

CONMED CORP  
Form 10-Q  
August 08, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended  
June 30, 2006

Commission File Number 0-16093

**CONMED CORPORATION**

(Exact name of the registrant as specified in its charter)

**New York**

(State or other jurisdiction of  
incorporation or organization)

**16-0977505**

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

**525 French Road, Utica, New York**  
(Address of principal executive offices)

**13502**  
(Zip Code)

**(315) 797-8375**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one).

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 registrant's common stock, as of August 1, 2006 is 27,885,768 shares.

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**CONMED CORPORATION**

**QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTER ENDED JUNE 30, 2006**

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**PART I FINANCIAL INFORMATION****Item 1.**

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

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>
Net sales	\$ 158,276	\$ 163,473	\$ 314,135	\$ 321,939
Cost of sales	76,152	85,699	151,536	166,265
Gross profit	82,124	77,774	162,599	155,674
Selling and administrative expense	53,559	58,123	106,091	116,497
Research and development expense	6,375	7,498	12,224	15,323
Other expense	2,576	1,584	4,476	2,154
	62,510	67,205	122,791	133,974
Income from operations	19,614	10,569	39,808	21,700
Loss on early extinguishment of debt	-	678	-	678
Interest expense	3,571	4,675	7,330	9,541
Income before income taxes	16,043	5,216	32,478	11,481
Provision for income taxes	5,535	1,802	11,205	3,727
Net income	\$ 10,508	\$ 3,414	\$ 21,273	\$ 7,754
<b>Per share data:</b>				
Net Income				
Basic	\$ .36	\$ .12	\$ .73	\$ .28
Diluted	.35	.12	.71	.27
Weighted average common shares				
Basic	29,494	28,061	29,301	28,068
Diluted	30,060	28,266	29,830	28,312

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

	December 31, 2005	June 30, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 3,454	\$ 5,080
Accounts receivable, net	83,327	80,920
Inventories	152,428	153,661
Deferred income taxes	12,887	12,341
Prepaid expenses and other current assets	3,419	3,902
Total current assets	255,515	255,904
Property, plant and equipment, net	104,224	109,058
Goodwill	335,651	336,150
Other intangible assets, net	191,402	191,256
Other assets	16,991	15,210
Total assets	\$ 903,783	\$ 907,578

**LIABILITIES AND SHAREHOLDERS' EQUITY**

Current liabilities:		
Current portion of long-term debt	\$ 4,208	\$ 3,053
Accounts payable	31,084	31,853
Accrued compensation and benefits	12,461	13,020
Income taxes payable	4,706	2,820
Accrued interest	1,095	1,108
Other current liabilities	8,578	10,186
Total current liabilities	62,132	62,040
Long-term debt	302,643	296,902
Deferred income taxes	62,554	65,597
Other long-term liabilities	23,448	25,982
Total liabilities	450,777	450,521

Commitments and contingencies

Shareholders' equity:

Preferred stock, par value \$.01 per share; authorized 500,000 shares; none outstanding.	-	-
Common stock, par value \$.01 per share; 100,000,000 shares authorized; 31,137,119 and 31,198,958 shares issued in 2005 and 2006, respectively	311	312

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Paid-in capital	278,281	281,103
Retained earnings	259,932	267,686
Accumulated other comprehensive income (loss)	(9,736)	(8,414)
Less 2,944,905 and 3,321,545 shares of common stock in treasury, at cost in 2005 and 2006, respectively	(75,782)	(83,630)
Total shareholders' equity	453,006	457,057
Total liabilities and shareholders' equity	\$ 903,783	\$ 907,578

