

OWENS & MINOR INC/VA/
Form 10-Q
November 02, 2016
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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 September 30, 2016

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 1-9810

Owens & Minor, Inc.
(Exact name of Registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	54-1701843 (I.R.S. Employer Identification No.)
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9120 Lockwood Boulevard, Mechanicsville, Virginia (Address of principal executive offices)	23116 (Zip Code)
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Post Office Box 27626, Richmond, Virginia (Mailing address of principal executive offices)	23261-7626 (Zip Code)
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Registrant's telephone number, including area code (804) 723-7000

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "larger accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

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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 of Owens & Minor, Inc.'s common stock outstanding as of October 28, 2016, was 61,509,219 shares.

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Part I. Financial Information

Item 1. Financial Statements

Owens & Minor, Inc. and Subsidiaries

Consolidated Statements of Income

(unaudited)

(in thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net revenue	\$2,415,601	\$2,471,669	\$7,355,069	\$7,285,032
Cost of goods sold	2,119,326	2,165,315	6,462,739	6,382,740
Gross margin	296,275	306,354	892,330	902,292
Distribution, selling, and administrative expenses	241,305	246,959	726,944	743,611
Acquisition-related and exit and realignment charges	2,739	6,134	19,974	21,757
Other operating income, net	(1,337)) (311)) (5,179)) (5,484)
Operating earnings	53,568	53,572	150,591	142,408
Interest expense, net	6,770	6,744	20,324	20,305
Income before income taxes	46,798	46,828	130,267	122,103
Income tax provision	16,967	18,652	48,585	50,761
Net income	\$29,831	\$28,176	\$81,682	\$71,342
Net income per common share:				
Basic	\$0.48	\$0.45	\$1.32	\$1.14
Diluted	\$0.48	\$0.45	\$1.32	\$1.14
Cash dividends per common share	\$0.255	\$0.2525	\$0.765	\$0.7575

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
 Consolidated Statements of Comprehensive Income
 (unaudited)

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	\$29,831	\$28,176	\$81,682	\$71,342
Other comprehensive income (loss), net of tax:				
Currency translation adjustments (net of income tax of \$0 in 2016 and 2015)	1,401	2,054	2,443	(19,281)
Change in unrecognized net periodic pension costs (net of income tax of \$194 and \$532 in 2016 and \$117 and \$402 in 2015)	218	284	701	802
Other (net of income tax of \$0 in 2016 and 2015)	82	(105)	119	(75)
Total other comprehensive income (loss), net of tax	1,701	2,233	3,263	(18,554)
Comprehensive income	\$31,532	\$30,409	\$84,945	\$52,788

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(in thousands, except per share data)	September 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	\$213,096	\$ 161,020
Accounts and notes receivable, net of allowances of \$12,927 and \$13,177	579,031	587,935
Merchandise inventories	944,897	940,775
Other current assets	283,753	284,970
Total current assets	2,020,777	1,974,700
Property and equipment, net of accumulated depreciation of \$202,535 and \$189,105	198,780	208,930
Goodwill, net	418,095	419,619
Intangible assets, net	86,982	95,250
Other assets, net	69,998	75,277
Total assets	\$2,794,632	\$2,773,776
Liabilities and equity		
Current liabilities		
Accounts payable	\$768,570	\$ 710,609
Accrued payroll and related liabilities	41,424	45,907
Other current liabilities	283,831	307,073
Total current liabilities	1,093,825	1,063,589
Long-term debt, excluding current portion	566,474	568,495
Deferred income taxes	83,553	86,326
Other liabilities	64,097	62,776
Total liabilities	1,807,949	1,781,186
Commitments and contingencies		
Equity		
Common stock, par value \$2 per share; authorized - 200,000 shares; issued and outstanding - 61,699 shares and 62,803 shares	123,398	125,606
Paid-in capital	216,866	211,943
Retained earnings	694,981	706,866
Accumulated other comprehensive loss	(48,562)	(51,825)
Total equity	986,683	992,590
Total liabilities and equity	\$2,794,632	\$2,773,776

See accompanying notes to consolidated financial statements.

Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Nine Months Ended September 30,	
	2016	2015
Operating activities:		
Net income	\$ 81,682	\$ 71,342
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	42,182	51,871
Share-based compensation expense	8,934	7,611
Provision for losses on accounts and notes receivable	(216)	(182)
Deferred income tax (benefit) expense	(3,233)	3,643
Changes in operating assets and liabilities:		
Accounts and notes receivable	5,023	(13,758)
Merchandise inventories	(5,066)	(25,339)
Accounts payable	58,742	83,434
Net change in other assets and liabilities	(44,903)	25,890
Other, net	686	1,526
Cash provided by operating activities	143,831	206,038
Investing activities:		
Additions to property and equipment	(13,682)	(15,321)
Additions to computer software and intangible assets	(7,081)	(16,876)
Proceeds from sale of property and equipment	4,497	119
Cash used for investing activities	(16,266)	(32,078)
Financing activities:		
Change in bank overdraft	21,753	—
Repayment of revolving credit facility	—	(33,700)

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Cash dividends paid	(47,802)	(47,780)
Repurchases of common stock	(48,654)	(15,821)
Excess tax benefits related to share-based compensation	680		521	
Other, net	(8,118)	(6,296)
Cash used for financing activities	(82,141)	(103,076)
Effect of exchange rate changes on cash and cash equivalents	6,652		(2,411)
Net increase (decrease) in cash and cash equivalents	52,076		68,473	
Cash and cash equivalents at beginning of period	161,020		56,772	
Cash and cash equivalents at end of period	\$ 213,096		\$ 125,245	
Supplemental disclosure of cash flow information:				
Income taxes paid, net	\$ 57,996		\$ 38,709	
Interest paid	\$ 20,023		\$ 20,195	

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
 Consolidated Statements of Changes in Equity
 (unaudited)

(in thousands, except per share data)	Common Shares Outstanding	Common Stock (\$ 2 par value)	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance December 31, 2014	63,070	\$ 126,140	\$ 202,934	\$ 685,765	\$ (24,001)	\$ 990,838
Net income				71,342		71,342
Other comprehensive loss					(18,554)	(18,554)
Dividends declared (\$0.7575 per share)				(47,648)		(47,648)
Shares repurchased and retired	(469)	(938)		(14,882)		(15,820)
Share-based compensation expense, exercises and other	331	661	5,282			5,943
Balance September 30, 2015	62,932	\$ 125,863	\$ 208,216	\$ 694,577	\$ (42,555)	\$ 986,101
Balance December 31, 2015	62,803	\$ 125,606	\$ 211,943	\$ 706,866	\$ (51,825)	\$ 992,590
Net income				81,682		81,682
Other comprehensive income					3,263	3,263
Dividends declared (\$0.765 per share)				(47,671)		(47,671)
Shares repurchased and retired	(1,378)	(2,757)		(45,896)		(48,653)
Share-based compensation expense, exercises and other	274	549	4,923			5,472
Balance September 30, 2016	61,699	\$ 123,398	\$ 216,866	\$ 694,981	\$ (48,562)	\$ 986,683

See accompanying notes to consolidated financial statements.

