WATERS CORP /DE/
Form 10-Q
November 05, 2010

Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended October 2, 2010

or

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

Commission File Number: 01-14010
Waters Corporation
(Exact name of registrant as specified in its charter)

Delaware	**13-3668640**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

34 Maple Street
Milford, Massachusetts 01757
(Address, including zip code, of principal executive offices)
(508) 478-2000
(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 þ No o

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). þ Yes o 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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(Do not check if smaller reporting company)	

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

Indicate the number of shares outstanding of the registrant s common stock as of October 29, 2010: 91,330,030

WATERS CORPORATION AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q
INDEX

Table of Contents

WATERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

	October 2, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 262,792	$ 341,111
Short-term investments	574,306	289,146
Accounts receivable, less allowances for doubtful accounts and sales returns of $7,230 and $6,723 at October 2, 2010 and December 31, 2009, respectively	337,562	314,247
Inventories	208,339	178,666
Other current assets	55,328	49,206
Total current assets	1,438,327	1,172,376
Property, plant and equipment, net	214,773	210,926
Intangible assets, net	183,182	182,165
Goodwill	292,424	293,077
Other assets	76,940	49,387
Total assets	$ 2,205,646	$ 1,907,931
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable and debt	$ 92,243	$ 131,772
Accounts payable	63,332	49,573
Accrued employee compensation	38,475	37,050
Deferred revenue and customer advances	120,850	94,680
Accrued income taxes	29,896	13,267
Accrued warranty	10,767	10,109
Other current liabilities	61,847	58,117
Total current liabilities	417,410	394,568
Long-term liabilities:		
Long-term debt	700,000	500,000
Long-term portion of retirement benefits	67,574	69,044
Long-term income tax liability	75,639	72,604
Other long-term liabilities	21,761	22,766
Total long-term liabilities	864,974	664,414
Total liabilities	1,282,384	1,058,982
Commitments and contingencies (Notes 5, 6, 7 and 11)		

Stockholders equity:				
Preferred stock, par value $0.01 per share, 5,000 shares authorized, none issued at October 2, 2010 and December 31, 2009				
Common stock, par value $0.01 per share, 400,000 shares authorized, 149,750 and 148,831 shares issued, 91,210 and 94,118 shares outstanding at October 2, 2010 and December 31, 2009, respectively		1,497		1,488
Additional paid-in capital		884,435		808,345
Retained earnings		2,491,875		2,236,716
Treasury stock, at cost, 58,540 and 54,713 shares at October 2, 2010 and December 31, 2009, respectively		(2,458,067)		(2,213,174)
Accumulated other comprehensive income		3,522		15,574
Total stockholders equity		923,262		848,949
Total liabilities and stockholders equity	$	2,205,646	$	1,907,931

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

Table of Contents

WATERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

	Three Months Ended	
	October 2, 2010	October 3, 2009
Product sales	$ 282,934	$ 259,532
Service sales	118,104	114,431
Total net sales	401,038	373,963
Cost of product sales	113,345	104,038
Cost of service sales	49,640	49,105
Total cost of sales	162,985	153,143
Gross profit	238,053	220,820
Selling and administrative expenses	111,306	102,675
Research and development expenses	20,524	19,310
Purchased intangibles amortization	2,408	2,723
Operating income	103,815	96,112
Interest expense	(3,810)	(2,864)
Interest income	516	785
Income from operations before income taxes	100,521	94,033
Provision for income taxes	5,802	18,097
Net income	$ 94,719	$ 75,936
Net income per basic common share	$ 1.03	$ 0.80
Weighted-average number of basic common shares	91,714	95,235
Net income per diluted common share	$ 1.02	$ 0.79

Weighted-average number of diluted common shares and equivalents	93,286	96,513

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

Table of Contents

WATERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

	Nine Months Ended	
	October 2, 2010	October 3, 2009
Product sales	$ 811,401	$ 740,501
Service sales	348,392	329,351
Total net sales	1,159,793	1,069,852
Cost of product sales	317,640	285,946
Cost of service sales	146,410	138,805
Total cost of sales	464,050	424,751
Gross profit	695,743	645,101
Selling and administrative expenses	324,938	311,417
Research and development expenses	61,407	57,364
Purchased intangibles amortization	7,642	8,022
Operating income	301,756	268,298
Interest expense	(10,045)	(8,643)
Interest income	1,293	2,288
Income from operations before income taxes	293,004	261,943
Provision for income taxes	37,845	42,753
Net income	$ 255,159	$ 219,190
Net income per basic common share	$ 2.75	$ 2.28
Weighted-average number of basic common shares	92,647	96,215
Net income per diluted common share	$ 2.71	$ 2.26

