items at March 31, 2008 and December 31, 2007.

Inventories

(in millions)	March 31, 2008	December 31, 2007
Finished goods	\$ 504	\$ 454
Work-in-process	142	132
Raw materials	135	139
	\$ 781	\$ 725

Property, plant and equipment, net

(in millions)	March 31, 2008	December 31, 2007
Property, plant and equipment	\$ 3,026	\$ 2,925
Less: accumulated depreciation	1,290	1,190
	\$ 1,736	\$ 1,735

Goodwill and other intangible assets, net

(in millions)	March 31, 2008	December 31, 2007
Goodwill	\$ 15,094	\$ 15,103
Technology - core	6,923	6,923
Other intangible assets	2,464	2,481
	24,481	24,507
Less: accumulated amortization	1,576	1,440
	\$ 22,905	\$ 23,067

Changes in our product warranty obligations during the three months ended March 31, 2008 consisted of the following (in millions):

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Balance at December 31, 2007	\$	66
Warranty claims provision		20
Settlements made		(20)
Balance at March 31, 2008	\$	66

NOTE D – INVESTMENTS AND NOTES RECEIVABLE

During 2007, in connection with our strategic initiatives, we announced our decision to monetize the majority of our investment portfolio in order to eliminate investments determined to be non-strategic. In the first quarter of 2008, we received gross proceeds of \$37 million from the sale of investments and collections of notes receivable, and recognized associated net gains of \$15 million, recorded in other, net in our accompanying unaudited condensed consolidated statements of operations. We intend to monetize the rest of our non-strategic portfolio investments over the next few quarters.

We regularly review our investments for impairment indicators. Based on this review, we recorded net losses of \$21 million in the first quarter of 2008 due primarily to other-than-temporary impairments associated with certain of our privately held investments, as well as adjustments related to investments accounted for under the equity method of accounting.

Many of our alliances involve equity investments in privately held equity securities or investments where an observable quoted market value does not exist. Many of these companies are in the developmental stage and have not yet commenced their principal operations. Our exposure to losses related to our alliances is generally limited to our equity investments and notes receivable associated with these alliances.

NOTE E – BORROWINGS AND CREDIT ARRANGEMENTS

We had total debt of \$7.568 billion at March 31, 2008 at an average interest rate of 6.02 percent, as compared to total debt of \$8.189 billion at December 31, 2007 at an average interest rate of 6.36 percent. During the first quarter of 2008, we prepaid \$625 million of our term loan. These prepayments satisfied the remaining \$300 million of our term loan due in 2009 and \$325 million of our term loan due in 2010. As of March 31, 2008, the revised debt maturity schedule for the term loan, as well as scheduled maturities of the other significant components of our debt obligations, is as follows:

(in millions)	Payments Due by Period						Total
	2008	2009	2010	2011	2012	Thereafter	
Term loan			\$ 1,375	\$ 2,000			\$ 3,375
Abbott Laboratories loan				900			900
Senior notes				850		\$ 2,200	3,050
Credit and security facility	\$ 250						250
	\$ 250	\$	\$ 1,375	\$ 3,750	\$	\$ 2,200	\$ 7,575

Note: The table above does not include capital leases, discounts associated with our Abbott loan and senior notes, and non-cash gains related to interest rate swaps used to hedge the fair value of certain of our senior notes.

Our term loan and revolving credit facility agreement requires that we maintain certain financial covenants, including a ratio of total debt to EBITDA, as defined by the amended agreement, of less than or equal to 4.5 to 1.0 through December 31, 2008. The maximum permitted ratio of total debt to EBITDA steps-down to 4.0 to 1.0 on March 31,

2009 and to 3.5 to 1.0 on September 30, 2009. The agreement also requires that we maintain a ratio of EBITDA, as defined by the amended agreement, to interest expense of greater than or equal to 3.0 to 1.0. As of March 31, 2008, we were in compliance with the required covenants. Exiting the quarter, our ratio of total debt to EBITDA was 2.9 to 1.0 and our ratio of EBITDA to interest expense was 4.6 to 1.0. If at any time we are not able to

maintain these covenants, we could be required to seek to renegotiate the terms of our credit facilities or seek waivers from compliance with these covenants, both of which could result in additional borrowing costs.

Interest Rate Swaps

We use interest rate derivative instruments to manage our exposure to interest rate movements and to reduce borrowing costs by converting floating-rate debt into fixed-rate debt or fixed-rate debt into floating-rate debt. We designate these derivative instruments either as fair value or cash flow hedges under Statement No. 133. We record changes in the fair value of fair value hedges in other income (expense), which is offset by changes in the fair value of the hedged debt obligation to the extent the hedge is effective. Interest expense includes interest payments made or received under interest rate derivative instruments. We record the effective portion of any change in the fair value of cash flow hedges as other comprehensive income, net of tax, until the hedged cash flow occurs.