Owens & Minor, Inc. and Subsidiaries
 Notes to Consolidated Financial Statements
 (unaudited)

(in thousands, unless otherwise indicated)

Note 1—Basis of Presentation and Use of Estimates

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Owens & Minor, Inc. and the subsidiaries it controls (we, us, or our) and contain all adjustments (which are comprised only of normal recurring accruals and use of estimates) necessary to conform with U.S. generally accepted accounting principles (GAAP). All significant intercompany accounts and transactions have been eliminated. The results of operations for interim periods are not necessarily indicative of the results expected for the full year.

Recently, we have made certain changes to the leadership team, organizational structure, budgeting and financial reporting processes which drive changes to segment reporting. These changes align our operations into three distinct business units: Domestic, International and Clinical & Procedural Solutions (CPS). Domestic is our U.S. distribution, logistics and value-added services business, while International is our European distribution, logistics and value-added services business. CPS provides product-related solutions, including surgical and procedural kitting and sourcing. Beginning with the quarter ended March 31, 2016, we now report our financial results using this three segment structure and have recast prior year segment results on the same basis.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation. Depreciation and amortization, previously reported as a separate financial statement line item in the consolidated statements of income is now

included in distribution, selling and administrative expenses for all periods presented.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make assumptions and estimates that affect reported amounts and related disclosures. Actual results may differ from these estimates.

Note 2—Fair Value

The carrying amounts of cash and cash equivalents, accounts receivable, financing receivables, accounts payable and financing payables included in the consolidated balance sheets approximate fair value due to the short-term nature of these instruments. The fair value of long-term debt is estimated based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market (Level 1) or, if quoted market prices or dealer quotes are not available, on the borrowing rates currently available for loans with similar terms, credit ratings and average remaining maturities (Level 2). We determine the fair value of our derivatives based on estimated amounts that would be received or paid to terminate the contracts at the reporting date based on current market prices for applicable currencies. See Note 7 for the fair value of long-term debt and Note 8 for the fair value of derivatives.

Note 3—Financing Receivables and Payables

At September 30, 2016 and December 31, 2015, we had financing receivables of \$190.7 million and \$198.5 million and related payables of \$98.4 million and \$148.5 million outstanding under our order-to-cash program and product financing arrangements, which were included in other current assets and other current liabilities, respectively, in the consolidated balance sheets.

Note 4—Goodwill and Intangible Assets

In connection with our new three segment structure, goodwill has been reallocated based on the relative fair value of the underlying reporting units. We performed an interim impairment analysis in the first quarter of 2016 as a result of this change and noted no impairment. The following table summarizes the changes in the carrying amount of goodwill through September 30, 2016:

	Domestic	International	CPS	Consolidated
Carrying amount of goodwill, December 31, 2015	\$ 180,006	\$ 23,426	\$ 216,187	\$ 419,619
Currency translation adjustments	—	(2,022)	498	(1,524)
Carrying amount of goodwill, September 30, 2016	\$ 180,006	\$ 21,404	\$ 216,685	\$ 418,095

Intangible assets at September 30, 2016, and December 31, 2015, were as follows:

	September 30, 2016		December 31, 2015	
	Customer Relationships	Other Intangibles	Customer Relationships	Other Intangibles
Gross intangible assets	\$ 120,999	\$ 3,910	\$ 121,888	\$ 4,621
Accumulated amortization (36,125)	(1,802)	(29,872)	(1,387)	()
Net intangible assets	\$84,874	\$ 2,108	\$92,016	\$ 3,234

At September 30, 2016, \$12.2 million in net intangible assets were held in the Domestic segment, \$12.0 million were held in the International segment and \$62.8 million were held in the CPS segment. Amortization expense for intangible assets was \$2.2 million and \$2.4 million for the three months ended September 30, 2016 and 2015 and \$6.6 million and \$7.2 million for the nine months ended September 30, 2016 and 2015.

Based on the current carrying value of intangible assets subject to amortization, estimated amortization expense is \$2.7 million for the remainder of 2016, \$9.7 million for 2017, \$9.1 million for 2018, \$9.0 million for 2019, \$8.9 million for 2020 and \$8.5 million for 2021.

Note 5—Exit and Realignment Charges

We periodically incur exit and realignment and other charges associated with optimizing our operations, which includes the consolidation of certain distribution and logistics centers, administrative offices and warehouses in the United States and Europe. These charges also include costs associated with our strategic organizational realignment which include management changes, certain professional fees and costs to streamline administrative functions and processes.

Exit and realignment charges by segment for the three and nine months ended September 30, 2016 and 2015 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Domestic segment	\$ 1,224	\$ 1,582	\$ 14,194	\$ 4,096
International segment	457	3,217	3,284	12,135
CPS segment	465	—	1,574	—
Total exit and realignment charges	\$ 2,146	\$ 4,799	\$ 19,052	\$ 16,231

For the three and nine months ended September 30, 2016, \$0.4 million and \$11.6 million in charges were associated with our voluntary employee separation program and other severance activities. The following table summarizes the activity related to exit and realignment cost accruals through September 30, 2016 and 2015:

	Lease Obligations	Severance and Other	Total
Accrued exit and realignment costs, December 31, 2015	\$ 486	\$ 1,840	\$2,326
Provision for exit and realignment activities	—	9,895	9,895
Cash payments, net of sublease income	(486)	(1,287)	(1,773)
Accrued exit and realignment costs, March 31, 2016	—	10,448	10,448
Provision for exit and realignment activities	—	1,254	1,254
Cash payments, net of sublease income	—	(7,087)	(7,087)
Accrued exit and realignment costs, June 30, 2016	—	4,615	4,615
Provision for exit and realignment activities	—	725	725
Change in Estimate	—	(268)	(268)
Cash payments, net of sublease income	—	(2,066)	(2,066)
Accrued exit and realignment costs, September 30, 2016	\$ —	\$ 3,006	\$3,006
Accrued exit and realignment costs, December 31, 2014	\$ 3,575	\$ 2,887	\$6,462
Provision for exit and realignment activities	256	142	398
Cash payments, net of sublease income	(385)	(873)	(1,258)
Accrued exit and realignment costs, March 31, 2015	3,446	2,156	5,602
Provision for exit and realignment activities	572	392	964
Cash payments, net of sublease income	(349)	(1,171)	(1,520)
Accrued exit and realignment costs, June 30, 2015	\$ 3,669	\$ 1,377	\$5,046
Provision for exit and realignment activities	—	1,033	1,033
Cash payments, net of sublease income	(446)	(285)	(731)
Accrued exit and realignment costs, September 30, 2015	\$ 3,223	\$ 2,125	\$5,348

In addition to the exit and realignment accruals in the preceding table, we also incurred \$1.7 million of costs that were expensed as incurred for the three months ended September 30, 2016, including \$0.7 million in other facility costs, \$0.5 million in labor costs, \$0.4 million in information systems costs, and \$0.1 million in other costs. For the nine months ended September 30, 2016, we recognized \$7.4 million of costs that were expensed as incurred, including \$3.6 million in consulting costs, \$1.8 million in information system costs, \$0.7 million in other facility costs, \$0.5 million in labor costs, and \$0.8 million in other costs.