Weighted-average number of diluted common shares and equivalents	94,271	97,027

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

Table of Contents

WATERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(unaudited)

	Nine Months Ended	
	October 2, 2010	October 3, 2009
Cash flows from operating activities:		
Net income	$ 255,159	$ 219,190
Adjustments to reconcile net income to net cash provided by operating activities:		
Provisions for doubtful accounts on accounts receivable	1,414	844
Provisions on inventory	7,309	5,577
Stock-based compensation	18,558	21,757
Deferred income taxes	(4,669)	1,696
Depreciation	25,897	23,782
Amortization of intangibles	19,621	18,790
Change in operating assets and liabilities, net of acquisitions:		
(Increase) decrease in accounts receivable	(20,713)	12,070
Increase in inventories	(35,771)	(18,619)
(Increase) decrease in other current assets	(1,325)	3,652
Increase in other assets	(1,256)	(1,584)
Increase in accounts payable and other current liabilities	36,311	906
Increase in deferred revenue and customer advances	23,335	14,245
Decrease in other liabilities	(101)	(3,902)
Net cash provided by operating activities	323,769	298,404
Cash flows from investing activities:		
Additions to property, plant, equipment and software capitalization	(47,277)	(80,399)
Business acquisitions, net of cash acquired		(36,086)
Purchase of short-term investments	(924,727)	(317,342)
Maturity of short-term investments	639,567	129,611
Net cash used in investing activities	(332,437)	(304,216)
Cash flows from financing activities:		
Proceeds from debt issuances	315,116	169,024
Payments on debt	(154,645)	(64,393)
Payments of debt issuance costs	(1,498)	
Proceeds from stock plans	26,850	8,159
Purchase of treasury shares	(244,893)	(157,212)
Excess tax benefit related to stock option plans	5,149	
(Payments for) proceeds from debt swaps and other derivative contracts	(4,968)	4,495
Net cash used in financing activities	(58,889)	(39,927)
Effect of exchange rate changes on cash and cash equivalents	(10,762)	7,634
Decrease in cash and cash equivalents	(78,319)	(38,105)
Cash and cash equivalents at beginning of period	341,111	428,522

Cash and cash equivalents at end of period	$ 262,792	$ 390,417

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

WATERS CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 Basis of Presentation and Summary of Significant Accounting Policies

Waters Corporation (Waters or the Company), an analytical instrument manufacturer, primarily designs, manufactures, sells and services, through its Waters Division, high performance liquid chromatography (HPLC), ultra performance liquid chromatography (UPLC® and together with HPLC, referred to as LC) and mass spectrometry (MS) instrument systems and support products, including chromatography columns, other consumable products and comprehensive post-warranty service plans. These systems are complementary products that can be integrated together and used along with other analytical instruments. LC is a standard technique and is utilized in a broad range of industries to detect, identify, monitor and measure the chemical, physical and biological composition of materials, and to purify a full range of compounds. MS instruments are used in drug discovery and development, including clinical trial testing, the analysis of proteins in disease processes (known as proteomics), food safety analysis and environmental testing. LC is often combined with MS to create LC-MS instruments that include a liquid phase sample introduction and separation system with mass spectrometric compound identification and quantification. Through its TA Division (TA®), the Company primarily designs, manufactures, sells and services thermal analysis, rheometry and calorimetry instruments, which are used in predicting the suitability of fine chemicals, polymers and viscous liquids for various industrial, consumer goods and healthcare products, as well as for life science research. The Company is also a developer and supplier of software-based products that interface with the Company s instruments and are typically purchased by customers as part of the instrument system.

The Company s interim fiscal quarter typically ends on the thirteenth Saturday of each quarter. Since the Company s fiscal year end is December 31, the first and fourth fiscal quarters will not consist of thirteen complete weeks. The Company s third fiscal quarters for 2010 and 2009 ended on October 2, 2010 and October 3, 2009, respectively.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by generally accepted accounting principles (GAAP) in the United States of America. The consolidated financial statements include the accounts of the Company and its subsidiaries, most of which are wholly owned. All material inter-company balances and transactions have been eliminated.