During the first quarter of 2008, we entered floating-to-fixed interest rate swaps indexed to three-month LIBOR to hedge variability in interest payments on \$2.0 billion of our LIBOR-indexed floating-rate loans. These interest rate swap agreements commence in June 2008 and mature in December 2009. We designated these interest rate swaps as cash flow hedges under Statement No. 133 and record fluctuations in the fair value of these derivative instruments as unrealized gains or losses in other comprehensive income, net of tax, and reclassify the gains or losses to interest expense during the hedged interest payment period.

We recorded a net unrealized loss of \$26 million, net of tax, in accumulated other comprehensive income at March 31, 2008 to recognize the fair value of all of our outstanding interest rate derivative instruments, as compared to \$11 million at December 31, 2007. As of March 31, 2008, \$26 million of unrealized losses relating to our current and prior interest rate derivative instruments may be reclassified to earnings during 2008, as compared to \$3 million as of December 31, 2007.

NOTE F – ACQUISITIONS

Purchased Research and Development

Our policy is to record certain costs associated with strategic alliances as purchased research and development. In accordance with this policy, we recorded \$13 million of purchased research and development in the first quarter of 2008 associated with entering a licensing and development arrangement with Surgi-Vision, Inc. for magnetic resonance imaging (MRI)-safe technology, which Surgi-Vision is developing. During the first quarter of 2007, we recorded \$5 million of purchased research and development associated with payments made for certain early-stage CRM technologies.

Acquisition-related Payments

During the first quarter of 2008, we made acquisition-related payments of \$654 million, consisting primarily of a \$650 million fixed payment made to the principal former shareholders of Advanced Bionics Corporation in connection with our 2007 amendment to the original merger agreement, which was accrued at December 31, 2007. Accrued at March 31, 2008 is \$472 million (\$465 million as of December 31, 2007), which represents the present value of a \$500 million final fixed payment to be made related to Advanced Bionics in March 2009. In addition to this obligation, certain of our acquisitions involve the payment of contingent consideration, which is generally contingent upon the acquired companies' reaching certain performance milestones, including attaining specified revenue levels, achieving product development targets or obtaining regulatory approvals. Consequently, we cannot currently determine the total required payments; however, we have developed an estimate of the maximum potential contingent consideration for each of our acquisitions with an outstanding earn-out obligation. The estimated maximum potential amount of future contingent consideration (undiscounted) that we could be required to make associated with these acquisitions, some of

which may be payable in common stock, is approximately \$1.1 billion. The milestones associated with the contingent consideration must be reached in

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certain future periods ranging from 2008 through 2022. The estimated cumulative specified revenue level associated with these maximum future contingent payments is approximately \$3.4 billion.

In April 2008, we signed a definitive agreement to acquire 100 percent of the fully diluted equity of CryoCor, Inc., under which we will pay a cash purchase price of approximately \$18 million, in addition to our previous investment. CryoCor is developing products using cryogenic technology for use in treating atrial fibrillation, the most common and difficult to treat cardiac arrhythmia (abnormal heartbeat). We expect the acquisition to close during the second quarter of 2008, subject to customary closing conditions. The acquisition is intended to allow us to further pursue therapeutic solutions for atrial fibrillation in order to advance our existing Cardiac Rhythm Management (CRM) and Electrophysiology product lines.

NOTE G – RESTRUCTURING ACTIVITIES

In October 2007, our Board of Directors approved, and we committed to, an expense and head count reduction plan, which will result in the elimination of approximately 2,300 positions worldwide. We are providing affected employees with severance packages, outplacement services and other appropriate assistance and support. As of March 31, 2008, we had completed more than half of the anticipated head count reductions. The plan is intended to bring expenses in line with revenues as part of our initiatives to enhance short- and long-term shareholder value. Key activities under the plan include the restructuring of several businesses and product franchises in order to better utilize resources, strengthen competitive positions, and create a more simplified and efficient business model; the elimination, suspension or reduction of spending on certain research and development (R&D) projects; and the transfer of certain production lines from one facility to another. We initiated these activities in the fourth quarter of 2007 and expect to be substantially completed worldwide by the end of 2008.

We expect that the execution of this plan will result in total pre-tax costs of approximately \$425 million to \$450 million. We expect that the plan will result in total cash payments of approximately \$375 million to \$400 million. The following table provides a summary of our estimates of total costs associated with the plan by major type of cost:

Type of cost	Total amount expected to be incurred
Termination benefits	\$250 million to \$260 million
Retention incentives	\$60 million to \$65 million
Asset write-offs and accelerated depreciation	\$50 million to \$55 million
Other *	\$65 million to \$70 million

* Other costs consist primarily of consultant fees and costs to transfer product lines from one facility to another.

In the first quarter of 2008, we incurred total restructuring costs of \$44 million. The following presents these costs by major type and line item within our unaudited condensed consolidated statements of operations:

(in millions)	Termination Benefits	Retention Incentives	Accelerated Depreciation	Other	Total
Cost of goods sold		\$ 3	\$ 1		\$ 4
Selling, general and administrative expenses		6	3		9
Research and development expenses					