In the three months ended September 30, 2015, we also incurred \$3.8 million of costs that were expensed as incurred, including \$1.2 million in information system costs, \$1.0 million in labor costs, \$0.5 million in professional fees, \$0.4 million in other facility costs and asset write-downs, \$0.3 million in accelerated amortization on an information system that has been replaced, and \$0.4 million in other costs. For the nine months ended September 30, 2015, we also incurred \$13.8 million of costs that were expensed as incurred, including \$4.5 million in accelerated amortization on an information system that has been replaced, \$3.0 million in other facility costs and asset write-downs, \$2.5 million in labor costs, \$2.2 million in information systems costs, \$0.5 million in professional fees, and \$1.1 million in other costs.

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Note 6—Retirement Plans

We have a noncontributory, unfunded retirement plan for certain officers and other key employees in the United States. Certain of our foreign subsidiaries also have defined benefit pension plans covering substantially all of their respective employees.

The components of net periodic benefit cost, which are included in distribution, selling and administrative expenses, for the three and nine months ended September 30, 2016 and 2015, were as follows:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Service cost	\$27	\$32	\$70	\$97
Interest cost	508	464	1,523	1,393
Recognized net actuarial loss	412	401	1,236	1,203
Net periodic benefit cost	\$947	\$897	\$2,829	\$2,693

Certain of our foreign subsidiaries have health and welfare plans covering substantially all of their respective employees. Our expense for these plans totaled \$0.4 million for the three months ended September 30, 2016 and 2015 and \$1.3 million and \$1.4 million for the nine months ended September 30, 2016 and 2015.

Note 7—Debt

We have \$275 million of 3.875% senior notes due 2021 (the “2021 Notes”) and \$275 million of 4.375% senior notes due 2024 (the “2024 Notes”), with interest payable semi-annually. The 2021 Notes were sold at 99.5% of the principal amount with an effective yield of 3.951%. The 2024 Notes were sold at 99.6% of the principal with an effective yield of 4.422%. We have the option to redeem the 2021 Notes and 2024 Notes in part or in whole prior to maturity at a redemption price equal to the greater of 100% of the principal amount or the present value of the remaining scheduled payments discounted at the Treasury Rate plus 30 basis points. As of September 30, 2016 and December 31, 2015, the estimated fair value of the 2021 Notes was \$284.5 million and \$273.7 million and the estimated fair value of the 2024 Notes was \$284.4 million and \$272.8 million, respectively.

We have a Credit Agreement with a \$450 million borrowing capacity which extends through September 2019. Under the Amended Credit Agreement, we have the ability to request two one-year extensions and to request an increase in aggregate commitments by up to \$200 million. The interest rate on the Amended Credit Agreement, which is subject to adjustment quarterly, is based on the London Interbank Offered Rate (LIBOR), the Federal Funds Rate or the Prime Rate, plus an adjustment based on the better of our debt ratings or leverage ratio (Credit Spread) as defined by the Amended Credit Agreement. We are charged a commitment fee of between 12.5 and 25.0 basis points on the unused portion of the facility. The terms of the Amended Credit Agreement limit the amount of indebtedness that we may incur and require us to maintain ratios for leverage and interest coverage, including on a pro forma basis in the event of an acquisition. Based on our leverage ratio at September 30, 2016, the interest rate under the credit facility is LIBOR plus 1.375%.

At September 30, 2016, we had no borrowings and letters of credit of approximately \$5.0 million outstanding under the Amended Credit Agreement, leaving \$445 million available for borrowing. We also have a \$1.2 million letter of credit outstanding as of September 30, 2016 and December 31, 2015, which supports our facilities leased in Europe. The Amended Credit Agreement and senior notes contain cross-default provisions which could result in the acceleration of payments due in the event of default of either agreement. We believe we were in compliance with our debt covenants at September 30, 2016.

Note 8—Derivatives

When deemed appropriate, we use derivatives, primarily forward contracts, as a risk management tool to mitigate the potential impact of foreign currency exchange risk. At September 30, 2016, we did not have any derivatives outstanding. The total notional values of our foreign currency derivatives as of December 31, 2015 was \$2.0 million. In 2016 and 2015, we did not have any derivatives designated as hedging instruments and all gains and losses

resulting from changes in the fair value of derivative instruments were immediately recognized into earnings. At December 31, 2015, the fair value of our foreign currency contracts included in other assets on the consolidated balance sheet was \$0.4 million. There was no impact from changes in the fair value of these foreign currency derivatives included in other operating expense for the three months ended September 30, 2016. The impact from changes in the fair value of these foreign currency derivatives included in other operating expense was \$0.4 million for the nine months ended September 30, 2016. The impact from changes in the fair value of these foreign currency derivatives included in other operating expense was \$0.3 million and \$0.1 million for the three and nine months ended September 30, 2015. We consider the risk of counterparty default to be minimal.

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Note 9—Income Taxes

The effective tax rate was 36.3% and 37.3% for the three and nine months ended September 30, 2016, compared to 39.8% and 41.6% in the same periods of 2015. The change in rate resulted from a higher percentage of the company's pretax income earned in lower tax rate jurisdictions compared to prior year and the deductibility of certain prior year acquisition-related charges for income tax purposes. The liability for unrecognized tax benefits was \$9.6 million at September 30, 2016, and \$7.7 million at December 31, 2015. Included in the liability at September 30, 2016 were \$4.6 million of tax positions for which ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility.

Note 10—Net Income per Common Share

The following summarizes the calculation of net income per common share attributable to common shareholders for the three and nine months ended September 30, 2016 and 2015.

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
(in thousands, except per share data)				
Numerator:				
Net income	\$29,831	\$28,176	\$81,682	\$71,342
Less: income allocated to unvested restricted shares	(291)	(262)	(855)	(620)
Net income attributable to common shareholders - basic	29,540	27,914	80,827	70,722
Add: undistributed income attributable to unvested restricted shares - basic	80	67	216	129
Less: undistributed income attributable to unvested restricted shares - diluted	(80)	(67)	(216)	(129)
Net income attributable to common shareholders - diluted	\$29,540	\$27,914	\$80,827	\$70,722
Denominator:				
Weighted average shares outstanding - basic	61,015	61,998	61,405	62,204
Dilutive shares - stock options	—	—	—	1
Weighted average shares outstanding - diluted	61,015	61,998	61,405	62,205
Net income per share attributable to common shareholders:				
Basic	\$0.48	\$0.45	\$1.32	\$1.14
Diluted	\$0.48	\$0.45	\$1.32	\$1.14

Note 11—Shareholders' Equity

Our Board of Directors has authorized a share repurchase program of up to \$100 million of our outstanding common stock to be executed at the discretion of management over a three-year period, expiring in February 2017. The program is intended, in part, to offset shares issued in conjunction with our stock incentive plans and return capital to shareholders. The program may be suspended or discontinued at any time. Purchases under the share repurchase program are made either pursuant to 10b5-1 plans entered into by the company from time to time and/or during the company's scheduled quarterly trading windows for officers and directors. During the nine months ended September 30, 2016, we repurchased in open-market transactions and retired approximately 1.4 million shares of our common stock for an aggregate of \$48.7 million, or an average price per share of \$35.29. As of September 30, 2016, we have approximately \$21.3 million remaining under the repurchase program. We have elected to allocate any excess of share repurchase price over par value to retained earnings.