The preparation of consolidated financial statements in conformity with GAAP requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities at the dates of the financial statements. Actual amounts may differ from these estimates under different assumptions or conditions.

It is management s opinion that the accompanying interim consolidated financial statements reflect all adjustments (which are normal and recurring) that are necessary for a fair statement of the results for the interim periods. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company s annual report on Form 10-K for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on February 26, 2010.

During the second quarter of 2010, the Company identified an error originating in periods prior to December 31, 2009. The error relates to an overstatement of the Company s incentive plan and other accrual balances. The Company identified and corrected the error in the three months ended July 3, 2010 which reduced selling and administrative expense. The Company does not believe that the prior period error, individually or in the aggregate, was material to the three months ended July 3, 2010, the nine months ended October 2, 2010 or any previously issued annual or quarterly financial statements.

Reclassifications

Certain amounts from the prior year have been reclassified in the accompanying financial statements in order to be consistent with the current year s classifications.

Fair Value Measurements

In accordance with the accounting standards for fair value measurements and disclosures, certain assets and liabilities are measured at fair value on a recurring basis as of October 2, 2010 and December 31, 2009. Fair values determined by Level 1 inputs utilize observable data, such as quoted prices in active markets. Fair values determined by Level 2 inputs utilize data points other than quoted prices in active markets that are observable either directly or

Table of Contents

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

indirectly. Fair values determined by Level 3 inputs utilize unobservable data points for which there is little or no market data, which require the reporting entity to develop its own assumptions.

The following table represents the Company s assets and liabilities measured at fair value on a recurring basis at October 2, 2010 (in thousands):

	Total at October 2, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$ 106,273	$	$ 106,273	$
Short-term investments	574,306		574,306	
Waters Retirement Restoration Plan assets	18,771		18,771	
Foreign currency exchange contract agreements	375		375	
Total	$ 699,725	$	$ 699,725	$
Liabilities:				
Foreign currency exchange contract agreements	$ 664	$	$ 664	$
Total	$ 664	$	$ 664	$

The following table represents the Company s assets and liabilities measured at fair value on a recurring basis at December 31, 2009 (in thousands):

	Total at December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$ 181,925	$	$ 181,925	$
Short-term investments	289,146		289,146	
Waters Retirement Restoration Plan assets	17,955		17,955	
Foreign currency exchange contract agreements	237		237	

Total	$	489,263	$		$	489,263	$	
Liabilities:								
Foreign currency exchange contract agreements	$	400	$		$	400	$	
Total	$	400	$		$	400	$	

The Company s financial assets and liabilities have been classified as Level 2. These assets and liabilities have been initially valued at the transaction price and subsequently valued, typically utilizing third-party pricing services. The pricing services use many inputs to determine value, including reportable trades, benchmark yields, credit spreads, broker/dealer quotes, current spot rates and other industry and economic events. The Company validates the prices provided by third-party pricing services by reviewing their pricing methods and obtaining market values from other

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

pricing sources. The fair values of the Company s cash equivalents, short-term investments, retirement restoration plan assets and foreign currency exchange contracts are determined through market and observable sources and have been classified as Level 2. After completing these validation procedures, the Company did not adjust or override any fair value measurements provided by third-party pricing services as of October 2, 2010 and December 31, 2009.

Fair Value of Other Financial Instruments

The Company s cash, accounts receivable, accounts payable and debt are recorded at cost, which approximates fair value.

Stockholders Equity

In February 2009, the Company s Board of Directors authorized the Company to repurchase up to $500 million of its outstanding common stock over a two-year period. During the nine months ended October 2, 2010 and October 3, 2009, the Company repurchased 3.8 million and 2.2 million shares at a cost of $241 million and $103 million, respectively, under this program.

In February 2007, the Company s Board of Directors authorized the Company to repurchase up to $500 million of its outstanding common stock over a two-year period. During the nine months ended October 3, 2009, the Company repurchased 1.4 million shares at a cost of $53 million under this program, which expired in February 2009.

Hedge Transactions

The Company operates on a global basis and is exposed to the risk that its earnings, cash flows and stockholders equity could be adversely impacted by fluctuations in currency exchange rates and interest rates.

The Company records its hedge transactions in accordance with the accounting standards for derivative instruments and hedging activities, which establishes the accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the consolidated balance sheets at fair value as either assets or liabilities. If the derivative is designated as a fair-value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income and are recognized in earnings when the hedged item affects earnings; ineffective portions of changes in fair value are recognized in earnings. In addition, disclosures required for derivative instruments and hedging activities include the Company s objectives for using derivative instruments, the level of derivative activity the Company engages in, as well as how derivative instruments and related hedged items affect the Company s financial position and performance.