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

	<u>Six months ended</u>	
	<u>June 30,</u>	
	<u>2005</u>	<u>2006</u>
Cash flows from operating activities:		
Net income	\$ 21,273	\$ 7,754
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	6,139	5,522
Amortization	9,143	9,148
Stock option expense	-	1,585
Deferred income taxes	7,365	3,650
Income tax benefit of stock option exercises	1,825	32
Excess tax benefits from stock-based compensation	-	(32)
Loss on extinguishment of debt	-	476
Increase (decrease) in cash flows from changes in assets and liabilities:		
Sale of accounts receivable	(3,000)	-
Accounts receivable	1,041	2,407
Inventories	(18,579)	(6,361)
Accounts payable	6,461	1,373
Income taxes payable	(833)	(1,979)
Accrued compensation and benefits	(3,063)	559
Accrued interest	(58)	13
Other assets	(2,580)	(824)
Other liabilities	4,761	4,142
	8,622	19,711
Net cash provided by operating activities	29,895	27,465
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(8,098)	(10,247)
Proceeds from sale of equity investment	-	1,205
Payments related to business acquisitions	(364)	(2,458)
Net cash used in investing activities	(8,462)	(11,500)
Cash flows from financing activities:		
Net proceeds from common stock issued under employee plans	13,020	1,238
Excess tax benefits from stock-based compensation	-	32
Repurchase of common stock	(7,759)	(7,848)
Payments on senior credit agreement	(28,623)	(141,484)
Proceeds of senior credit agreement	8,000	135,000
Payments on mortgage notes	(356)	(412)
Payments related to issuance of long-term debt	(135)	(1,260)

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Net change in cash overdrafts	(261)	(604)
Net cash used in financing activities	(16,114)	(15,338)
Effect of exchange rate changes on cash and cash equivalents	(3,002)	999
Net increase in cash and cash equivalent	2,317	1,626
Cash and cash equivalents at beginning of period	4,189	3,454
Cash and cash equivalents at end of period	\$ 6,506	\$ 5,080

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

**Note 1 - Operations and Significant Accounting Policies**

**Organization and operations**

The accompanying consolidated condensed financial statements include the accounts of CONMED Corporation and its controlled subsidiaries (“CONMED”, the “Company”, “we” or “us”). All intercompany accounts and transactions have been eliminated. CONMED is a medical technology company with an emphasis on surgical devices and equipment for minimally invasive procedures and monitoring. The Company’s products serve the clinical areas of arthroscopy, powered surgical instruments, electrosurgery, cardiac monitoring disposables, endosurgery and endoscopic technologies. They are used by surgeons and physicians in a variety of specialties including orthopedics, general surgery, gynecology, neurosurgery, and gastroenterology.

CONMED conducts its business through five principal operating units, CONMED Electrosurgery, CONMED Endoscopic Technologies, CONMED Endosurgery, CONMED Linvatec and CONMED Patient Care. All of our operating units qualify for aggregation under SFAS 131 except CONMED Patient Care. The economic characteristics of CONMED Patient Care do not meet the criteria for aggregation due to the lower overall operating income in this segment. Accordingly, we have provided comparable information for the prior year. Based upon the aggregation criteria for segment reporting, we have grouped all of our operating units except CONMED Patient Care into a single segment comprised of medical instruments and systems used in surgical and other medical procedures. CONMED Patient Care is comprised of cardiac monitoring disposables as well as a variety of other medical products.

**Note 2 - Interim financial information**

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Results for the period ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

The consolidated condensed financial statements and notes thereto should be read in conjunction with the financial statements and notes for the year-ended December 31, 2005 included in our Annual Report on Form 10-K.

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**Note 3 - Other comprehensive income**

Comprehensive income consists of the following:

	<u>Three months ended</u>		<u>Six months ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>
Net income	\$ 10,508	\$ 3,414	\$ 21,273	\$ 7,754
Other comprehensive income:				
Foreign currency translation adjustment	(2,186)	1,149	(2,702)	1,322
Comprehensive income	\$ 8,322	\$ 4,563	\$ 18,571	\$ 9,076

Accumulated other comprehensive income consists of the following:

	<u>Minimum Pension Liability</u>	<u>Cumulative Translation Adjustments</u>	<u>Accumulated Other Comprehensive Income (loss)</u>
Balance, December 31, 2005	\$ (10,135)	\$ 399	\$ (9,736)
Foreign currency translation adjustments	-	1,322	1,322
Balance, June 30, 2006	\$ (10,135)	\$ 1,721	\$ (8,414)

**Note 4 - Stock-based compensation**

The Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”) in December 2004. We adopted SFAS 123R effective January 1, 2006. SFAS 123R requires that all share-based payments to employees, including grants of employee stock options, be recognized in the financial statements based on their fair values.