In October 2016, our Board of Directors authorized a new share repurchase program of up to \$100 million of the company's outstanding common stock to be executed at the discretion of management over a three-year period. The new authorization will take effect upon the earlier of the completion of the existing authorization, or its expiration. The timing of repurchases and the exact number of shares of common stock to be purchased will depend upon market conditions and other factors and may be suspended or discontinued at any time.

Note 12—Accumulated Other Comprehensive Income

The following table shows the changes in accumulated other comprehensive income (loss) by component for the three and nine months ended September 30, 2016 and 2015:

	Retirement Plans	Currency Translation Adjustments	Other	Total
Accumulated other comprehensive income (loss), June 30, 2016	\$ (9,999)	\$ (40,186)	\$ (78)	\$ (50,263)
Other comprehensive income (loss) before reclassifications	—	1,401	82	1,483
Income tax	—	—	—	—
Other comprehensive income (loss) before reclassifications, net of tax	—	1,401	82	1,483
Amounts reclassified from accumulated other comprehensive income (loss)	412	—	—	412
Income tax	(194)	—	—	(194)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	218	—	—	218
Other comprehensive income (loss)	218	1,401	82	1,701
Accumulated other comprehensive income (loss), September 30, 2016	\$ (9,781)	\$ (38,785)	\$ 4	\$ (48,562)
Accumulated other comprehensive income (loss), June 30, 2015	\$ (9,805)	\$ (34,982)	\$ (1)	\$ (44,788)
Other comprehensive income (loss) before reclassifications	—	2,054	(105)	1,949
Income tax	—	—	—	—
Other comprehensive income (loss) before reclassifications, net of tax	—	2,054	(105)	1,949
Amounts reclassified from accumulated other comprehensive income (loss)	401	—	—	401
Income tax	(117)	—	—	(117)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	284	—	—	284
Other comprehensive income (loss)	284	2,054	(105)	2,233
Accumulated other comprehensive income (loss), September 30, 2015	\$ (9,521)	\$ (32,928)	\$ (106)	\$ (42,555)

	Retirement Plans	Currency Translation Adjustments	Other	Total
Accumulated other comprehensive income (loss), December 31, 2015	\$(10,482)	\$(41,228)	\$(115)	\$(51,825)
Other comprehensive income (loss) before reclassifications	—	2,443	119	2,562
Income tax	—	—	—	—
Other comprehensive income (loss) before reclassifications, net of tax	—	2,443	119	2,562
Amounts reclassified from accumulated other comprehensive income (loss)	1,233	—	—	1,233
Income tax	(532)	—	—	(532)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	701	—	—	701
Other comprehensive income (loss)	701	2,443	119	3,263
Accumulated other comprehensive income (loss), September 30, 2016	\$(9,781)	\$(38,785)	\$4	\$(48,562)
Accumulated other comprehensive income (loss), December 31, 2014	\$(10,323)	\$(13,647)	\$(31)	\$(24,001)
Other comprehensive income (loss) before reclassifications	—	(19,281)	(75)	(19,356)
Income tax	—	—	—	—
Other comprehensive income (loss) before reclassifications, net of tax	—	(19,281)	(75)	(19,356)
Amounts reclassified from accumulated other comprehensive income (loss)	1,204	—	—	1,204
Income tax	(402)	—	—	(402)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	802	—	—	802
Other comprehensive income (loss)	802	(19,281)	(75)	(18,554)
Accumulated other comprehensive income (loss), September 30, 2015	\$(9,521)	\$(32,928)	\$(106)	\$(42,555)

We include amounts reclassified out of accumulated other comprehensive income related to defined benefit pension plans as a component of net periodic pension cost recorded in distribution, selling and administrative expenses. For the three months ended September 30, 2016 and 2015, we reclassified \$0.4 million of actuarial net losses. For the nine months ended September 30, 2016 and 2015, we reclassified \$1.2 million of actuarial net losses.

Note 13—Segment Information

We periodically evaluate our application of accounting guidance for reportable segments and disclose information about reportable segments based on the way management organizes the enterprise for making operating decisions and assessing performance. We report our business under three segments: Domestic, International and Clinical & Procedural Solutions (CPS). The Domestic segment includes our United States distribution, logistics and value-added services business. The International segment consists of our European distribution, logistics and value-added services business. CPS provides product-related solutions, including surgical and procedural kitting and sourcing.

We evaluate the performance of our segments based on their operating earnings excluding acquisition-related and exit and realignment charges, certain purchase price fair value adjustments, and other substantive items that, either as a result of their nature or size, would not be expected to occur as part of our normal business operations on a regular basis. Segment assets exclude inter-segment account balances as we believe their inclusion would be misleading or not meaningful. We believe all inter-segment sales are at prices that approximate market.

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The following tables present financial information by segment:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net revenue:				
Segment net revenue				
Domestic	\$2,287,233	\$2,321,301	\$6,954,687	\$6,850,731
International	83,751	92,777	255,861	281,144
CPS	132,705	143,866	409,022	409,225
Total segment net revenue	\$2,503,689	\$2,557,944	\$7,619,570	\$7,541,100
Inter-segment revenue				
CPS	(88,088)	(86,275)	(264,501)	(256,068)
Total inter-segment revenue	(88,088)	(86,275)	(264,501)	(256,068)
Consolidated net revenue	\$2,415,601	\$2,471,669	\$7,355,069	\$7,285,032
Operating earnings (loss):				
Domestic	\$41,034	\$41,979	\$126,202	\$118,478
International	1,382	1,649	3,402	2,492
CPS	14,340	16,604	41,866	43,636
Inter-segment eliminations	(449)	(526)	(905)	(441)
Acquisition-related and exit and realignment charges ⁽¹⁾	(2,739)	(6,134)	(19,974)	(21,757)
Consolidated operating earnings	\$53,568	\$53,572	\$150,591	\$142,408
Depreciation and amortization:				
Domestic	\$7,360	\$8,621	\$22,399	\$26,592
International	4,259	4,792	13,125	14,430
CPS	2,218	2,034	6,658	6,375
Consolidated depreciation and amortization	\$13,837	\$15,447	\$42,182	\$47,397
Capital expenditures:				
Domestic	\$3,071	\$2,041	\$10,274	\$13,399
International	3,223	7,235	8,053	18,025
CPS	1,009	96	2,436	773
Consolidated capital expenditures	\$7,303	\$9,372	\$20,763	\$32,197

	September 30, 2016	December 31, 2015
Total assets:		
Domestic	\$1,677,898	\$1,728,345
International	460,616	464,003
CPS	443,022	420,408
Segment assets	2,581,536	2,612,756
Cash and cash equivalents	213,096	161,020
Consolidated total assets	\$2,794,632	\$2,773,776

⁽¹⁾ The three and nine months ended September 30, 2015 include \$0.3 million and \$4.5 million, respectively in accelerated amortization related to an information system that has been replaced in the International segment.