The Company currently uses derivative instruments to manage exposures to foreign currency and interest rate risks. The Company s objectives for holding derivatives are to minimize foreign currency and interest rate risk using the most effective methods to eliminate or reduce the impact of foreign currency and interest rate exposures. The Company documents all relationships between hedging instruments and hedged items and links all derivatives designated as fair-value, cash flow or net investment hedges to specific assets and liabilities on the consolidated balance sheets or to specific forecasted transactions. In addition, the Company considers the impact of its counterparties credit risk on the fair value of the contracts as well as the ability of each party to execute under the contracts. The Company also assesses and documents, both at the hedges inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows associated with the hedged items.

Cash Flow Hedges

The Company uses interest rate swap agreements to hedge the risk to earnings associated with fluctuations in interest rates related to outstanding U.S. dollar floating rate debt. In August 2007, the Company entered into two floating-to-fixed-rate interest rate swaps, each with a notional amount of $50 million and maturity dates of April 2009 and October 2009, to hedge floating rate debt related to the term loan facility of its outstanding debt. At both October 2, 2010 and December 31, 2009, the Company had no outstanding interest rate swap agreements. For the three and nine months ended October 3, 2009, the Company recorded a cumulative pre-tax unrealized gain of $1 million and $2 million, respectively, in accumulated other comprehensive income on the interest rate agreements. For the three and nine months ended October 3, 2009, the Company recorded additional interest expense of less than $1 million and $2 million, respectively.

Table of Contents

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other

The Company enters into forward foreign exchange contracts, principally to hedge the impact of currency fluctuations on certain inter-company balances and short-term assets and liabilities. Principal hedged currencies include the Euro, Japanese Yen, British Pound and Singapore Dollar. The periods of these forward contracts typically range from one to three months and have varying notional amounts, which are intended to be consistent with changes in the underlying exposures. Gains and losses on these forward contracts are recorded in selling and administrative expenses in the consolidated statements of operations. At October 2, 2010 and December 31, 2009, the Company held forward foreign exchange contracts with notional amounts totaling $152 million and $138 million, respectively. At both October 2, 2010 and December 31, 2009, the Company had assets of less than $1 million in other current assets in the consolidated balance sheets related to the foreign currency exchange contracts. At October 2, 2010 and December 31, 2009, the Company had liabilities of $1 million and less than $1 million, respectively, in other current liabilities in the consolidated balance sheets related to the foreign currency exchange contracts. For the three months ended October 2, 2010, the Company recorded cumulative net pre-tax gains of $2 million, which consists of realized gains of $2 million relating to the closed forward contracts. For the nine months ended October 2, 2010, the Company recorded cumulative net pre-tax losses of $5 million, which consists of realized losses of $5 million relating to the closed forward contracts. For the three months ended October 3, 2009, the Company recorded cumulative net pre-tax losses of $4 million, which consists of realized losses of $4 million relating to the closed forward contracts. For the nine months ended October 3, 2009, the Company recorded cumulative net pre-tax gains of $6 million, which consists of realized gains of $5 million relating to the closed forward contracts and $1 million of unrealized gains relating to the open forward contracts.

Product Warranty Costs

The Company accrues estimated product warranty costs at the time of sale, which are included in cost of sales in the consolidated statements of operations. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component supplies, the Company s warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. The amount of the accrued warranty liability is based on historical information, such as past experience, product failure rates, number of units repaired and estimated costs of material and labor. The liability is reviewed for reasonableness at least quarterly.

The following is a summary of the activity of the Company s accrued warranty liability for the nine months ended October 2, 2010 and October 3, 2009 (in thousands):

	Balance at Beginning of Period	Accruals for Warranties	Settlements Made	Balance at End of Period
Accrued warranty liability:				
October 2, 2010	$10,109	$4,849	$(4,191)	$10,767
October 3, 2009	$10,276	$4,485	$(4,414)	$10,347

Subsequent Events

The Company did not have any material recognizable subsequent events.

2 Inventories

Inventories are classified as follows (in thousands):

	October 2, 2010	December 31, 2009
Raw materials	$ 67,670	$ 57,223
Work in progress	19,709	15,419
Finished goods	120,960	106,024

Total inventories	$	208,339