Prior to January 1, 2006, we accounted for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25 “Accounting for Stock Issued to Employees” (“APB 25”). No compensation expense was recognized for stock options under the provisions of APB 25 since all options granted had an exercise price equal to the market value of the underlying stock on the grant date.

SFAS No. 123R was adopted using the modified prospective transition method. Under this method, the provisions of SFAS No. 123R apply to all awards granted or modified after the date of adoption. In addition, compensation expense must be recognized for any nonvested stock option awards outstanding as of the date of adoption. Prior periods have not been restated.

We have elected to adopt the alternative transition method, as permitted by FASB Staff Position No. FAS 123R-3 “Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards,” to calculate the tax effects of stock-based compensation pursuant to SFAS 123R for those employee awards that were outstanding upon adoption of SFAS 123R. The alternative transition method allows the use of a simplified method to calculate the

beginning pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption

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of SFAS 123R.

Prior to the adoption of SFAS 123R, the Company reported all tax benefits resulting from the exercise of stock options as operating cash flows in the Consolidated Condensed Statements of Cash Flows. SFAS 123R requires cash flows resulting from the tax deductions in excess of the related compensation cost recognized in the financial statements (excess tax benefits) to be classified as financing cash flows. In accordance with SFAS 123R, excess tax benefits recognized in periods after the adoption date have been properly classified as financing cash flows. Excess tax benefits recognized in periods prior to the adoption date are classified as operating cash flows.

During the second quarter of 2006, the shareholders approved the 2006 Stock Incentive Plan ("the 2006 Plan"). Awards under this plan may be made to any officer, director, employee, consultant or to any other individual who may perform services for the Company and its subsidiaries and affiliates selected by the committee that administers the 2006 Plan. The 2006 Plan provides for grants of options, stock appreciation rights ("SARs"), dividend equivalent rights, restricted stock, restricted stock units ("RSUs"), and other equity-based and equity-related awards (collectively, "Awards").

We have reserved 7.7 million shares of common stock for issuance to employees and directors under four shareholder-approved share-based compensation plans (the "Plans") of which approximately 859,000 shares remain available for grant at June 30, 2006. The exercise price on all outstanding options and SARs is equal to the quoted fair market value of the stock at the date of grant. RSUs are valued at the market value of the underlying stock on the date of grant. Stock options, SARs and RSUs are non-transferable other than on death and generally become exercisable over a five year period from date of grant. Stock options and SARs expire ten years from date of grant. SARs are only settled in shares of the Company's stock.

Total pre-tax stock-based compensation expense recognized in the Consolidated Condensed Statements of Income was \$771 and \$1,585 for the three and six months ended June 30, 2006, respectively. This amount is included in selling and administrative expenses on the Consolidated Condensed Statements of Income. Tax related benefits of \$79 and \$135 were also recognized for the three and six months ended June 30, 2006. Cash received from the exercise of stock options was \$13.0 million and \$1.2 million for the six months ended June 30, 2005 and 2006, respectively and is reflected in cash flows from financing activities in the Consolidated Condensed Statements of Cash Flows.

The weighted average fair value of awards of options and SARs granted in the three and six months ended June 30, 2006 were \$8.91 and \$8.92, respectively. The fair value of these options and SARs was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for options and SARs granted for the three and six months ended June 30, 2006, respectively: risk-free interest rate of 5.17% and 5.16%; volatility factor of the expected market price of the Company's common stock of 37.90% and 37.97%; a weighted-average expected life of the option and SAR of 5.7 years; and that no dividends would be paid on common stock. The risk free interest rate is based on the option and SAR grant date for a traded zero-coupon U.S. Treasury bond with a maturity date equal to the expected life. Expected volatilities are based upon historical volatility of the Company's stock over a period equal to the expected life of each option and SAR grant. The expected life selected for options and SARs granted

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during the three and six months ended June 30, 2006 represents the period of time that the options and SARs are expected to be outstanding based on a study of historical data of option holder exercise and termination behavior.

The following table illustrates the stock option and SAR activity for the six months ended June 30, 2006:

	<b>Number of Shares</b>	<b>Weighted- Average Exercise Price</b>
Outstanding at December 31, 2005	3,085	\$ 22.12
Granted	228	19.93
Exercised	(29)	14.66
Forfeited	(26)	