Note 14—Condensed Consolidating Financial Information

The following tables present condensed consolidating financial information for: Owens & Minor, Inc. (O&M); the guarantors of Owens & Minor, Inc.'s 2021 Notes and 2024 Notes, on a combined basis; and the non-guarantor subsidiaries of the 2021 Notes and 2024 Notes, on a combined basis. The guarantor subsidiaries are 100% owned by Owens & Minor, Inc. Separate financial statements of the guarantor subsidiaries are not presented because the guarantees by our guarantor subsidiaries are full and unconditional, as well as joint and several, and we believe the condensed consolidating financial information is more meaningful in understanding the financial position, results of operations and cash flows of the guarantor subsidiaries.

Three Months Ended September 30, 2016	Owens & Minor, Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Statements of Income					
Net revenue	\$ —	\$2,287,335	\$ 168,216	\$ (39,950)	\$2,415,601
Cost of goods sold	—	2,070,639	89,192	(40,505)	2,119,326
Gross margin	—	216,696	79,024	555	296,275
Distribution, selling and administrative expenses	(52)	169,451	71,906	—	241,305
Acquisition-related and exit and realignment charges	—	2,237	502	—	2,739
Other operating income, net	—	(1,205)	(132)	—	(1,337)
Operating earnings (loss)	52	46,213	6,748	555	53,568
Interest expense (income), net	7,403	(1,345)	712	—	6,770
Income (loss) before income taxes	(7,351)	47,558	6,036	555	46,798
Income tax (benefit) provision	—	14,131	2,836	—	16,967
Equity in earnings of subsidiaries	37,182	—	—	(37,182)	—
Net income (loss)	29,831	33,427	3,200	(36,627)	29,831
Other comprehensive income (loss)	1,701	299	1,402	(1,701)	1,701
Comprehensive income (loss)	\$ 31,532	\$33,726	\$ 4,602	\$ (38,328)	\$31,532
Three Months Ended September 30, 2015					
Statements of Income					
Net revenue	\$ —	\$2,321,301	\$ 194,659	\$ (44,291)	\$2,471,669
Cost of goods sold	—	2,106,623	102,923	(44,231)	2,165,315
Gross margin	—	214,678	91,736	(60)	306,354
Distribution, selling and administrative expenses	27	171,336	75,596	—	246,959
Acquisition-related and exit and realignment charges	—	1,980	4,154	—	6,134
Other operating income, net	—	(28)	(283)	—	(311)
Operating earnings (loss)	(27)	41,390	12,269	(60)	53,572
Interest expense (income), net	7,257	(1,235)	722	—	6,744
Income (loss) before income taxes	(7,284)	42,625	11,547	(60)	46,828
Income tax (benefit) provision	—	10,927	7,725	—	18,652
Equity in earnings of subsidiaries	35,460	—	—	(35,460)	—
Net income (loss)	28,176	31,698	3,822	(35,520)	28,176
Other comprehensive income (loss)	2,233	179	2,054	(2,233)	2,233
Comprehensive income (loss)	\$ 30,409	\$31,877	\$ 5,876	\$ (37,753)	\$30,409

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Nine Months Ended September 30, 2016	Owens & Minor, Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Statements of Income					
Net revenue	\$ —	\$6,954,983	\$ 516,131	\$(116,045)	\$7,355,069
Cost of goods sold	—	6,305,489	273,927	(116,677)	6,462,739
Gross margin	—	649,494	242,204	632	892,330
Distribution, selling and administrative expenses	838	504,984	221,122	—	726,944
Acquisition-related and exit and realignment charges	—	15,888	4,086	—	19,974
Other operating income, net	—	(3,952)	(1,227)	—	(5,179)
Operating earnings (loss)	(838)	132,574	18,223	632	150,591
Interest expense (income), net	21,134	(2,808)	1,998	—	20,324
Income (loss) before income taxes	(21,972)	135,382	16,225	632	130,267
Income tax (benefit) provision	—	40,237	8,348	—	48,585
Equity in earnings of subsidiaries	103,654	—	—	(103,654)	—
Net income (loss)	81,682	95,145	7,877	(103,022)	81,682
Other comprehensive income (loss)	3,263	821	2,442	(3,263)	3,263
Comprehensive income (loss)	\$ 84,945	\$95,966	\$ 10,319	\$(106,285)	\$84,945
Nine Months Ended September 30, 2015					
Statements of Income					
Net revenue	\$ —	\$6,850,731	\$ 554,862	\$(120,561)	\$7,285,032
Cost of goods sold	—	6,204,950	298,530	(120,740)	6,382,740
Gross margin	—	645,781	256,332	179	902,292
Distribution, selling and administrative expenses	696	510,269	232,646	—	743,611
Acquisition-related and exit and realignment charges	—	5,813	15,944	—	21,757
Other operating income, net	—	(2,360)	(3,124)	—	(5,484)
Operating earnings (loss)	(696)	132,059	10,866	179	142,408
Interest expense (income), net	20,142	(654)	817	—	20,305
Income (loss) before income taxes	(20,838)	132,713	10,049	179	122,103
Income tax (benefit) provision	(773)	42,683	8,851	—	50,761
Equity in earnings of subsidiaries	91,407	—	—	(91,407)	—
Net income (loss)	71,342	90,030	1,198	(91,228)	71,342
Other comprehensive income (loss)	(18,554)	726	(19,280)	18,554	(18,554)
Comprehensive income (loss)	\$ 52,788	\$90,756	\$ (18,082)	\$(72,674)	\$52,788

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September 30, 2016	Owens & Minor, Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Balance Sheets					
Assets					
Current assets					
Cash and cash equivalents	\$ 156,484	\$ 20,001	\$ 36,611	\$—	\$ 213,096
Accounts and notes receivable, net	—	493,650	95,000	(9,619)	579,031
Merchandise inventories	—	886,894	59,758	(1,755)	944,897
Other current assets	73	81,341	202,339	—	283,753
Total current assets	156,557	1,481,886	393,708	(11,374)	2,020,777
Property and equipment, net	—	98,570	100,210	—	198,780
Goodwill, net	—	180,006	238,089	—	418,095
Intangible assets, net	—	12,174	74,808	—	86,982
Due from O&M and subsidiaries	—	671,236	—	(671,236)	—
Advances to and investment in consolidated subsidiaries	2,048,858	—	—	(2,048,858)	—
Other assets, net	—	52,287	17,711	—	69,998
Total assets	\$2,205,415	\$2,496,159	\$ 824,526	\$(2,731,468)	\$2,794,632
Liabilities and equity					
Current liabilities					
Accounts payable	\$—	\$ 717,969	\$ 59,834	\$(9,233)	\$ 768,570
Accrued payroll and related liabilities	—	31,562	9,862	—	41,424
Other current liabilities	9,170	119,756	154,905	—	283,831
Total current liabilities	9,170	869,287	224,601	(9,233)	1,093,825
Long-term debt, excluding current portion	544,624	3,577	18,273	—	566,474
Due to O&M and subsidiaries	664,938	—	59,328	(724,266)	—
Intercompany debt	—	138,890	—	(138,890)	—
Deferred income taxes	—	61,704	21,849	—	83,553
Other liabilities	—	57,832	6,265	—	64,097
Total liabilities	1,218,732	1,131,290	330,316	(872,389)	1,807,949
Equity					
Common stock	123,398	—	—	—	123,398
Paid-in capital	216,866	174,612	583,867	(758,479)	216,866
Retained earnings (deficit)	694,981	1,199,932	(50,770)	(1,149,162)	694,981
Accumulated other comprehensive income (loss)	(48,562)	(9,675)	(38,887)	48,562	(48,562)
Total equity	986,683	1,364,869	494,210	(1,859,079)	986,683
Total liabilities and equity	\$2,205,415	\$2,496,159	\$ 824,526	\$(2,731,468)	\$2,794,632

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December 31, 2015	Owens & Minor, Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Balance Sheets					
Assets					
Current assets					
Cash and cash equivalents	\$103,284	\$5,614	\$ 52,122	\$—	\$ 161,020
Accounts and notes receivable, net	—	507,673	89,895	(9,633)	587,935
Merchandise inventories	—	883,232	59,930	(2,387)	940,775
Other current assets	104	72,683	212,183	—	284,970
Total current assets	103,388	1,469,202	414,130	(12,020)	1,974,700
Property and equipment, net	—	103,219	105,711	—	208,930
Goodwill, net	—	180,006	239,613	—	419,619
Intangible assets, net	—	13,731	81,519	—	95,250
Due from O&M and subsidiaries	—	518,473	—	(518,473)	—
Advances to and investments in consolidated subsidiaries	1,967,176	—	—	(1,967,176)	—
Other assets, net	—	57,409	17,868	—	75,277
Total assets	\$2,070,564	\$2,342,040	\$ 858,841	\$(2,497,669)	\$2,773,776
Liabilities and equity					
Current liabilities					
Accounts payable	\$—	\$662,909	\$ 56,073	\$(8,373)	\$710,609
Accrued payroll and related liabilities	—	32,094	13,813	—	45,907
Other current liabilities	6,924	109,137	191,012	—	307,073
Total current liabilities	6,924	804,140	260,898	(8,373)	1,063,589
Long-term debt, excluding current portion	543,982	4,527	19,986	—	568,495
Due to O&M and subsidiaries	527,068	—	70,089	(597,157)	—
Intercompany debt	—	138,890	—	(138,890)	—
Deferred income taxes	—	67,562	18,764	—	86,326
Other liabilities	—	57,573	5,203	—	62,776
Total liabilities	1,077,974	1,072,692	374,940	(744,420)	1,781,186
Equity					
Common stock	125,606	—	—	—	125,606
Paid-in capital	211,943	174,612	583,873	(758,485)	211,943
Retained earnings (deficit)	706,866	1,104,787	(58,648)	(1,046,139)	706,866
Accumulated other comprehensive income (loss)	(51,825)	(10,051)	(41,324)	51,375	(51,825)
Total equity	992,590	1,269,348	483,901	(1,753,249)	992,590
Total liabilities and equity	\$2,070,564	\$2,342,040	\$ 858,841	\$(2,497,669)	\$2,773,776

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Nine Months Ended September 30, 2016	Owens & Minor, Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Statements of Cash Flows					
Operating activities:					
Net income (loss)	\$ 81,682	\$ 95,145	\$ 7,877	\$ (103,022)	\$ 81,682
Adjustments to reconcile net income to cash provided by (used for) operating activities:					
Equity in earnings of subsidiaries	(103,654)	—	—	103,654	—
Depreciation and amortization	—	22,497	19,685	—	42,182
Share-based compensation expense	—	8,934	—	—	8,934
Provision for losses on accounts and notes receivable	—	(84)	(132)	—	(216)
Deferred income tax expense (benefit)	—	(3,233)	—	—	(3,233)
Changes in operating assets and liabilities:					
Accounts and notes receivable	—	14,107	(9,385)	301	5,023
Merchandise inventories	—	(3,662)	(771)	(633)	(5,066)
Accounts payable	—	55,060	3,982	(300)	58,742
Net change in other assets and liabilities	2,277	(512)	(46,668)	—	(44,903)
Other, net	641	319	(274)	—	686
Cash provided by (used for) operating activities	(19,054)	188,571	(25,686)	—	143,831
Investing activities:					
Additions to property and equipment	—	(7,337)	(6,345)	—	(13,682)
Additions to computer software and intangible assets	—	(2,937)	(4,144)	—	(7,081)
Proceeds from the sale of property and equipment	—	78	4,419	—	4,497
Cash used for investing activities	—	(10,196)	(6,070)	—	(16,266)
Financing activities:					
Change in intercompany advances	172,057	(162,206)	(9,851)	—	—
Change in bank overdraft	—	—	21,753	—	21,753
Cash dividends paid	(47,802)	—	—	—	(47,802)
Repurchases of common stock	(48,654)	—	—	—	(48,654)
Excess tax benefits related to share-based compensation	680	—	—	—	680
Other, net	(4,027)	(1,782)	(2,309)	—	(8,118)
Cash provided by (used for) financing activities	72,254	(163,988)	9,593	—	(82,141)
Effect of exchange rate changes on cash and cash equivalents	—	—	6,652	—	6,652
Net increase (decrease) in cash and cash equivalents	53,200	14,387	(15,511)	—	52,076
Cash and cash equivalents at beginning of period	103,284	5,614	52,122	—	161,020
Cash and cash equivalents at end of period	\$ 156,484	\$ 20,001	\$ 36,611	\$ —	\$ 213,096

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Nine months ended September 30, 2015	Owens & Minor, Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Statements of Cash Flows					
Operating activities:					
Net income (loss)	\$ 71,342	\$ 90,030	\$ 1,198	\$ (91,228)	\$ 71,342
Adjustments to reconcile net income to cash provided by (used for) operating activities:					
Equity in earnings of subsidiaries	(91,407)	—	—	91,407	—
Depreciation and amortization	—	26,653	25,218	—	51,871
Share-based compensation expense	—	7,611	—	—	7,611
Provision for losses on accounts and notes receivable	—	(36)	(146)	—	(182)
Deferred income tax expense (benefit)	—	2,957	686	—	3,643
Changes in operating assets and liabilities:					
Accounts and notes receivable	—	14,416	(33,212)	5,038	(13,758)
Merchandise inventories	—	(22,618)	(5,203)	2,482	(25,339)
Accounts payable	—	76,841	12,046	(5,453)	83,434
Net change in other assets and liabilities	847	26,282	1,007	(2,246)	25,890
Other, net	641	740	145	—	1,526
Cash provided by (used for) operating activities	(18,577)	222,876	1,739	—	206,038
Investing activities:					
Additions to property and equipment	—	(10,728)	(4,593)	—	(15,321)
Additions to computer software and intangible assets	—	(1,670)	(15,206)	—	(16,876)
Proceeds from the sale of property and equipment	—	82	37	—	119
Cash used for investing activities	—	(12,316)	(19,762)	—	(32,078)
Financing activities:					
Change in intercompany advances	143,872	(160,123)	16,251	—	—
Change in bank overdraft	—	—	—	—	—
Repayment of revolving credit facility	—	(33,700)	—	—	(33,700)
Cash dividends paid	(47,780)	—	—	—	(47,780)
Repurchases of common stock	(15,821)	—	—	—	(15,821)
Excess tax benefits related to share-based compensation	521	—	—	—	521
Other, net	(2,039)	(1,881)	(2,376)	—	(6,296)
Cash provided by (used for) financing activities	78,753	(195,704)	13,875	—	(103,076)
Effect of exchange rate changes on cash and cash equivalents	—	—	(2,411)	—	(2,411)
Net increase (decrease) in cash and cash equivalents	60,176	14,856	(6,559)	—	68,473
Cash and cash equivalents at beginning of period	22,013	3,912	30,847	—	56,772
Cash and cash equivalents at end of period	\$ 82,189	\$ 18,768	\$ 24,288	\$ —	\$ 125,245

Note 15—Recent Accounting Pronouncements

On January 1, 2016, we adopted ASU 2015-03, Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs, which requires that our \$3.6 million in debt issuance costs at September 30, 2016 related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. As a result of this adoption, we have also presented \$4.1 million in debt issuance costs from our December 31, 2015 balance sheet in a manner that conforms to the new presentation. The adoption of this standard did not affect our results of operations or cash flows in either the current or prior interim or annual periods.

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, Leases. The new standard establishes a right-of-use model that requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than twelve months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted and should be applied using a modified retrospective approach. We are in the process of evaluating the potential impacts of this new guidance on our consolidated financial statements and related disclosures. In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting. The amendments in this updated guidance include changes to simplify the Codification for several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is permitted. We are in the process of evaluating the potential impacts of this new guidance on our consolidated financial statements.

There has been no change in our significant accounting policies from those contained in our Annual Report on Form 10-K for the year ended December 31, 2015.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis describes results of operations and material changes in the financial condition of Owens & Minor, Inc. and its subsidiaries since December 31, 2015. Trends of a material nature are discussed to the extent known and considered relevant. This discussion should be read in conjunction with the consolidated financial statements, related notes thereto, and management's discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the year ended December 31, 2015.

Overview

Owens & Minor, Inc., along with its subsidiaries, (we, us, or our) is a leading global healthcare services company that connects the world of medical products to the point of care. Recently, we have made certain changes to the leadership team, organizational structure, budgeting and financial reporting processes which drive changes to segment reporting. These changes align our operations into three distinct business units: Domestic, International and Clinical & Procedural Solutions (CPS). Domestic is our U.S. distribution, logistics and value-added services business, while International is our European distribution, logistics and value-added services business. CPS provides product-related solutions, including surgical and procedural kitting and sourcing. Furthermore, the basis for segment reporting shifts from the geography of the end customer to the business unit selling the product or providing the service. This includes intercompany transactions as well. Beginning with the first quarter of 2016, we now report our financial results using this three segment structure and have recast prior year segment results on the same basis. Segment financial information is provided in Note 13 of Notes to Consolidated Financial Statements included in this quarterly report.

Financial highlights. The following table provides a reconciliation of reported operating earnings, net income and net income per diluted common share to non-GAAP measures used by management.

(Dollars in thousands except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating earnings, as reported (GAAP)	\$53,568	\$53,572	\$150,591	\$142,408
Acquisition-related and exit and realignment charges	2,739	6,134	19,974	21,757
Operating earnings, adjusted (non-GAAP) (Adjusted Operating Earnings)	\$56,307	\$59,706	\$170,565	\$164,165
Net income, as reported (GAAP)	\$29,831	\$28,176	\$81,682	\$71,342
Acquisition-related and exit and realignment charges	2,739	6,134	19,974	21,757
Income tax expense (benefit)	(1,015)	(755)	(6,615)	(2,916)
Net income, adjusted (non-GAAP) (Adjusted Net Income)	\$31,555	\$33,555	\$95,041	\$90,183
Net income per diluted common share, as reported (GAAP)	\$0.48	\$0.45	\$1.32	\$1.14
Acquisition-related and exit and realignment charges, per diluted common share	0.03	0.09	0.21	0.30
Net income per diluted common share, adjusted (non-GAAP)(Adjusted EPS)	\$0.51	\$0.54	\$1.53	\$1.44

Net income per diluted share was \$0.48 and \$1.32 for the three and nine months ended September 30, 2016, an improvement of \$0.03 and \$0.18 when compared to the same periods of 2015. Adjusted EPS (non-GAAP) was \$0.51 and \$1.53 for the three and nine months ended September 30, 2016, a decline of \$0.03 for the quarter and a year-to-date improvement of \$0.09 compared to prior year. Domestic segment operating earnings were \$41.0 million and \$126.2 million for the three and nine month periods ended September 30, 2016, compared to \$42.0 million and \$118.5 million for the same periods of 2015. Results for the quarter were negatively impacted by the previously announced exit of a large customer and lower income from manufacturer product price changes compared to prior year, partially offset by reduced operating expenses. Revenue growth during the first half of the year and expense control initiatives contributed to the increased earnings on a year-to-date basis. We expect revenue and gross margin to continue to be negatively impacted by this customer exit as well as other competitive dynamics in the fourth quarter of 2016 and into next year. The International segment reported operating earnings of \$1.4 million for the quarter and improved by \$0.9 million to \$3.4 million for the year-to-date period compared to prior year. The improvement was a result of continued cost control and improved operational efficiency. CPS operating earnings of \$14.3 million and \$41.9 million for the three and nine month periods of 2016 declined compared to prior year by \$2.3 million and \$1.8 million, respectively, as a result of lower revenues compared to prior year.

Use of Non-GAAP Measures

Adjusted operating earnings, adjusted net income and adjusted EPS are an alternative view of performance used by management, and we believe that investors' understanding of our performance is enhanced by disclosing these performance measures. In general, the measures exclude items and charges that (i) management does not believe reflect our core business and relate more to strategic, multi-year corporate activities; or (ii) relate to activities or actions that may have occurred over multiple or in prior periods without predictable trends. Management uses these non-GAAP financial measures internally to evaluate our performance, evaluate the balance sheet, engage in financial and operational planning and determine incentive compensation.

Management provides these non-GAAP financial measures to investors as supplemental metrics to assist readers in assessing the effects of items and events on our financial and operating results and in comparing our performance to that of our competitors. However, the non-GAAP financial measures used by us may be calculated differently from, and therefore may not be comparable to, similarly titled measures used by other companies.

The non-GAAP financial measures disclosed by us should not be considered a substitute for, or superior to, financial measures calculated in accordance with GAAP, and the financial results calculated in accordance with GAAP and reconciliations to those financial statements set forth above should be carefully evaluated.

Acquisition-related charges were \$0.6 million and \$0.9 million for the three and nine months ended September 30, 2016 compared to \$1.3 million and \$5.7 million for the same periods of 2015. The current quarter amount related primarily to costs incurred to settle certain obligations and address other on-going matters associated with the acquisitions of ArcRoyal and Medical Action which were partially offset on a year-to-date basis by the first quarter gain on the sale of property acquired with

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Medical Action. Charges in 2015 consisted primarily of costs to continue the integration of Medical Action and ArcRoyal which were acquired in the fourth quarter of 2014 including certain severance and contractual payments to the former owner and costs to transition information technology and other administrative functions.

Exit and realignment charges were \$2.1 million and \$19.1 million for the three and nine months ended September 30, 2016. Charges in the third quarter and year-to-date periods of 2016 were associated with severance activities (including our voluntary employee separation program in the first quarter of 2016), and other costs associated with our strategic organizational realignment which include certain professional fees and costs to streamline administrative functions and processes in the United States and Europe. Similar charges in 2015 totaled \$4.8 million and \$16.1 million in the comparable periods and also included the consolidation of distribution and logistics centers and closure of offsite warehouses in the United States and Europe. More information about these charges is provided in Note 5 of Notes to Consolidated Financial Statements included in this quarterly report.

These charges have been tax effected in the preceding table by determining the income tax rate depending on the amount of charges incurred in different tax jurisdictions and the deductibility of those charges for income tax purposes.

Results of Operations

Net revenue.

	Three Months Ended September 30,		Change	
(Dollars in thousands)	2016	2015	\$	%
Domestic	\$2,287,233	\$2,321,301	\$(34,068)	(1.5)%
International	83,751	92,777	(9,026)	(9.7)%
CPS	132,705	143,866	(11,161)	(7.8)%
Inter-segment	(88,088)	(86,275)	(1,813)	2.1 %
Net revenue	\$2,415,601	\$2,471,669	\$(56,068)	(2.3)%
	Nine Months Ended September 30,		Change	
(Dollars in thousands)	2016	2015	\$	%
Domestic	\$6,954,687	\$6,850,731	\$103,956	1.5 %
International	255,861	281,144	(25,283)	(9.0)%
CPS	409,022	409,225	(203)	— %
Inter-segment	(264,501)	(256,068)	(8,433)	3.3 %
Net revenue	\$7,355,069	\$7,285,032	\$70,037	1.0 %

Consolidated net revenue declined in the third quarter of 2016 primarily as a result of the previously announced exit of a large domestic customer and unfavorable foreign exchange impacts. We expect revenue for the fourth quarter of 2016 to be negatively impacted by this customer exit as well. On a year-to-date basis, growth with our other large healthcare provider customers and an additional sales day in the first quarter of 2016 contributed to the improvement compared to 2015. In the International segment, excluding the impact of a U.K.-based customer exit last year and the negative impact of foreign exchange, revenues declined by \$0.9 million for the quarter and \$3.8 million year-to-date. CPS revenue for the quarter was impacted by temporary production challenges in capacity and workforce availability but was relatively consistent on a year-to-date basis compared to 2015.

Cost of goods sold.

	Three Months Ended		Change	
	September 30,			
(Dollars in thousands)	2016	2015	\$	%
Cost of goods sold	\$2,119,326	\$2,165,315	\$(45,989)	(2.1)%
	Nine Months Ended		Change	
	September 30,			
(Dollars in thousands)	2016	2015	\$	%
Cost of goods sold	\$6,462,739	\$6,382,740	\$79,999	1.3%

Cost of goods sold includes the cost of the product (net of supplier incentives and cash discounts) and all costs incurred for shipments of products from manufacturers to our distribution centers for all customer arrangements where we are the primary obligor, bear risk of general and physical inventory loss and carry all credit risk associated with sales. These are sometimes referred to as distribution or buy/sell contracts. Cost of goods sold also includes direct and certain indirect labor, material and overhead costs associated with our kitting businesses. There is no cost of goods sold associated with our fee-for-service business. As a result of the factors discussed above which impacted sales activity through our distribution and kitting businesses, cost of goods sold decreased from prior year by \$46.0 million and increased \$80.0 million for the three and nine month periods ended September 30, 2016, respectively.

Gross margin.

	Three Months Ended		Change	
	September 30,			
(Dollars in thousands)	2016	2015	\$	%
Gross margin	\$296,275	\$306,354	\$(10,079)	(3.3)%
As a % of net revenue	12.27 %	12.39 %		
	Nine Months Ended		Change	
	September 30,			
(Dollars in thousands)	2016	2015	\$	%
Gross margin	\$892,330	\$902,292	\$(9,962)	(1.1)%
As a % of net revenue	12.13 %	12.39 %		

The decreases in gross margin compared to the prior year were largely attributable to lower income from manufacturer product price changes, the previously announced exit of a large domestic customer in September 2016 and the unfavorable impact of foreign currency translation of \$3.9 million for the quarter and \$6.6 million year-to-date. The exit of a U.K.-based customer in July 2015 also negatively impacted the year-to-date comparison. These impacts were partially offset by increased margin due to revenue growth from other large customer accounts. With increasing customer cost pressures and competitive dynamics in healthcare, we believe that we will experience increased gross margin pressure in the fourth quarter and next year.

Operating expenses.

	Three Months Ended		Change	
	September 30,			
(Dollars in thousands)	2016	2015	\$	%
Distribution, selling and administrative expenses	\$241,305	\$246,959	\$(5,654)	(2.3)%
As a % of net revenue	9.99 %	9.99 %		
Other operating income, net	\$(1,337)	\$(311)	\$(1,026)	329.9%
	Nine Months Ended		Change	
	September 30,			
(Dollars in thousands)	2016	2015	\$	%
Distribution, selling and administrative expenses	\$726,944	\$743,611	\$(16,667)	(2.2)%
As a % of net revenue	9.88 %	10.21 %		
Other operating income, net	\$(5,179)	\$(5,484)	\$305	(5.6)%

Distribution, selling and administrative (DS&A) expenses include labor and warehousing costs associated with our distribution and logistics services and all costs associated with our fee-for-service arrangements. Shipping and handling costs are included in DS&A expenses and include costs to store, move, and prepare products for shipment, as well as costs to deliver products to customers. The costs to convert new customers to our information systems are included in DS&A and are generally incurred prior to the recognition of revenues from the new customers.

The decrease in DS&A expenses compared to prior year reflected the decreased sales activity in the quarter, benefits of cost control initiatives, lower fuel costs and improved operational efficiency as well as favorable foreign currency translation impacts of \$3.9 million and \$6.9 million for the three and nine months ended September 30, 2016.

The increase in other operating income, net for the three months ended September 30, 2016 compared to 2015 was attributed primarily to an expense for the settlement of a legal matter in the prior year which did not re-occur in the current period.

A discussion of acquisition-related and exit and realignment charges is included above in the Overview section.

Interest expense, net.

	Three Months		Change	
	Ended September 30,			
(Dollars in thousands)	2016	2015	\$	%
Interest expense, net	\$6,770	\$6,744	\$26	0.4%
Effective interest rate	4.76 %	4.62 %		

	Nine Months		Change	
	Ended September 30,			
(Dollars in thousands)	2016	2015	\$	%
Interest expense, net				